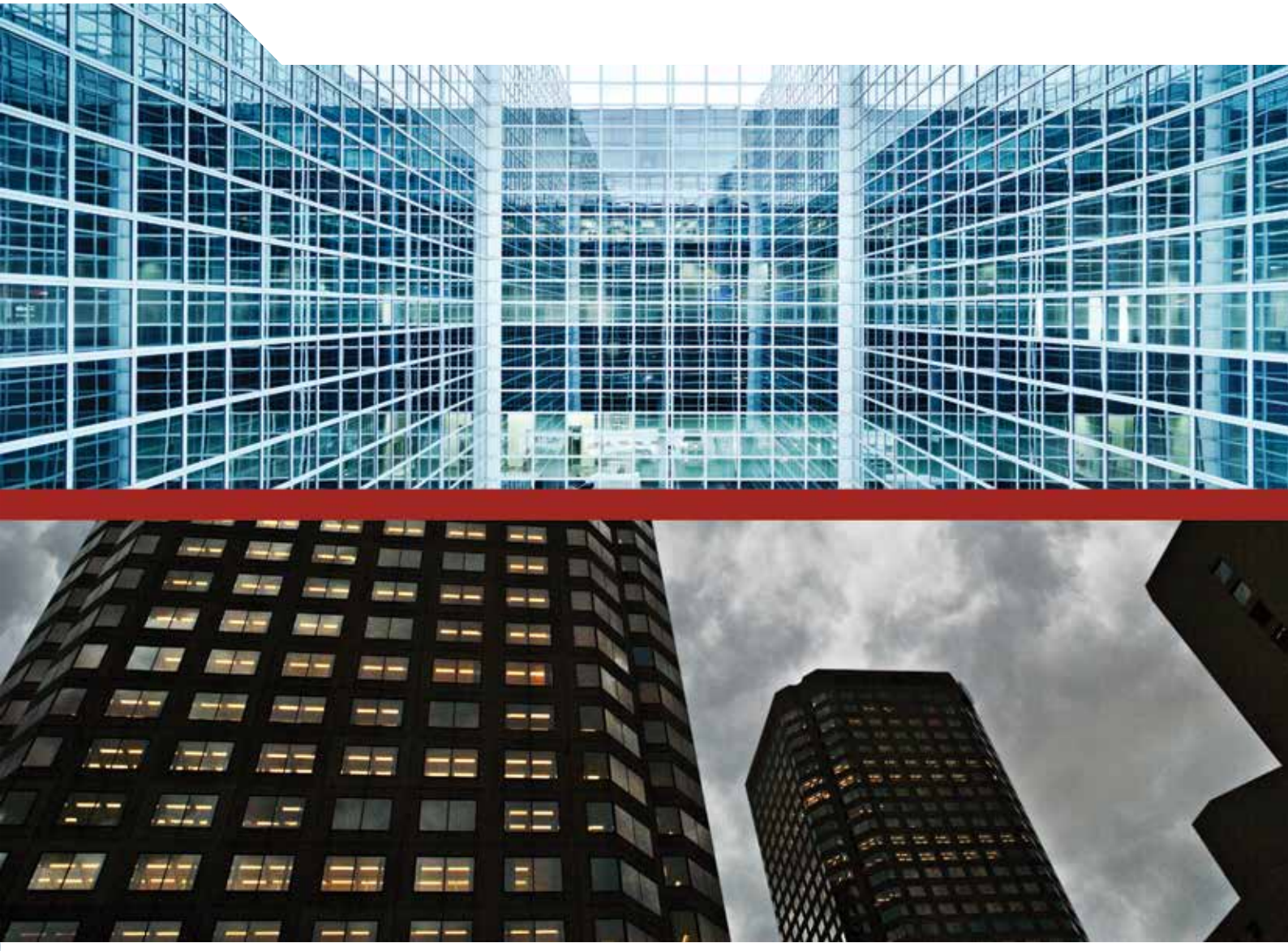
Illicit Financial Flows from Developing Countries

MEASURING OECD RESPONSES



OECD

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BETTER POLICIES FOR BETTER LIVES

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Foreword

The issue of illicit financial flows (IFFs) is at the forefront of the international agenda. Governments worldwide are joining forces to combat money laundering, tax evasion and international bribery, which make up the bulk of IFFs. Although the exact scale of the problem is unknown, IFFs have devastating effects on developing countries. Instead of attempting to quantify precisely what is, by definition, a hidden activity, now is the time to determine where public funds should best be targeted to make the most impact.

The G8 and G20 are urging countries to take action on several fronts: strengthening their anti-money laundering regimes, enforcing greater transparency of company ownership, and supporting efforts to trace, freeze and recover stolen assets. They are also committed to automatic exchange of information to tackle tax evasion. And given the interconnectedness of our economies, global compliance is required to tackle many of today's challenges.

Governments are committed to taking action on these issues by ratifying existing global standards and by being active members of relevant administering bodies. *Illicit Financial Flows from Developing Countries: Measuring OECD Responses* is the first report to measure how well countries are performing in their fight against IFFs. It draws on public data describing the situation in these policy areas and the role of donor agencies. The report is a key output of the OECD Strategy on Development, which was launched in 2012, and provides a unique comparison of country performance on some of these global standards.

The report shows that we are making progress on the fight against IFFs. In recent years, countries have implemented standards and complied with most recommendations of the Financial Action Task Force. One thousand three hundred tax information exchange agreements have been signed and hundreds of offenders for foreign bribery have been sanctioned. In addition, almost USD 150 million in proceeds of corruption, according to the report, were returned between 2010 and June 2012.

While we applaud these successes, we also recognise that we need to continue to rally international support to tackle existing performance gaps and shortfalls. Without action, for example, OECD countries are at risk of becoming safe havens for illicit assets by neglecting transparency of ownership: 27 out of 34 OECD countries perform below expectations on beneficial ownership of corporate vehicles and trusts. Furthermore, OECD countries will need to continue to prosecute foreign bribery offenders: this report shows that only approximately half of OECD countries have sanctioned a party for a foreign bribery offense.

Strengthening OECD firewalls can only do so much to combat a phenomenon which thrives on weak governance. In the longer term, combating illicit flows from developing countries must focus on improving governance at the source, through building a sound business environment and increasing opportunities for citizens, giving them incentives to

engage in legal economic activities, pay their taxes and dues, and reinvest their profits at home. As this report highlights, donor agencies can support this goal through their central role in linking OECD and developing countries, and using their aid to support governments willing to tackle these issues.

We hope this report will contribute to the wider debate around IFFs and help highlight the main areas where OECD countries need to tighten their systems. We also hope that some of the ideas will encourage development agencies to use their aid funds effectively to combat illicit flows from developing countries.

The OECD is trying to support these efforts through our Strategy on Development, to achieve better policies for better lives!



Angel Gurría
Secretary-General,
OECD



Erik Solheim
Chair, OECD Development
Assistance Committee (DAC)

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Acronyms and abbreviations

AAA	Accra Agenda for Action
ACTT	Anti-Corruption Task Team (OECD)
AEOI	Automatic exchange of information
AFAR	Arab Forum on Asset Recovery
AML	Anti-money laundering
APF	Africa Partnership Forum
ARO	Asset recovery office
ATAF	African Tax Administration Forum
BMZ	Ministry for Economic Co-operation and Development (Germany) *Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung*
CARIN	Camden Assets Recovery Interagency Network
CDD	Customer due diligence
CEN	Global Customs Enforcement Network
CFT	Combating the Financing of Terrorism
CIAT	Inter-American Center of Tax Administrations
CIDA	Canadian International Development Agency
CRS	Creditor Reporting System
CSO	Civil society organisation
CSP	Corporate service provider
CTP	Centre for Tax Policy (OECD)
DAC	Development Assistance Committee (OECD)
DfID	Department for International Development (United Kingdom)
DNFBP	Designated non-financial businesses and professions
DPA	Deferred prosecution agreement
DTC	Double Tax Convention
ECA	Economic Commission for Africa
EOI	Exchange of information
EU	European Union

EUR	Euro
FATCA	Foreign Account Tax Compliance Act (United States)
FATF	Financial Action Task Force
FDI	Foreign direct investment
FFI	Foreign financial institution
FIU	Financial intelligence unit
FSAP	Financial Sector Assessment Program (World Bank/IMF)
FSRB	FATF-style regional body
FuR	Follow-up report
GDP	Gross domestic product
GFI	Global Financial Integrity
GIZ	Agency for International Co-operation (Germany) *Deutsche Gesellschaft für Internationale Zusammenarbeit*
GNC	Globally networked customs
ICAR	International Centre for Asset Recovery (Switzerland)
ICG	International Corruption Group (United Kingdom)
ICTD	International Centre for Tax and Development
IFC	International Financial Corporation
IFF	Illicit financial flows
IMF	International Monetary Fund
IRS	Internal Revenue Service (United States)
ITC	International Tax Compact
ITD	International Tax Dialogue
LDC	Least developed country
MDG	Millennium Development Goal
MENA	Middle East and North Africa
MLA	Mutual legal assistance
MNE	Multinational enterprise
NCB	Non-conviction based
NGO	Non-governmental organisation
Norad	Norwegian Agency for Development Co-operation
NPA	Non-prosecution agreement
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development

OFAC	Office of Foreign Asset Control (United States)
PCD	Policy coherence for development
PEP	Politically exposed person
PFM	Public financial management
ROSC	Reports on the Observance of Standards and Codes
StAR	Stolen Asset Recovery Initiative (World Bank/UNODC)
STR	Suspicious transaction report
TBML	Trade-based money laundering
TCSP	Trust and company service provider
TIEA	Tax information exchange agreement
TIWB	Tax Inspectors Without Borders
TP	Transfer pricing
TTU	Trade transparency unit
UN	United Nations
UNCAC	United Nations Convention against Corruption
UNDP	United Nations Development Programme
UNODC	United Nations Office on Drugs and Crime
UNSC	United Nations Security Council
UNTOC	United Nations Convention against Transnational Organized Crime
USAID	United States Agency for International Development
USD	United States dollar
VAT	Value added tax
WCO	World Customs Organisation
WGB	Working Group on Bribery in International Business Transactions (OECD)

Executive summary

Illicit financial flows originating in developing countries – from money laundering, tax evasion and bribery – often reach OECD countries. Recognising these risks, OECD countries are taking action to avoid being safe havens for illegal money.

Combating illicit financial flows depends on the quality of national regulations, their implementation and whether they comply with international best practices. This report highlights the performance of OECD countries against the essential international standards for countering illicit financial flows. It focuses on five policy areas: money laundering, tax evasion, bribery, asset recovery and the role of donor agencies. These policy areas are described using publicly available data and by compliance reviews following international agreements. Taken together, the analyses provide a measure of OECD countries' performance in fighting illicit financial flows. The report's key findings are highlighted below.

Money laundering

Illicit financial flows often leave developing countries via the commercial financial system. Through this system, funds are laundered to disguise their origin. Anti-money laundering and combatting the financing of terrorist (AML/CFT) regimes are effective tools to prevent illicit funds from being held, received, transferred and managed by major banks and financial centres.

Anti-money laundering and counter terrorist financing efforts are governed by the recommendations of the Financial Action Task Force (FATF). OECD countries' anti-money laundering regimes have improved since the first set of Recommendations was established in 2003, although not evenly across the board. On average, OECD countries' compliance with central FATF Recommendations is low. This report suggests that countries strengthen their regulatory and supervision regimes, and fully implement the new 2012 Financial Action Task Force Recommendations.

Tax evasion

Fighting international tax evasion is important because it is a major source of illicit financial flows from developing countries. Sub-Saharan African countries still mobilise less than 17% of their gross domestic product (GDP) in tax revenues. To combat tax crimes, effective exchange of information (EOI) among countries is essential.

Since 2000, the number of agreements on EOI between OECD countries and developing countries has steadily increased. Although most of the agreements signed since 2005 comply with standards of the Global Forum on Transparency and Exchange of Information for Tax Purposes, there is room for improvement. Automatic exchange of information (AEOI) can be a powerful tool in this respect, deterring tax evaders and increasing the amount of taxes paid voluntarily. While AEOI is becoming more widely recognised for its effectiveness, it remains an exception. Developing countries' tax

systems suffer from weak capacity and corruption, and therefore often lack the capacity to engage effectively in EOI. This report recommends strengthening institutions and systems to prevent tax evasion.

International bribery

An estimated USD 1 trillion is paid each year in bribes. Reducing bribery reduces the opportunities for illicit gains, and hence illicit financial flows. The 1997 OECD Anti-Bribery Convention tackles the supply side: the bribe payers. The criminalization of bribe payers outside of developing countries, as well as their effective prosecution, is central for drying up this source of illicit financial flows.

In OECD countries, the sanctions for foreign bribery offenses are increasing. While peer reviews confirm that OECD countries are taking a harder stance against corruption, around half of OECD countries have yet to see a single prosecution. Some countries have loopholes for bribe payers in their legal frameworks, including overly narrow definitions or short statutes of limitations; other countries impose impractical burdens of proof, or let strategic considerations influence whether or not to pursue a bribery case. To mitigate these challenges, potent mechanisms to uncover bribery and prosecute bribe payers are needed, including penalties that will constitute a tangible deterrent. Effective protection for whistleblowers is also essential.

Stolen asset recovery

Repatriation of stolen assets to their country of origin can provide developing countries with additional resources, offering a powerful deterrent as well as justice for the societies whose funds are repatriated.

Progress in OECD countries in repatriation has been modest, however, with only a limited number of countries having frozen or returned assets. The countries that are the most successful in tracing, freezing and repatriating assets have legal frameworks that allow for non-conviction based forfeiture and civil prosecutions. Proving that assets are linked to criminal conduct can be a complex process. As seen in some cases, one successful way to counter this problem is to require proof that excessive wealth has a legitimate origin. In addition, countries can contribute by accepting foreign confiscation orders and providing assistance to foreign jurisdictions. Adequately resourced and trained specialist units to investigate stolen assets and prosecute offenders are central, as is enhanced information sharing on asset recovery cases among jurisdictions and institutions. By offering legal and technical assistance, and encouraging proper cost-sharing arrangements, OECD countries can encourage developing countries to seek co-operation.

The role of donor agencies

Over the past years, donor agencies have become increasingly involved in tackling illicit financial flows. Agencies have supported civil society organisations and researchers working on this agenda, and have supported countries' efforts to build capacity in fighting tax evasion, money laundering and corruption. Donor agencies are the link between OECD countries and countries that are the source of illicit financial flows. They can play an effective role by supporting the fight against illicit financial flows and strengthening their own preventive and investigative capacities against economic crime.

Key numbers

- Twenty-seven out of 34 OECD countries store or require insufficient beneficial ownership information for legal persons, and no country is fully compliant with the beneficial ownership recommendations for legal arrangements.
- Since 2000, OECD countries have signed roughly 1 300 bilateral exchange of information agreements with developing countries.
- As of 2012, 221 individuals and 90 companies had been sanctioned for foreign bribery, yet around half of all OECD countries have yet to see a single prosecution.
- Between 2010 and 2012, OECD countries returned USD 147 million and frozen almost USD 1.4 billion of stolen assets.

A list of consolidated recommendations can be found in the assessment and recommendations section.

Recommendations

Combating money laundering

Countries should:

- Fully implement the new 2012 Financial Action Task Force Recommendations to adapt their anti-money laundering regimes to current challenges.
- Ensure that financial institutions and designated non-financial institutions conduct proper customer due diligence.
- Require institutions to determine beneficial owners and ensure that this information is available to the relevant authorities.
- Strengthen their regulatory and supervision regimes, particularly for non-financial institutions, and enforce these rules consistently.

Combating tax evasion

Countries should:

- Continue to implement international standards on exchange of information and continue to expand their networks.
- Enact more automatic exchange of information agreements.
- Strengthen institutions and systems to prevent tax evasion and investigate and prosecute offenders.

Combating international bribery

Countries should:

- Put in place institutional and regulatory mechanisms to uncover bribery, including appropriate penalties that constitute an effective deterrent.
- Prosecute bribe payers consequently.

Recommendations (*cont.*)

- Provide effective protection to whistleblowers.
- Signal that the fight against bribery is a political priority.

Freezing, recovering and repatriating stolen assets

Countries should:

- Ratify the United Nations Convention against Corruption and the United Nations Convention against Transnational Organized Crime.
- Install and enforce an effective legal framework.
- Establish adequately resourced and trained specialist units which investigate stolen assets and prosecute offenders.
- Implement comprehensive, strategic policies and best practices for rapid tracing, freezing and repatriating stolen assets, such as non-conviction based forfeiture, acceptance of foreign confiscation orders, recovery by civil trial and assistance to foreign jurisdictions.
- Enhance information sharing on asset recovery cases with other jurisdictions and between institutions.
- Provide technical assistance, capacity-building support and case assistance to other countries.

OECD countries should encourage developing countries to:

- Request and engage in mutual legal assistance.
- Demonstrate commitment to combating corruption and bringing the guilty to justice.
- Examine the best options for managing returned funds.
- Discuss with developed countries proper cost-sharing arrangements for asset recovery cases.

A distinct word on donor agencies

Donor agencies can play an effective role by:

- Following an agenda that supports the fight against illicit financial flows, for example by developing exchange of tax information agreements, building transfer pricing capacity and encouraging further research on issues related to illicit financial flows.
- Strengthening their preventive and investigative capacities to tackle economic crime in their own projects, for example by undertaking due diligence and risk assessments or sensitizing staff to potential "red flags" for economic crime.
- Fostering political commitment to combat economic and financial crimes in developing countries.

Chapter 1

What do illicit financial flows mean for developing countries?

Illicit financial flows (IFFs) are generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws. The funds strip urgently needed resources from developing countries, which then lack means to finance their development efforts. Illicit financial flows generally fall in one of four categories: money laundering, bribery and tax evasion by international companies, and trade mispricing. There are many international initiatives underway that aim at combatting illicit financial flows. OECD countries have a large role in this agenda, as OECD country systems in this area often exhibit weaknesses.

The scale and impact of illicit financial flows

Every year huge sums of money are transferred out of developing countries illegally. These illicit financial flows (IFFs) strip resources from developing countries that could be used to finance much-needed public services, from security and justice to basic social services such as health and education, weakening their financial systems and economic potential. While such practices occur in all countries – and are damaging everywhere – the social and economic impact on developing countries is more severe given their smaller resource base and markets. Estimates vary greatly and are heavily debated,[1] but there is a general consensus that illicit financial flows likely exceed aid flows and investment in volume.

The most immediate impact of IFFs is a reduction in domestic expenditure and investment, both public and private. This means fewer hospitals and schools, fewer police officers on the street, fewer roads and bridges.

It also means fewer jobs. Furthermore, many of the activities which generate the illicit funds are criminal; and while financial crimes like money laundering, corruption and tax evasion are damaging to all countries, the effects on developing countries are particularly corrosive. For example, corruption diverts public money from public use to private consumption. We know that, in general, private consumption has much lower positive multiplier effects than public spending on social services like health and education. Proceeds of corruption or criminal activities will generally be spent on consumption of items such as luxury vehicles, or invested in real estate, art or precious metals. The social impact of a euro spent on buying a yacht or importing champagne will be very different from that of a euro spent on primary education (Global Witness, 2009).

On another front, money laundering is harmful to the financial sector: a functioning financial sector depends on a general reputation of integrity, which money laundering undermines. In this way, money laundering can impair long-term economic growth, harming the welfare of entire economies.

What are illicit financial flows?

There are various definitions of illicit financial flows, but essentially they are generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws.

Current literature on this issue suggests that illicit financial flows generally involve the following practices: money laundering,[2] bribery and tax evasion by international companies, and trade mispricing.

These categories, however, do not tell us anything about the source or origin of such flows. They may have arisen from illegal or corrupt practices such as smuggling, fraud or counterfeiting; or the source of funds may be legal, but their transfer may be illegal, such as in the case of tax evasion by individuals and companies. Nor do they tell us about their intended use. They may be intended for other illegal activities, such as terrorist financing or bribery, or for legal consumption of goods.

In practice, illicit financial flows range from something as simple as a private individual transfer of funds into private accounts abroad without having paid taxes, to highly complex schemes involving criminal networks that set up multi-layered, multi-jurisdictional structures to hide ownership.

In the limited literature on this phenomenon, most attention has been given to outflows of corrupt profits, particularly those of kleptocrats such as Sani Abacha (Nigeria), Valdimiro Montesinos (Peru) and Ferdinand Marcos (Philippines).

Each of them in some way looted their country, whether through direct control of the central bank (Abacha), extortion of defence contractors (Montesinos) or confiscation of businesses (Marcos). After having left power, whether through death, political upheaval or criminal conviction, each was found to have large fortunes invested overseas in a wide variety of assets. Just below this level are semi-autonomous political figures, such as the governors of two Nigerian states recently convicted in London courts of having acquired assets in the United Kingdom with funds stolen from state development funds. The money was generally moved by quite simple means, such as wire transfers through complicit banks or the carrying of cash in large denominations across borders.

There are numerous reasons for kleptocrats to move money to other countries. The funds are less subject to seizure if a new regime, kleptocratic or otherwise, takes power. Keeping funds in foreign jurisdictions also provides access to luxury goods that may not be available domestically. Finally, funds held abroad can be used to curry favour in other countries which might later provide a safe haven if the kleptocrat has to exit.

Much less is known about the outflows associated with tax evasion, perhaps the most ubiquitous of the sources of illicit financial flows. Again, the purpose of moving the money out of the country illicitly may be protective; the domestic tax collection agency may improve its monitoring efficiency; assets held outside the country are harder to trace.

The scope of this report

This report aims to measure and compare the efforts of OECD countries to control illicit financial flows from developing countries by measuring their performance against international standards for combating economic and financial crimes. It does not attempt to assess the accuracy of existing estimates concerning the scale of illicit flows, nor the relative importance of the various forms or methods used for transferring funds.

The policy areas covered by this report are largely determined by the availability of open source data. It does not aim to cover all aspects of the complex IFF picture, as presented in current debates. Rather, it focuses on areas where there are international agreements already in place and some process for measuring progress on these agreements, and where there are comparable data on compliance. The areas of central importance in the fight against financial and economic crime covered in this report are:

Money laundering (Chapter 2)

The International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation (FATF, 2013) have been endorsed by over 180 countries, with regular assessments and a follow-up mechanism implemented by the Global Network of the Financial Action Task Force (FATF) and its eight FATF-style regional bodies.

Tax evasion (Chapter 3)

The Global Forum on Transparency and Exchange of Information for Tax Purposes monitors the implementation of agreed standards for the exchange of information for tax purposes.

Bribery (Chapter 4)

The OECD Working Group on Bribery monitors signatories' compliance with the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

Asset recovery (Chapter 5)

There is an international initiative in place to promote asset recovery; the OECD and the Stolen Asset Recovery Initiative (StAR) have carried out a survey on OECD country efforts on asset recovery.

Development co-operation (Chapter 6)

Development agencies have an important role in supporting various parts of the IFF agenda. Chapter 6 outlines some of the innovative efforts by development agencies to combat illicit financial flows from developing countries and proposes ideas for further action.

This report provides a snapshot of OECD country performance in the above areas, focusing on issues that are of critical relevance for preventing and detecting illicit financial flows and for recovering stolen assets. More comprehensive analysis in each of these areas is being conducted by institutions such as the Financial Action Task Force, the Global Forum on Transparency and Exchange of Information for Tax Purposes, the OECD's Working Group on Bribery and its Stolen Asset Recovery Initiative. The reviews carried out by these bodies cover the various issues in great depth, making detailed recommendations on how countries can improve compliance and effectiveness.

The cross-country comparable data in this report should provide a useful overview of how well OECD member countries perform on the implementation of the various international instruments named above. This report aims to provide useful information to countries that wish to improve their institutional performance or policies in these areas.

What efforts are underway at the international level to tackle illicit financial flows?

Recognising the particularly damaging effects of illicit financial flows on developing countries, leaders meeting at the Fourth High-Level Forum on Aid Effectiveness in Busan in 2011 agreed to:

> …accelerate our individual efforts to combat illicit financial flows by strengthening anti-money laundering measures, addressing tax evasion, and strengthening national and international policies, legal frameworks and institutional arrangements for the tracing, freezing and recovery of illegal assets. This includes ensuring enactment and implementation of laws and practices that facilitate effective international co-operation. (OECD, 2011a)

Two of the leading international political groupings – the G20 and G8 – have also taken on various parts of this agenda. At their most recent summit in St. Petersburg, the G20 leaders, stressed their commitment to the FATF standards, especially with regards to the identification of beneficial owners and committed to automatic exchange of information for tax purposes as the new global standard. The G8 Deauville Partnership with Arab Countries in Transition – which includes a number of the Arab Spring countries[3] – has an ambitious agenda for recovering stolen assets, including the Arab Forum on Asset Recovery (AFAR). AFAR was launched in Doha, Qatar in

September 2012 to speed up efforts to identify and repatriate stolen assets to Middle East and North African (MENA) countries. The 2013 G8 summit in Lough Erne stressed the need to improve the exchange of tax information, increase the availability of beneficial ownership information, and ensure that G8 country policies were not damaging to developing countries.

What role do OECD countries play?

OECD ministers have long recognised the need to ensure that the policies and practices of OECD countries are consistent with their development objectives, and that they are not damaging to developing countries. Known as policy coherence for development (PCD), this agenda has recently recognised illicit financial flows as an issue of central importance because of their damaging impact on developing countries' ability to mobilise their own financing for private and public sector investments. The report *Better Policies for Development: Recommendations for Policy Coherence* (OECD, 2011b) points to the need for action in three areas: *i)* stemming illegal earnings at the source by fighting bribery, ensuring good corporate governance and promoting greater transparency in high-risk sectors; *ii)* making illegal money transfer more difficult by strengthening money laundering measures and increasing the use of automatic exchange of information (AEOI); and *iii)* identifying and returning illegally transferred funds to their destination through effective mutual legal assistance and other forms of co-operation on corruption and asset recovery.

OECD country systems still have weaknesses that allow the entry of illicit funds. It is important that OECD countries take measures to avoid becoming safe havens for illicit financial flows from the developing world. The OECD supports its members on issues related to financial crime and illicit financial flows through numerous initiatives and instruments. Examples include the fight against tax havens, the promotion of exchange of tax information and the implementation of the Anti-Bribery Convention, amongst others. The OECD is also an observer to the Financial Action Task Force, the standard-setter for efforts to combat money laundering and terrorist financing.

Combating illicit financial flows is a shared agenda, requiring action by both OECD and developing countries. Illicit flows are often a symptom of deeper governance failures and just one element of a wider set of governance challenges faced by many countries. High levels of corruption, combined with weak institutions – and sometimes illegitimate regimes – are drivers for such outflows. Ultimately, the fight against illicit flows from the developing world must focus on building responsive, effective institutions which deliver services to their population. This will encourage citizens and companies to engage in legal activities, report their earnings and pay their taxes and dues in accordance with national laws. Seen in this wider perspective, reforms undertaken in OECD countries will only address one part of the challenge. Yet while the initiative and energy to combat corruption and stem illicit flows must come from developing countries themselves, OECD countries can do their part to support this effort.

Notes

1. Most existing estimates of the scale of illicit financial flows come from non-governmental organisations (NGOs). Most prominent are the estimates developed by Global Financial Integrity (GFI), a Washington-based NGO. The GFI relies on discrepancies in various trade and international macroeconomic statistics to identify these hidden flows. The GFI estimates that between 2001 and 2010, illicit financial flows from developing countries totalled as much as USD 5.8 trillion; the People's Republic of China was responsible for almost half of the total, five times as much as the next highest source country, Mexico. The next three highest sources of illicit financial flows were Malaysia, the Russian Federation and Saudi Arabia. For 2010, the global figure was close to USD 1 trillion (GFI, 2012). There has been minimal academic research on the topic, but some scholarly critiques of the GFI approach can be found in a recent volume of essays from the World Bank. For example, Nitsch (2012) suggests that the GFI estimates make unrealistic assumptions about trade-related transport costs and ignore many other factors that could account for errors in international trade and finance statistics.

2. Money laundering is defined as the possession, transfer, use, and concealment (etc.) of the proceeds of crime.

3. The partnership includes Canada, Egypt, France, Germany, Italy, Japan, Jordan, Libya, Kuwait, Morocco, Qatar, the Russian Federation, Saudi Arabia, Tunisia, Turkey, the United Arab Emirates, the United Kingdom, the United States and the European Union.

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Chapter 2

Combating money laundering

Anti-money laundering and counter terrorist financing regimes are among the most effective tools for combating financial crime and illicit financial flows. This chapter looks at the most recent reviews of OECD country compliance with the 2003 Financial Action Task Force (FATF) Recommendations in these two areas.

In order to stem illicit financial flows and to avoid becoming safe havens for illicit financial flows, as well as to be in line with the revised 2012 FATF Recommendations, OECD countries should begin by adopting a risk-based approach to combating money laundering and terrorist financing. Based on the analysis of areas where countries have faced the biggest difficulties in complying with the 2003 FATF standards, the following may deserve particular attention: i) *strengthening implementation of customer due diligence procedures;* ii) *improving compliance with beneficial ownership requirements;* iii) *ensuring effective regulation, supervision and sanctions, including for non-financial businesses and professions, and trust and company service providers.*

Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Introduction

Individuals from developing countries whose wealth is of an illicit nature often seek to place it outside their own countries not only to avoid scrutiny, but also as a means of diversifying their investment portfolios and spreading risk. For this reason, they are likely to choose countries with stable and predictable financial systems, as well as those where the risk of detection is low because of weak anti-money laundering regimes. An examination of major corruption cases over recent years shows that significant amounts of illicit financial flows from developing countries have found their way into OECD countries (Van der Does de Willebois, 2011; see Table 2.1). According to the United Nations Office on Drugs and Crime (UNODC), in 2009 criminal proceeds amounted to 3.6% of global gross domestic product (GDP), with 2.7% (or USD 1.6 trillion) being laundered (UNODC, 2011).

Table 2.1. **Recent anti-money laundering related sanctions involving OECD-based financial institutions**

Bank	Sanction
HSBC	In 2012, the HSBC paid a record-fine of USD 1 921 million to avoid criminal proceedings. US authorities investigated allegations that the bank laundered money originating from OFAC-sanctioned countries, including Cuba, Iran, Libya, Myanmar and Sudan. In addition, the HSBC allegedly laundered proceeds of criminal activity in Colombia and Mexico. Additional fines by UK regulators. (Financial Times, 2012)
Standard Chartered	Following US investigations, Standard Chartered in 2012 paid a total of USD 677 million as civil penalty and under a deferred prosecution agreement to US authorities. The bank violated sanctions on Iran, Libya, Myanmar and Sudan. (BBC, 2012; New York Times, 2012)
ING	In 2012, ING settled allegation by US regulators that it laundered money from Cuba and Iran, countries sanctioned by US Office of Foreign Asset Control (OFAC). ING paid USD 619 million. (United States Department of the Treasury, 2012a; 2012b)
JP Morgan	In 2011, JP Morgan was fined USD 88.3 million by the US Department of the Treasury, for violating sanctions by OFAC. JP Morgan conducted transactions with clients from Cuba, Iran, Sudan and Liberia. (United States Department of the Treasury, 2011; CNBC, 2011; Wall Street Journal, 2011a)
Barclays	In 2010, Barclays paid USD 298 million in financial penalties as part of a deferred prosecution agreement to settle criminal charges by the US Department of Justice, which alleged that Barclays had conducted transactions with sanctioned countries Cuba, Iran, Myanmar and Sudan. (The Guardian, 2010; The Telegraph, 2010a; United States Department of Justice, 2010a)
RBS (ABN AMRO)	In 2010, RBS paid a USD 500 million penalty as part of a deferred prosecution agreement with US authorities. ABN AMRO, which was acquired by RBS, had illegally processed transactions from clients in Iran and Libya. (United States Department of Justice, 2010b; The Telegraph, 2010b; Wall Street Journal, 2011b)
Credit Suisse	In 2009, Credit Suisse paid a USD 538 million penalty for hiding transactions made by clients from Cuba, Iran, Libya, Myanmar and Sudan, as part of a deferred prosecution agreement with the US Department of Justice. (Bloomberg, 2009; United States Department of the Treasury, 2009a)
Lloyds Banking Group	In 2009, Lloyds Banking Group agreed to a deferred prosecution arrangement with US prosecutors. The bank avoided prosecution for its dealings with clients in Iran, Libya and Sudan by paying USD 350 million. (Financial Times, 2009; United States Department of the Treasury, 2009b)
Riggs Bank	In 2004, Riggs Bank plead guilty to money laundering charges and paid a USD 16 million penalty. The bank failed to report suspicious activity by clients in Chile and Equatorial Guinea. Accounts were held, among others, by former dictator Augusto Pinochet. (Washington Post, 2005)

Fighting money laundering has been high on the international agenda for over two decades and several conventions have been put in place to criminalise these acts: the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances; the 1999 UN International Convention for the Suppression of the Financing of Terrorism; and the 2000 United Nations Convention against

Transnational Organized Crime, among others. The commitments in these conventions have been incorporated into the Recommendations of the Financial Action Task Force (FATF), the most comprehensive instrument for tackling money laundering to date. The 2003 FATF Recommendations consist of 40 specific recommendations, which for the purposes of this study, are organised into 4 broad categories and 13 sub-categories[1] (Table 2.2). These include putting in place the necessary anti-money laundering/ combating the financing of terrorism (AML/CFT) legal framework; putting in place measures to prevent, detect, prosecute and sanction AML-related crimes; and promoting better international co-operation to deal with financial crimes of an international nature.

Table 2.2. **FATF categories, sub-categories and recommendations**

	Category	Sub-category	Recommendation
1	Legal systems	I. Scope of the criminal offence of money laundering	1-2
		II. Provisional measures and confiscation	3
2	Measures to be taken by financial institutions and non-financial businesses and professions to prevent money laundering and terrorist financing	III. Financial secrecy	4
		IV. Customer due diligence and record keeping	5-12
		V. Reporting of suspicious transactions and compliance	13-16
		VI. Other measures to deter money laundering and terrorist financing	17-20
		VII. Measures to be taken with respect to countries that do not or insufficiently comply with the FATF Recommendations	21-22
		VIII. Regulation and supervision	23-25
3	Institutional and other measures necessary in systems for combating money laundering and terrorist financing	IX. Competent authorities, their powers and resources	26-32
		X. Transparency of legal persons and arrangements	33-34
4	International co-operation	XI. Conventions	35
		XII. Mutual legal assistance and extradition	36-39
		XIII. Other forms of co-operation	40

Source: adapted from FATF (Financial Action Task Force) (2010), *FATF 40 Recommendations 2003*, FATF/OECD, Paris, available at: www.fatf-gafi.org/topics/fatfrecommendations/documents/the40recommendationspublishedoctober2004.html.

The FATF – along with the IMF, the World Bank and FATF-style regional bodies (FSRBs) – regularly carries out detailed mutual evaluation reviews of all FATF/FSRB member countries, assessing their compliance with the FATF Recommendations. All OECD countries are members of the Global Network of FATF and FATF-style regional bodies.[2] These bodies also promote the FATF standards and carry out similar reviews and assessments of members' compliance with them. The Global Network currently covers 192 countries and jurisdictions.

This chapter reports on OECD country performance against the 2003 FATF Recommendations, as measured by compliance scores given through the Mutual Evaluation Review (MER) process. It also uses findings from other studies and reports as illustrations. The MER scores provide a retroactive look at how members were deemed to perform at the time of each review (see Table 2.A1.1). Given the significant variance in the dates of the MERs, the compliance ratings presented in this chapter should not be taken as indicative of current OECD country performance. Rather, this analysis highlights the areas in which OECD countries have had difficulty in complying with the 2003 FATF standards in the past. Many of these general findings and observations still apply.

The FATF Recommendations were revised in February 2012. The FATF has also developed a new methodology and process for assessing compliance with these revised recommendations, and was expected to begin applying them in assessments towards the end of 2013 or early 2014. The FATF is an inter-governmental policy body which sets illicit finance standards on combating anti-money laundering, counter terrorist financing, and proliferation financing and supports their effective implementation. The FATF Secretariat is located at the OECD but is not part of the organisation.

Anti-money laundering and counter terrorist financing regimes (AML/CFT) are some of the most comprehensive tools to detect and combat a wide range of economic and financial crimes, including cross-border illicit financial flows. Anyone seeking to transfer illicit financial resources of a significant amount into an OECD country for the purposes of investment or consumption will most likely be required, at some point, to use the banking or financial system to conduct transactions. For this reason, AML regimes hold great potential in combating such flows.

How is money laundered?

Money laundering is any process by which illegal funds (money and goods) are made to appear legitimate. While this can be achieved best through a series of complex transactions which aim to hide the illicit nature of the funds (Box 2.1), in line with the FATF definitions the mere possession of illicit funds by the criminal is considered money laundering and is illegal. This is supported by the definition given by the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, which states that money laundering is the possession, acquisition, use, conversion, transfer, concealment and disguise of illicit funds.

Box 2.1. **The ABCs of money laundering**

The steps through which these funds are "laundered" or "cleaned" can vary greatly from case to case, but money laundering generally involves the following steps:

- Placement: Funds are introduced into the financial system.
- Layering: Criminal funds are separated from their source, usually through a series of transactions that may include real or fake purchases and sale of goods and property, investment instruments or simple international bank transfers.
- Integration: The apparently clean funds enter the legitimate economy and are "re-invested" in various ways, such as through purchasing real estate and other investment vehicles.

There is an extensive variety of methods and channels used to launder illegally obtained assets. Financial and non-financial institutions – from banks to currency exchange institutions, real estate agents and "trust and company service providers" (TCSPs) – may be willing to take the risk of accepting illicit funds or to be misused to launder funds. Illicit funds can be used to finance a luxurious lifestyle through the purchase of goods – such as mansions, art, jewelry and yachts – that can eventually be resold in order to conceal the illicit origin of the funds. "Dirty" money can be laundered through casinos or simply smuggled across borders inside a suitcase. Fake invoices for import and export transactions conducted by legitimate companies can take money outside a country. In cases where those involved in illegal activities also hold positions of power, funds can be transferred using official channels, including through the diplomatic

courier system. This explains why gauging how much money is being laundered on a global scale is a difficult task.

How well do OECD countries comply with the 2003 FATF Recommendations?

The findings in this chapter are based exclusively on publicly available data from FATF assessments of compliance with the 2003 FATF Recommendations.[3] In some cases, compliance scores from FATF mutual evaluation reports have been converted to numerical values as follows: non-compliant (NC) = 0, partially compliant (PC) = 1, largely compliant (LC) = 2, fully compliant (C) = 3, in order to generate average scores across several recommendations and across countries. There are several caveats which must be highlighted when interpreting this data. First, there are considerable time lags between peer reviews of individual countries. It is also likely that some countries have carried out important reforms that are not captured by these ratings. Finally, the comparability of the ratings may also be subject to some reservations – and there may be variations within the same ratings, and over time. (See Annex 2.A1 for more details on the data.)

Figure 2.1 shows average OECD country compliance scores for each of the 13 FATF sub-categories listed in Table 2.2. Figures 2.A1.1 and 2.A1.2 in the Annex also include the complete scores for each OECD country on each of the 40 Recommendations, as well as OECD average scores.

There is significant variation in average compliance across the various categories (Figure 2.1). Average OECD country compliance is lowest for "transparency of legal persons and arrangements". Countries also scored poorly on average for their compliance with "regulation and supervision", "measures taken towards high-risk jurisdictions", "customer due diligence and record keeping", and "reporting of suspicious transactions and compliance".

Figure 2.2 shows average OECD country compliance on each of the 40 Recommendations. The lowest scores can be observed on Recommendations 6 (politically exposed persons), 7 (correspondent banking), and 33 and 34 (beneficial ownership). The regulation and performance of designated non-financial businesses and professions (DNFBPs) on many of these recommendations is another area of weakness (see Recommendations 12, 16 and 24).

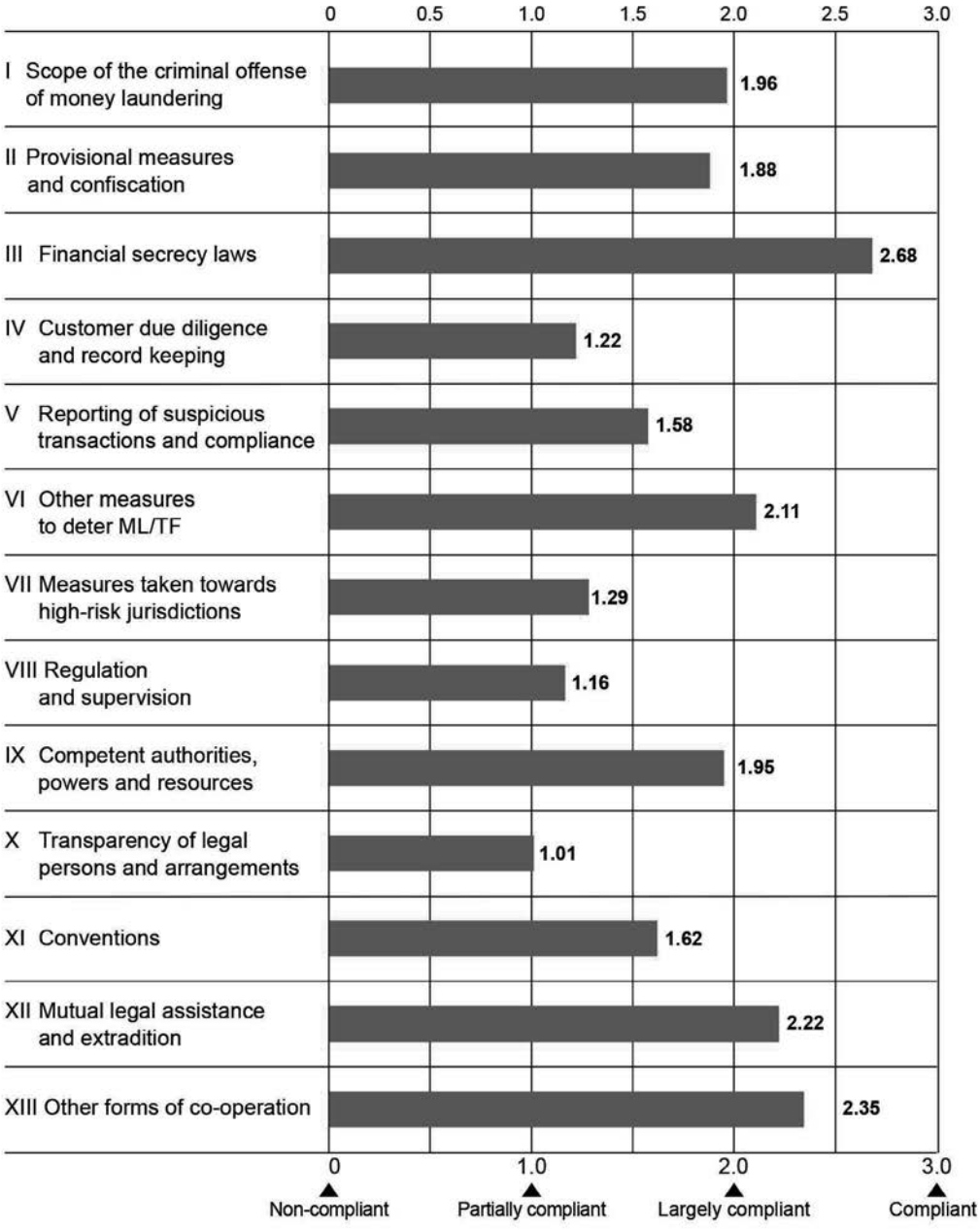
The remainder of this chapter looks at OECD country performance on the sub-categories and Recommendations where OECD performance is low, as these present the weakest links in members' AML regimes. Compliance with sub-category IX "mutual legal assistance and extradition" and Recommendation 17 "sanctions" are also examined briefly. Finally, the chapter looks at improvements in FATF Core and Key Recommendations as a result of the peer review process.

Customer due diligence and record keeping

This sub-category covers Recommendations 5-12. These Recommendations require that financial institutions and certain non-financial businesses and professions – such as lawyers, trust and company service providers, casinos, real estate agents and precious metals dealers – put in place mechanisms to minimise the risk of exposure to money laundering. Such mechanisms include implementing customer due diligence systems; in other words, knowing their customers, understanding their risk profiles, and their source of wealth/funds, and monitoring correspondent institutions[4] and transactions. The average

OECD score on this sub-category is 1.37 (between "partially" and "largely" compliant), but there is great variation amongst countries. Eight countries were non-compliant on 4 or more of the 8 recommendations in this sub-category and 16 countries were either non-compliant or partially compliant on 5 or more (Table 2.3). Twelve countries were either compliant or largely compliant on a majority of the recommendations.

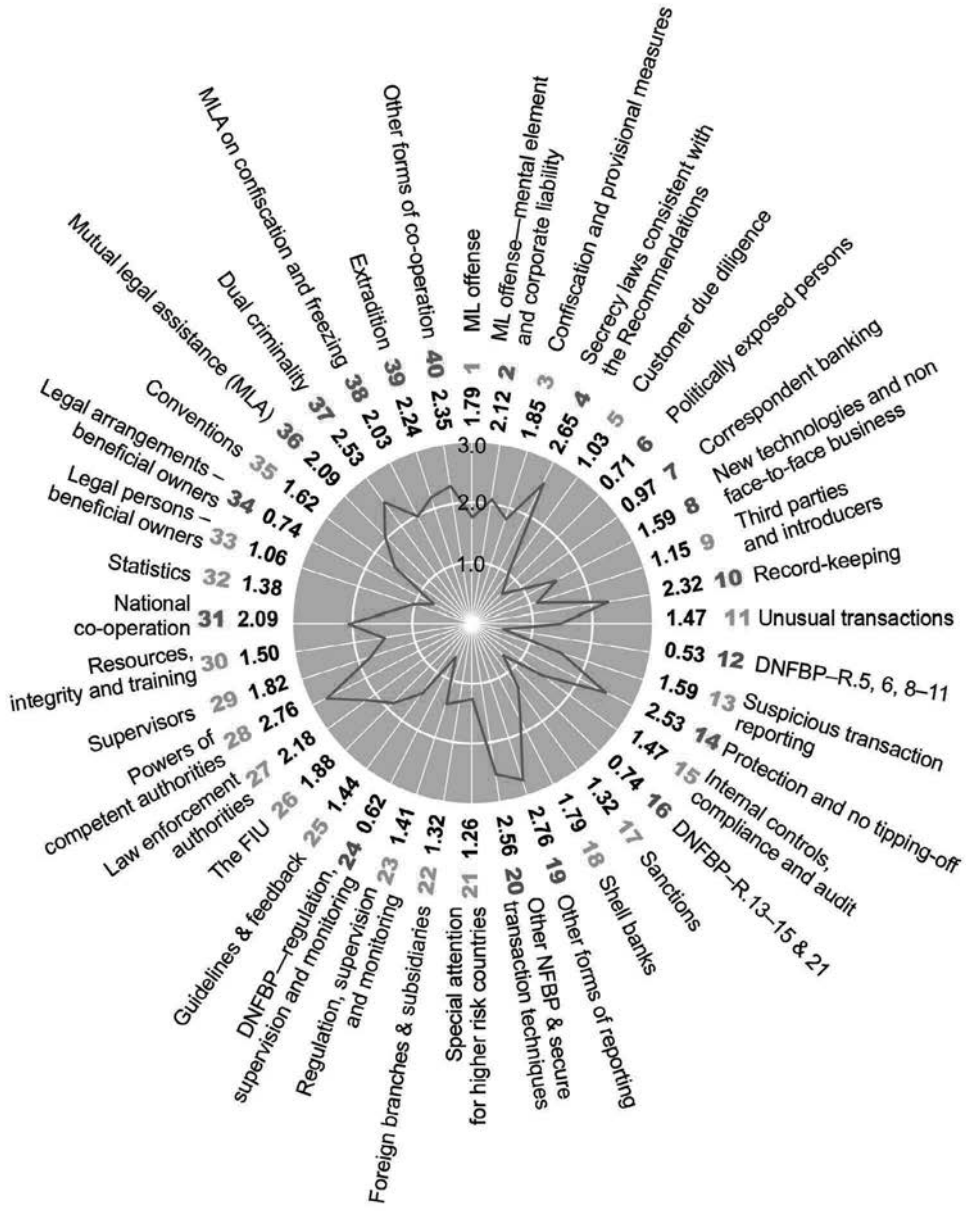
Figure 2.1. **OECD average compliance by FATF sub-category**



Note: ML/TF: money laundering/terrorist financing.

Source: based on public FATF data.

Figure 2.2. **Average OECD compliance (inner number) on each of the 40 FATF Recommendations**



Notes: DNFBP: designated non-financial businesses and professions; FIU: financial intelligence unit; ML: money laundering; MLA: mutual legal assistance.

Recommendation 5 requires that financial institutions carry out proper customer due diligence. This means identifying their client, including the ultimate "beneficial owner" (see Boxes 2.2 and 2.3) where the client is a corporate vehicle or legal arrangement such as a trust. It also asks institutions to understand the nature and purpose of the business relationship.

Table 2.3. **OECD country compliance ratings on FATF Recommendations 5-12: Customer due diligence and record-keeping procedures**

Measures to be taken with respect to countries that do not or insufficiently comply with FATF Recommendations				
Country	Number of recommendations: Compliant ●	Number of recommendations: Largely compliant ■	Number of recommendations: Partly compliant ■	Number of recommendations: Non compliant ○
Belgium	●●●●●	■■		○
Hungary	●●●●	■■■■		
Norway	●●●		■■	○○
Italy	●●	■	■■	○○○
Spain	●●		■■■	○○
Switzerland	●●	■■	■■■	○
Portugal	●●	■■	■■	○
United Kingdom	●●		■■■■	○○
Denmark	●		■	○○○○○○
Slovenia	●	■■■■■		○○
Austria	●	■■■■		○○○
Chile	●	■■■	■■■	○
Mexico	●	■■■	■■■	○
Iceland	●	■■	■■■■	○
Korea	●	■	■	○○○○○
Finland	●		■■■	○○○○
Ireland	●		■■■■	○○○
Turkey	●		■	○○○○○○
United States		■■■■■	■	○
Estonia		■■■■■		○○○
Slovak Republic		■■■■■	■■■	
France		■■■■		○○○○
Netherlands		■■■■	■■■	○
Germany		■■■	■■■■	○
Sweden		■■■	■■	○○
Greece		■■	■■■■	○○
Israel		■■	■■■■	○
Czech Republic		■■		○○○○○
New Zealand		■		○○○○○○○
Luxembourg		■	■■■■■	○○
Canada		■	■■	○○○○○
Japan		■	■■	○○○○
Australia			■■	○○○○○○
Poland			■■■	○○○○

In addition, financial institutions are required to monitor transactions to ensure that these correspond with the information provided by the client. If institutions are unable to carry out these tasks, they should not commence or continue business relations with or perform any transactions for the client, and they should consider filing a suspicious

transaction report (STR) with the relevant authorities. If transactions do not seem justified by the client's profile (i.e. transactions are larger than foreseen), then financial institutions should seek to understand the reasons for the discrepancies and consider additional measures, including submitting an STR.

Box 2.2. How do banks comply with customer due diligence and politically exposed person requirements?

In OECD countries, banks are generally required to identify their clients – including place of residence – and to verify this information. This usually means requesting a government-issued identification and some proof of residence, such as a utility bill or other official documents. Some banks will also check with credit reference agencies. Banks are also required to identify the "beneficial owner" (i.e. the natural person(s) who ultimately benefits from or controls a legal entity, account, investment) in cases where the customer is a representative of the controlling party of a company, partnership or trust.

Customer due diligence (CDD) compliance may also include conducting a risk assessment of the client, on the basis of which a risk rating is constructed. When establishing a new business relationship, banks will also want to understand the purpose of the relationship, the sources of funds, expected transactions, where the transactions will be coming from, etc. They may ask for detailed information on the type of business, its articles of organisation, and for official documents which show that the business is registered with the authorities, including copies of financial statements in some cases.

Banks are also required to carry out ongoing monitoring of transactions. Many banks have a threshold over which occasional transactions could be subject to CDD measures. In the United Kingdom for example, any occasional transaction over EUR 15 000 which takes place outside of established business relationships requires CDD measures to be applied.[1] Banks are also requested to conduct CDD for transactions under this threshold when the nature of the transaction means that there is a higher risk of money laundering (multiple transactions of the same value, or if the origin of transfer is a high-risk jurisdiction, etc.).

Enhanced CDD measures are normally required in certain higher risk cases, such as when dealing with a politically exposed person (PEP). Establishing a banking relationship with a PEP will usually require senior management approval, including determining the source of wealth and funds, along with stricter ongoing monitoring of the relationship. But determining whether a person is a PEP is not easy, and banks often do not have the necessary power, means or information at their disposal to detect such people (Wolfsberg Group, n.d.). Many banks rely on self-reporting, by simply asking a person at the time of opening an account whether or not they are a PEP or closely related to one, without any subsequent verification. In some cases, banks screen their clients against commercially available databases with lists of PEPs.[2] It has been noted that in practice, many banks do not apply effective PEP screening. Where customers have been identified as PEPs, enhanced due diligence measures have not always been taken and red flags have not always been followed up.

Notes: 1. See the United Kingdom's Customs and Excise webpage on "Your everyday responsibilities under money laundering regulations", available at www.hmrc.gov.uk/mlr/your-role/resposibilities.htm (accessed 16 January 2013). 2. See www.worldcompliance.com for an example.

Recommendation 6 requires that financial institutions determine whether a client might be a politically exposed person (PEP) – i.e. a current or recent public official or someone closely linked to such individuals – in which case they are required to put in place enhanced due diligence safeguards over and above those of Recommendation 5. This includes gaining senior management approval for establishing the business relationship, understanding the source of wealth and funds, and increased monitoring.

Box 2.3. **When banks' customer due diligence and politically exposed person controls work**

Dr. Aguinaldo Jaime, a senior Angolan government official, was head of Banco Nacional de Angola (BNA), the Angolan central bank. On two occasions in 2002 he attempted to transfer USD 50 million in government funds to a private account in the United States, only to have the transfers reversed by the US financial institutions involved. Dr. Jaime invoked his authority as BNA Governor to wire transfer the funds to a private bank account in California during the first attempt and, during the second attempt, to purchase USD 50 million in US Treasury bills for transfer to a private securities account in California. Both transfers were initially allowed, then reversed by bank or securities firm personnel who became suspicious. Partly as a result of those transfers and the corruption concerns they raised, in 2003 Citibank closed not only the accounts it had maintained for BNA, but all other Citibank accounts for Angolan government entities, and closed its office in Angola.

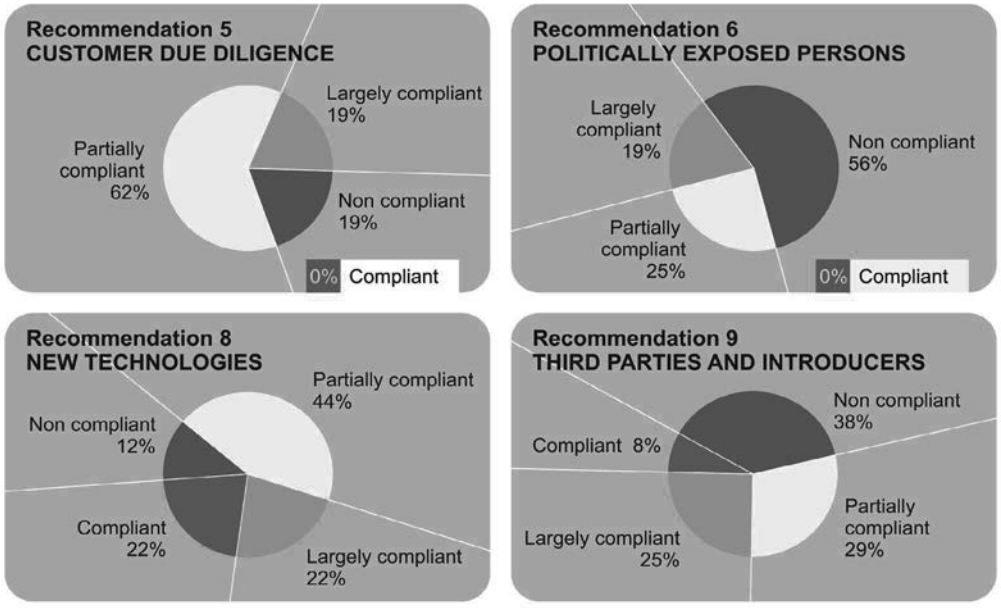
Source: United States Senate Subcommittee on Investigations (2010), *Keeping Foreign Corruption Out of the United States: Four Case Histories*, United States Senate Subcommittee on Investigations, Washington, DC.

This does not suggest that all PEPs are involved in corrupt practices, it merely indicates that there is a higher risk in dealing with such individuals due to their position of power and the risk that they could use it for their personal gain or that of their relatives or close associates (FATF, 2011, 2012a; Wolfsberg Group, n.d.). Recent corruption cases have uncovered a number of instances of PEPs using their positions of influence to launder the proceeds of corruption (FATF, 2011; see Box 2.3). The FATF recently issued comprehensive guidance on PEPs.

This compliance rating of over one-third of the OECD countries in this study with regard to the PEP Recommendations was insufficient; six countries did not comply with basic customer due diligence requirements. The general weaknesses in this area have been confirmed by reports from national supervisory authorities. A 2011 review by the United Kingdom's Financial Services Authority (now reorganised as the Financial Conduct Authority), for example, found that over one-third of the banks in the United Kingdom routinely flout CDD/PEP requirements, even when they have enough information to be able to identify clients as PEPs (FSA, 2011). Over half did not step up their CDD measures in higher risk situations. A 2010 report by the United States Senate Subcommittee on Investigations also showed serious weaknesses in the CDD/PEP requirements of some United States banks (US Senate Permanent Subcommittee on Investigations, 2010). In one case, a known arms dealer was able to conduct business without any additional due diligence by the bank holding his account. The 2010 US Senate report calls for the creation and operation of more up-to-date and effective PEP databases, and for annual reviews of PEP accounts. This echoes a 2009 World Bank/StAR report examining how the banking sector applies PEP measures (World Bank, 2009). The FATF guidance on PEP was, among other things, issued to assist countries in addressing lack of compliance.

Countries can allow financial institutions to use third parties to perform parts of the CDD process as long as they are regulated and supervised, and are able to provide the financial institutions with all the necessary documentation for the CDD process (see FATF Recommendation 9: Third Parties and Introducers). This report shows, however, that over 20% of OECD countries did not allow for such third-party contracting (Figure 2.3).

Figure 2.3. **OECD countries' compliance with FATF Recommendations 5, 6, 8 and 9**



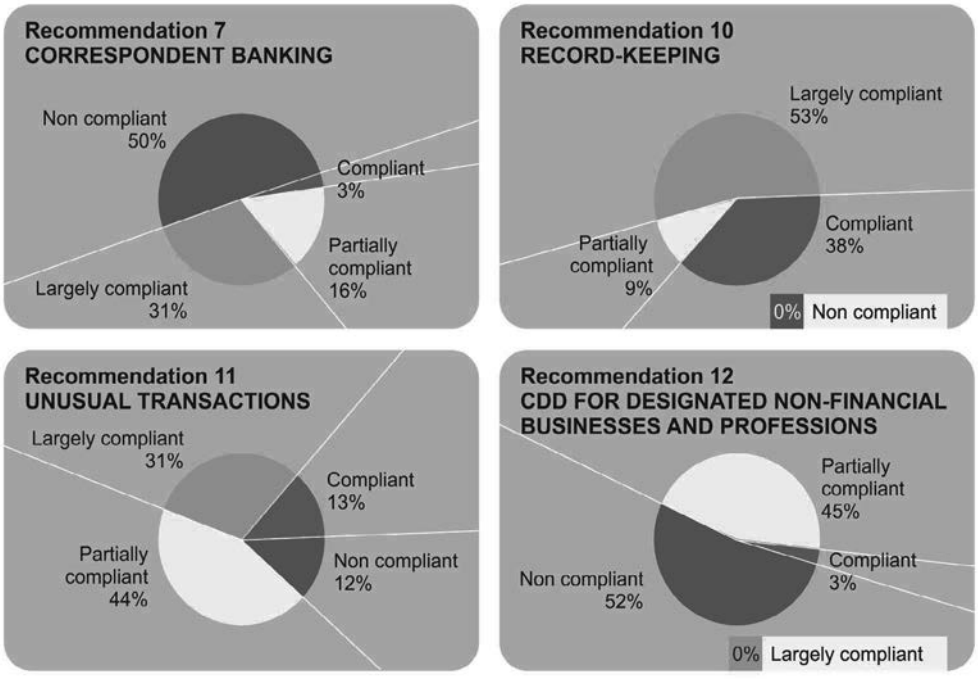
Recommendation 8 asks countries to pay particular attention to money laundering threats from new technologies that facilitate anonymity, such as payment methods that do not require bank transfers – e.g. prepaid cards, electronic purses, mobile payments, Internet payment services that do not rely on a bank account and digital precious metals (FATF, 2006a). Over half of OECD countries were either largely compliant or compliant on this recommendation.

Financial institutions are also asked to pay special attention to complex and large, unusual transactions or patterns of transactions, as these may indicate illegal activities. Such unusual transactions could include multiple transactions of the same amounts: money launderers can try and avoid scrutiny by authorities by staying under a certain threshold (often referred to as "smurfing"). But the definition of "unusual transactions" would also depend on the profile of the client making those transactions, and financial institutions need to invest resources in understanding their client in order to make such nuanced and subjective assessments effectively. Some banks will continuously monitor and update client files, noting transaction patterns which could, in some cases, be included in STRs for investigation by a financial intelligence unit. Smaller banks and financial service companies, however, may not have the necessary staff and resources to ensure such close monitoring.

Banks often depend on other banks ("correspondent banks") to act on their behalf in areas where they do not have a presence. Their services could include taking deposits, making payments and collecting documentation. Correspondent banks are commonly used for conducting business in a foreign country. When engaging in such relationships, financial institutions must satisfy themselves that the correspondent bank has proper AML/CTF controls in place and they are required to gather publicly available information to determine the reputation and standards of the institution in question (Recommendation 7). Senior management approval is recommended when establishing new correspondent relationships. In addition, when providing "payable-through

accounts",[5] a bank should be sure that the correspondent bank has performed satisfactory CDD controls on people with access to such accounts. Correspondent banks is an area where the score of OECD countries is uneven – 50% are considered non-compliant (Figure 2.4 and Box 2.4). A review by the United Kingdom's Financial Services Authority found that smaller UK banks in particular conducted very little due diligence on correspondent banks (and in some cases none), even when these were located in higher risk jurisdictions and other factors indicated a money laundering risk (FSA, 2011).

Figure 2.4. **OECD countries' compliance with FATF Recommendations 7, 10, 11 and 12**



Note: CDD: customer due diligence.

Finally, financial institutions should keep all relevant records on business relationships for at least five years, including copies of identification documents and information on transactions (currency, amounts, etc.). They should be able to share such information with relevant investigative authorities (Recommendation 10). Half of OECD countries were largely compliant and 41% compliant with this recommendation.

All the aforementioned recommendations (5,6 and 8-11) also apply to designated non-financial businesses and professions (DNFBPs), such as casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, accountants and trust and company service providers (Box 2.5). Recommendation 12 on DNFBPs applies when these actors prepare or carry out transactions on behalf of their clients.

Box 2.4. **Deficiencies in correspondent banking: The case of HSBC**

A recent report by the United States Senate Subcommittee on Investigations (2012) uncovered serious shortcomings in the way that HSBC US (HBUS) managed the establishment of business relationships and transactions with correspondent banks. The report highlights several severe deficiencies in the bank's AML system, through practices such as:

- opening US correspondent bank accounts for high-risk affiliates without conducting due diligence
- facilitating transactions that hinder the United States' efforts to stop terrorists, drug traffickers and rogue jurisdictions and others from using the US financial system
- providing US correspondent services to banks with links to terrorism
- clearing bulk US dollar travellers' cheques despite signs of suspicious activity
- offering high-risk bearer share corporate accounts.

For example, the bank's Mexican affiliate transferred over USD 7 billion into the United States in bulk cash shipments despite the United States' and Mexican authorities' warnings of probable links to drug trafficking. The bank also failed to carry out CDD procedures and kept several high-profile criminals as clients. It failed to monitor and report on transactions which normally should have raised red flags about potentially suspicious activities. The bank also manipulated wire transfer documentation in order to avoid having to apply a "filter" that banks are required to use in order to identify and stop transactions involving blacklisted individuals or institutions.

The report notes a lack of a proper AML programme by the bank, and insufficient action to remedy these weaknesses despite earlier warnings by the US regulatory authorities. In December 2012, the US authorities and HSBC reached a deferred prosecution agreement related to numerous money laundering and sanctions breaches. The agreement includes fines worth USD 1.9 billion and a detailed plan (costed at USD 700 million) by the bank to improve compliance with CDD requirements. In addition, an independent monitor will be placed inside the bank – the first time the United States has taken such a step in a foreign bank (United States District Court, 2012; Financial Times, 2012). Several other banks are co-operating with US authorities over similar investigations.

Source: United States Senate Subcommittee on Investigations (2012), U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History, Hearing of the US Senate SubCommittee on Investigations, 17 July, available at: www.hsgac.senate.gov/subcommittees/investigations/hearings/us-vulnerabilities-to-money-laundering-drugs-and-terrorist-financing-hsbc-case-history.

Several studies have shown the widespread use of lawyers and other professionals (company service providers) to carry out transactions on behalf of a client, sometimes for the purpose of keeping the client's identity secret (Box 2.5; and see FATF, 2012b). This is an area of significant weakness in OECD countries. Recommendation 12 has the second lowest average score (0.76): a full 44% of OECD countries do not comply with the recommendation to ensure that CDD and record-keeping requirements also apply to DNFBPs. Poor compliance on CDD requirements by corporate service providers is of serious concern given their important role in the setting up and management of companies (Box 2.6).

Box 2.5. **Trust and company service providers (TCSPs)**

Trust and company service providers (TCSPs) provide a range of business services for clients wishing to establish corporate vehicles such as companies, trusts and foundations (FATF, 2012b). Given their centrality in forming and managing corporate "vehicles" and given the frequent use of corporate vehicles in money laundering cases, TSCPs are also particularly exposed to money laundering risk. Case studies show that they have been used, sometimes willingly, as a conduit in money laundering schemes (FATF, 2010b). TCSPs often provide a range of services other than company formation – such as being nominee managers for corporations and limited liability companies, or functioning as the trustee for a trust – in essence managing or representing the corporate vehicle on behalf of the beneficial owner. As such, they are often privy to detailed information about their clients, and could therefore play an important role in applying CDD measures and in providing information to relevant authorities on beneficial ownership. In some cases, however, TSCPs have willingly helped conceal the beneficial owners of corporate vehicles and have knowingly helped transfer large sums of funds into OECD countries in contravention of the FATF Recommendations (United States Senate Permanent Subcommittee on Investigations, 2010).

Many TCSPs are lawyers, notaries or accountants. A 2010 FATF study, *Money Laundering Using Trust and Company Service Providers*, shows that regulation of TCSPs is uneven across jurisdictions. In some countries, "TCSP" is not a distinct business category and so regulation only applies to lawyers, accountants, notaries, etc., when they provide such TCSP business services, and supervision is often carried out by their respective professional bodies. In other countries, only some aspects of TCSP services – such as trust services – are subject to regulation. Some jurisdictions require TCSPs to be licensed as a separate business category, as a financial institution, or for some of the services they provide.

Box 2.6. **The Global Shell Games Report: Testing customer due diligence compliance of corporate service providers**

In a 2012 study, three academics conducted the first and only comprehensive test of actual customer due diligence compliance by corporate service providers (firms who help clients set up companies). In the test, the authors sent out over 7 400 email solicitations to more than 3 700 company service providers in 182 countries. The emails used fake names and included various fictitious "profiles" which indicated differing types of risks (money laundering, terrorism, etc.). The aim was to see what kinds of CDD measures corporate service providers (CSP) have in place to vet customers and ensure compliance with international standards related to identifying their clients. The findings include:

- Nearly half (48%) of all replies received from CSPs did not demand proper identification documents in order to set up companies or trusts; 22% did not demand any identity documentation at all.
- Providers from developing countries were also more compliant with global standards than those from developed countries.
- CSPs were less likely to reply to solicitations from customers with clear corruption risks; however, those that did reply were very unlikely to demand certified identification documents.
- CSPs were significantly unlikely to respond to solicitations from customers with a "terrorist" profile (i.e. from countries with terrorism links) – but again, those that did reply rarely asked for proper identity documentation.

Box 2.6. **The Global Shell Games Report: Testing customer due diligence compliance of corporate service providers** (*cont.*)

- When the authors referred to existing CDD requirements in their correspondence with CSPs, this did not increase compliance.
- Finally, when customers offered to pay CSPs a premium to ignore international rules, the rate of demand for identification documents fell – in other words, customers can simply pay to avoid basic money laundering requirements.

These findings show that in the absence of national legislation, it is quite easy for anyone to set up an untraceable shell company, despite international rules to prevent such practices. When CSPs do not collect sufficient identifying information, they also cannot provide proper beneficial ownership information if the authorities request it.

Source: Findley, M., D. Nielson and J. Sharman (2012), "Global shell games: Testing money launderers' and terrorist financiers' access to shell companies", Centre for Governance and Public Policy, Griffith University, Brisbane.

Transparency of legal persons and arrangements

Individuals who are engaged in illegal activities have a strong incentive to disguise their identity. One way to do so is to hide behind corporate vehicles or other legal structures, including limited liability companies, partnerships and trusts. Major corruption cases show that the misuse of corporate vehicles to hide ownership or to disguise illegal activities is widespread (Van der Does de Willebois et al., 2011; FATF, 2006b). Corporate vehicles have been used in every single major international corruption and money laundering case in recent years (Box 2.7; and see Van der Does de Willebois et al., 2011).

Box 2.7. **The use of corporate vehicles for money laundering**

A World Bank review of 150 grand corruption cases showed that in all cases corporate vehicles were used as a way to hide ownership and provide a veneer of legitimacy for illicit activities. Several features of corporate vehicles make them ideal for separating the origin of funds from the real beneficial owner:

- They can be easily created and dissolved in most jurisdictions.
- They can be created as part of a multi-layered chain of inter-jurisdictional structures, whereby a corporation in one jurisdiction may control or be controlled by other companies or trusts in another, making it difficult to identify the ultimate beneficial owner.
- Specialised intermediaries, professionals or nominees can be used to conceal true ownership.
- Regulations vary amongst jurisdictions, but very few collect beneficiary information at the time of company formation, which increases the challenges of international co-operation.

Source: adapted from FATF (2011), *Laundering the Proceeds of Corruption*, FATF, Paris; Van der Does de Willebois, E., et al. (StAR, Stolen Asset Recovery Initiative 2011), *Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, World Bank Publications, Washington, DC.

A popular method for hiding ownership or control of corporate vehicles is to use "gatekeepers" – i.e. other persons nominated as the controlling party of the legal entity, sometimes corporate service providers or lawyers. This additional layer between the person holding control and the legal entity can make it very challenging for banks or even judicial authorities to identify the beneficial owner, especially if corporate laws do not require the registration of beneficial owners when a company is set up. Another related method is to use frontmen/women, which might simply involve listing a trusted partner (often close associates, relatives, etc.) as the nominal owners, to keep the controlling party hidden.

In order to prevent, uncover and eventually prosecute and/or sanction individuals who engage in such illegal practices, authorities must be able to identify the people who are the ultimate beneficial owners of corporate vehicles in a timely and cost-effective manner (Box 2.8). The FATF Recommendations 33 and 34 require countries to prevent the unlawful use of legal persons (companies) and arrangements (trusts) by money launderers, by ensuring that adequate, accurate and timely information on the beneficial ownership and control of these can be obtained by competent authorities. Whereas Recommendation 5 focuses on the responsibility of financial institutions and DNFBPs to make a reasonable effort to identify their clients, Recommendations 33 and 34 require national authorities to put in place laws and systems which demand that such information is required and collected in the first place.

Box 2.8. **Defining beneficial ownership**

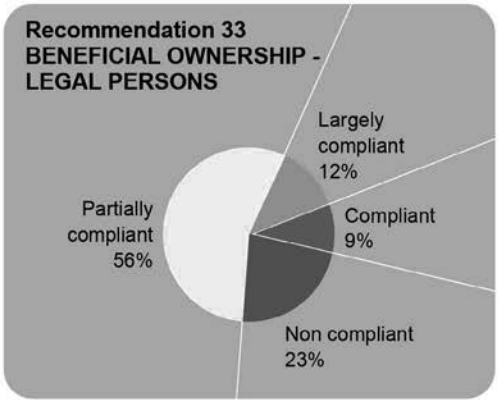
There is some variation among jurisdictions about the exact meaning of "beneficial ownership". The FATF defines a beneficial owner as the natural person (i.e. a person as opposed to a legal entity) who ultimately exercises power and stands to benefit from an arrangement – such as a corporation, trust, account, security, etc. The World Bank and the UNODC support this definition and call for countries to adopt this substantive approach to defining beneficial ownership (Van der Does de Willebois et al., 2011). A substantive definition refers to the *de facto* control over an entity, and goes beyond a legally defined position, such as a director of a company or foundation or a shareholder who owns more than a certain percentage of shares (as defined in current EU legislation).

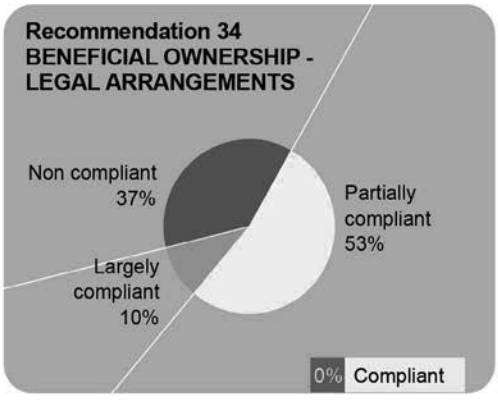
Identifying the ultimate beneficial owner is not always a straightforward task, given that many corporate vehicles have complex multiple layers of owners and shareholders, often themselves corporate vehicles, and sometimes spanning multiple jurisdictions. Practically, this can be a complex, costly and time-consuming process, as some jurisdictions may not be able to share company information in a timely manner, and sometimes the necessary information may not be available in the first place. Some jurisdictions do not require beneficial ownership information on all types of legal structures. This is particularly the case for trusts, but is also the case for other legal structures, such as limited liability companies.

OECD country compliance with Recommendations 33 and 34 (beneficial ownership) has been generally weak – in fact it has been the weakest sub-category of all (Figure 2.5). Some OECD countries do not require beneficial ownership information to be collected at all when a business is being set up, with the result that this information is subsequently unavailable to relevant institutions or authorities. Recommendation 34 (beneficial owners of legal arrangements) did not apply to 15 OECD countries at the time of their reviews, because legal arrangements, such as trusts, did not exist or were not recognised according

to the assessors.[6] Some jurisdictions do not require any information at all on beneficial ownership for the establishment of corporate vehicles. Box 2.9 outlines some practical ways to improve practices on beneficial ownership.

Figure 2.5. **Average and individual OECD country scores on FATF Recommendations 33 and 34**





Transparency of legal persons and arrangements

Country	33. Beneficial owners - Legal persons	34. Beneficial owners - Legal arrangements
Australia	▲	❑
Austria	❑	❑
Belgium	❑	
Canada	●	❑
Chile	❑	●
Czech Republic	❑	
Denmark	❑	❑
Estonia	▲	
Finland	❑	
France	▲	▲
Germany	●	●
Greece	●	
Hungary	■	
Iceland	❑	
Ireland	❑	❑
Israel	❑	❑
Italy	■	❑
Japan	●	●
Korea	●	●
Luxembourg	❑	●
Mexico	●	▲
Netherlands	❑	❑
New Zealand	❑	●
Norway	▲	
Poland	❑	
Portugal	❑	❑
Slovak Republic	❑	
Slovenia	■	
Spain	❑	
Sweden	❑	
Switzerland	●	
Turkey	❑	
United Kingdom	❑	❑
United States	●	●
TOTALS		
■ Compliant	3	0
▲ Largely compliant	4	2
❑ Partially compliant	19	10
● Non-compliant	8	7

Box 2.9. **Better practice on beneficial ownership**

Determining beneficial ownership of a corporate entity is key in fighting money laundering. Identifying beneficial ownership can be challenging. StAR suggests a number of best practices, by which countries can greatly facilitate this process (Van der Does de Willebois et al., 2011). A synthesis of the most important recommendations is outlined below.

1.) Countries should improve available beneficial ownership information and its accessibility.

Countries should establish comprehensive company registries that collect and store beneficial ownership information. Countries should ensure that every company is registered and that it provides beneficial ownership information. In addition, beneficial ownership information should be accessible at minimum to relevant authorities in a timely manner, and information should be kept up-to date. There is also a possibility of outsourcing the maintenance of a company registry to a third party.

2.) Countries should outlaw or regulate instruments which allow for secrecy – for example, the use of bearer shares.

Apart from prohibiting bearer shares, possible measures towards greater transparency are to immobilize bearer shares, or convert them to registered shares. Shareholders should be required to notify the company of any changes in their holding. Nominee directors should be required to disclose their nominator.

3.) Countries should properly regulate trust and company service providers (TCSPs).

Regulations should cover the obligation to collect, verify and allow access to beneficial ownership information. TCSPs could play a bigger role in fighting money laundering, given their often close relationships with their clients. Carrying out customer due diligence, monitoring business relationships and reporting suspicious activity are possible mechanisms by which TSCPs can reduce risk. Requiring TCSPs to conduct CDD checks, including determining beneficial ownership, would also make it more difficult for them to be wilfully ignorant (Van der Does de Willebois et al., 2011).

Reporting suspicious transactions and compliance

This sub-category covers Recommendations 13-16. Suspicious transaction reports (STRs) are an important tool for detecting potential cases of money laundering. The FATF requires those institutions at risk of facilitating or detecting money laundering – such as financial institutions and DNFBPs – to put in place a risk management system to help them identify complex, unusual and suspicious transactions (Recommendation 13). They must then report all suspicious transactions to a financial intelligence unit (FIU). Suspicious transactions may emerge when a PEP is identified when establishing a client relationship, or during transactions above a certain threshold, or transactions that show abnormal patterns, such as multiple transactions of similar amounts. As required by the FATF, many countries require an STR to be filed for attempted transactions that are not accepted by the financial institution or abandoned by the customer. Some authorities also require all unusual transactions, or all transactions above a certain threshold, to be reported. This makes country comparisons of numbers of STRs difficult. The STRs should be analysed by the FIU against certain parameters, such as whether any parties to a transaction have been involved in activities related to money laundering. Some FIUs use advanced analytical techniques and tools to look for patterns and links with other

transactions. Depending on the findings, the STRs are then sent on to relevant agencies for subsequent follow-up or action.

The volume of STRs has generally increased significantly over recent years. While this is encouraging, it is not necessarily a sign of increased compliance. It is clear, however, that STRs are an important means of identifying financial crimes. There is no ideal target number of STRs to be submitted: this depends on the level of risk facing an institution, sector or country, as well as the size and composition of an economy. Nevertheless, it is useful to look at STR volumes for a general indication of such reporting for countries with similar characteristics (Table 2.4).

Table 2.4. **How Denmark, Norway and Sweden compare for the number of suspicious transaction reports filed, 2008**

	Denmark	Norway	Sweden
Total suspicious transaction reports submitted	1 529	6 082	13 048
Suspicious transaction reports per USD 1 billion in GDP	4.48	13.46	27.24
Suspicious transaction reports per million population	278	1 276	1 415

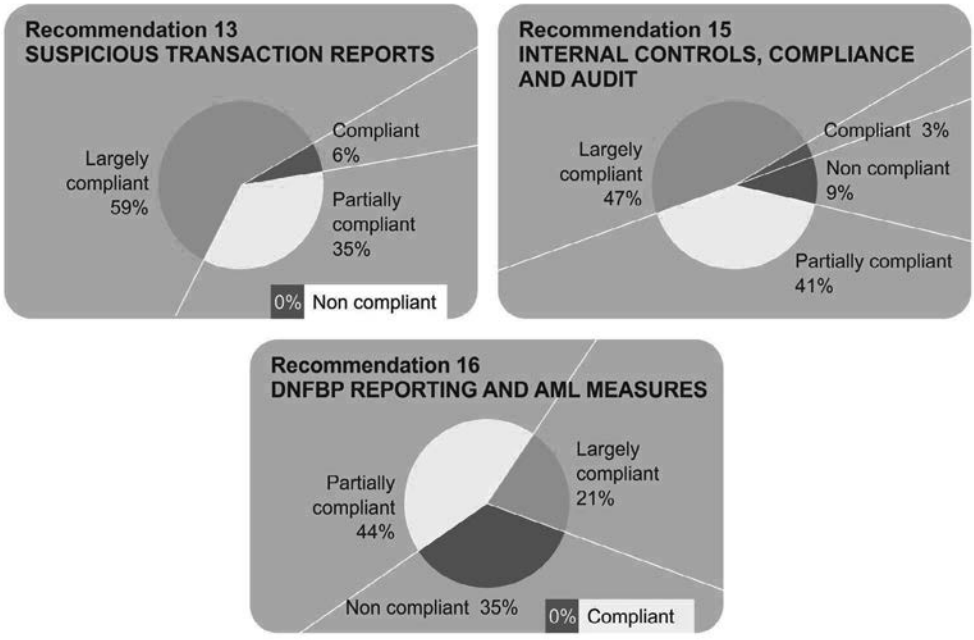
Source: FATF (2010), *Mutual Evaluation of Denmark Third Follow-Up Report*, FATF/OECD, Paris.

For example, the 2010 FATF follow-up report for Denmark noted a significant increase in the number of STRs filed, though the number of STRs is still well below the average for its GDP and population size. Over 1.4 million STRs were submitted in the United States during 2011 (FinCEN, 2011).

Recommendation 15 requires financial institutions to develop programmes to combat money laundering and terrorist financing, including employee training and an audit function to test their AML systems. Almost half of OECD countries largely comply with this recommendation, but 41% partially comply and 9% do not comply (Figure 2.6).

Recommendation 16 asks countries to ensure that all DNFBPs, such as lawyers, notaries or other independent legal professionals and accountants, are subject to the same requirements as financial businesses when it comes to: *i)* filing suspicious transaction reports to the FIU (see Recommendation 13); *ii)* developing a programme against money laundering and terrorist financing (see Recommendation 15); and *iii)* taking special care with business relationships and transactions which involve companies, financial institutions and people from countries which do not or insufficiently apply the FATF Recommendations (see Recommendation 21). But these recommendations only apply when such DNFBPs carry out certain specified types of transactions on behalf of their clients. Also, DNFBPs are not required to report their suspicions if the information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege (FATF Recommendation 16). This issue is difficult to regulate and control. Studies show that a vast majority of STRs are submitted by credit institutions (i.e. banks), with relatively few reports by DNFBPs, although this varies by country. For example, the Denmark follow-up report notes negligible reporting by insurers and investment managers, with not a single report submitted by the sector since 2006 (FATF, 2010a).

Figure 2.6. **OECD country compliance scores on reporting and internal controls**



Note: DNFBP: designated non-financial businesses and professions; AML: anti-money laundering.

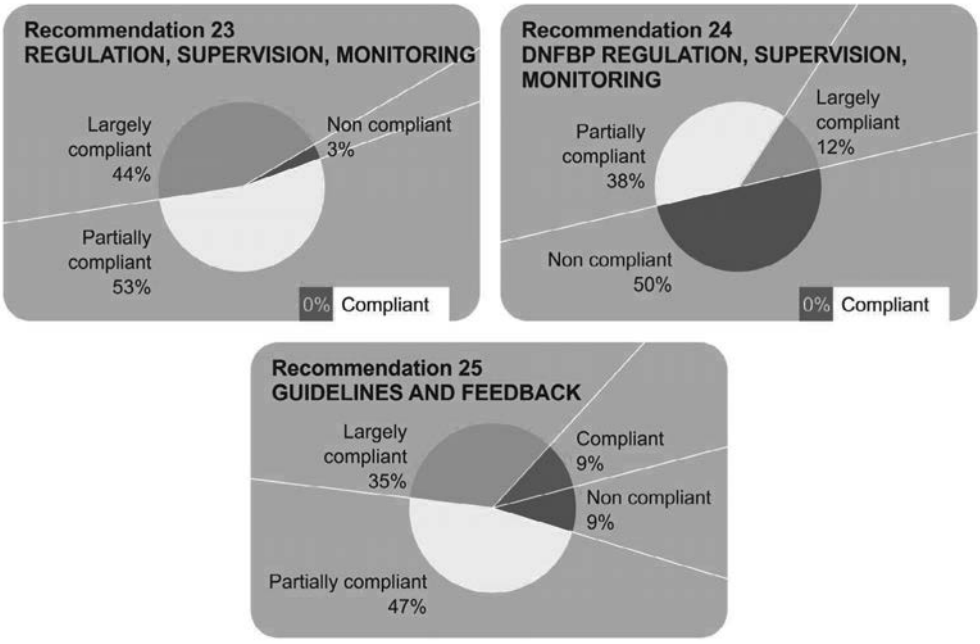
Regulation and supervision

This category covers FATF Recommendations 23-25, which ask countries to ensure adequate regulation and supervision for implementing the recommendations effectively. This includes preventing criminals or their close associates from being beneficial owners, or from holding a controlling interest or a management function in a financial institution. It also recommends that countries properly license, register and monitor businesses which provide a service of money or value transfers. These recommendations also apply to DNFBPs. Countries are asked to base their classification, registration and oversight of such businesses on a risk-sensitive basis.

In the case of lawyers and accountants, the risk resides primarily in the potential misuse of these professions for concealing the identities of the beneficiary owners of the transactions done through them (MENAFATF, 2008). For example, as already noted, lawyers frequently act as nominee managers of companies, or as trustees for trusts. Some countries define trust and company service providers as financial institutions, so they would not fall within the DNFBP category for domestic purposes (but they are a DNFBP for assessment purposes).

Under the regulation and supervision category, the least compliance concerns Recommendation 24, which deals with the regulation of DNFBPs (Table 2.6). 41% of countries are rated non-compliant, 35% partially compliant, and only 24% largely compliant. Non-compliance essentially means that in these countries, some or all important categories of DFNBPs are poorly regulated and receive little or inadequate supervision (Table 2.5).

Figure 2.7. **OECD average compliance with Recommendations on 23-25: Regulation and supervision**



Note: DNFBP: designated non-financial businesses and professions.

Table 2.5. **OECD country ratings on Recommendation 24: Regulation, supervision and monitoring of DNFBPs**

Non-compliant	Partially compliant	Largely compliant	Fully compliant
Canada	Australia	Hungary	
Finland	Austria	Norway	
France	Belgium	Slovenia	
Germany	Chile		
Greece	Czech Republic		
Ireland	Estonia		
Israel	Japan		
Italy	Netherlands		
Korea	Poland		
Mexico	Portugal		
New Zealand	Slovak Republic		
Spain	United Kingdom		
Turkey	United States		

This gap in licensing procedures and supervision is an area of significant weakness and leaves some countries vulnerable to money laundering and other financial crimes.

Measures taken with respect to countries that do not comply, or insufficiently comply, with the FATF Recommendations

The ability of OECD countries to stem illicit flows from developing countries also depends on developing countries' own willingness to put in place systems to prevent, detect and sanction financial crime. Many jurisdictions have significant deficiencies in their financial systems, which means that conducting business transactions with such jurisdictions presents considerable risks for other (OECD) institutions.

Table 2.6. **OECD countries' score on FATF Recommendations 21-22: Dealing with high-risk jurisdictions**

Measures to be taken with respect to countries that do not or insufficiently comply with FATF Recommendations		
Country	21. Special attention for higher risk countries	22. Foreign branches and subsidiaries
Australia	■	○
Austria	■	■
Belgium	●	■
Canada	■	○
Chile	■	■
Czech Republic	■	■
Denmark	■	■
Estonia	○	■
Finland	■	■
France	■	■
Germany	■	■
Greece	○	■
Hungary	●	●
Iceland	■	■
Ireland	■	■
Israel	■	■
Italy	■	■
Japan	○	○
Korea	○	■
Luxembourg	○	■
Mexico	■	●
Netherlands	■	■
New Zealand	○	○
Norway	●	■
Poland	○	○
Portugal	■	■
Slovak Republic	○	■
Slovenia	●	■
Spain	●	■
Sweden	■	■
Switzerland	■	■
Turkey	○	○
United Kingdom	■	○
United States	■	■
● Compliant	5	
■ Largely compliant	10	
■ Partially compliant	10	
○ Non compliant	9	

The FATF compiles a list of "high-risk and non co-operative jurisdictions".[7] Recommendations 21, and to some extent 22, require members to give special attention to business relationships and transactions with individuals and legal persons from these high-risk countries, or to transactions within their own branches operating in such countries. Performance amongst OECD member countries on Recommendations 21 and 22 varies (Table 2.6).

Weak compliance with these recommendations can indicate that countries' financial systems are at risk of abuse from or through such high-risk jurisdictions.

International co-operation

This category covers FATF Recommendations 35-40. The ability and willingness of judicial authorities to share information and take action on the behalf of authorities in other countries is another crucial element of fighting international financial crime. Judicial authorities must rely on their foreign counterparts to provide them with information for a range of purposes, from client background checks to investigations and evidence in legal cases and for the identification, seizure and confiscation of criminal proceeds. But delays and barriers to effective co-operation caused by administrative and legal requirements often allow criminals to move their funds out of the reach of judicial authorities. Under various international treaties and conventions such as the United Nations Convention against Corruption (UNCAC), and in line with the FATF Recommendations, OECD countries have agreed to provide the widest possible range of legal assistance in relation to money laundering, and to facilitate information exchange in a timely and proactive manner when requested. This means in practice that they have committed to avoid placing excessively restrictive conditions on the provision of rapid and effective legal assistance, by not invoking financial secrecy laws as a justification for not rendering mutual legal assistance (MLA) or to require dual criminality as a condition for providing assistance, and finally to recognise money laundering as an extraditable offence.

Most OECD countries score well on the five recommendations on international co-operation (Recommendations 35-40): 65% comply with Recommendation 36 on MLA and 20% comply fully. Not a single country is non-compliant. Performance on Recommendation 37 on dual criminality is even stronger, with 56% fully compliant, 32% largely compliant and only 12% partially compliant. Ratings for Recommendation 38 on confiscation and freezing assets show that about four-fifths of OECD countries (those that are compliant or largely compliant) should be in a position to freeze and confiscate assets on behalf of developing countries when requested, and almost 95% of OECD countries should be in a position to extradite their own nationals for prosecution for money laundering offences.

Nevertheless, many countries are still unable to provide rapid and effective mutual legal assistance. For example, in many cases, procedures for requesting MLA are cumbersome, which could have particular consequences for developing countries whose capacities may be limited. As found in MERs, some countries (e.g. Iceland, Luxembourg and the Netherlands) have an overly limited interpretation of dual criminality for granting MLA, which could also be a barrier.[8] Others have dual criminality requirements only for some forms of MLA – such as search and seizure measures – but not for others, like requests for information (e.g. the Netherlands).

Another result of these weaknesses is that several countries have difficulties freezing or confiscating assets when asked to do so by another country. In the Netherlands, for example, confiscation orders issued by non-EU member countries may not be directly executed – instead a domestic court has to issue its own confiscation order, unless a bilateral treaty exists between the requesting country and the Netherlands. In many countries, the scope of legal privilege can prevent law enforcement authorities from accessing information and documents held by notaries, lawyers and accountants. Several countries also have significant restrictions on their ability to share confiscated assets with foreign jurisdictions.

These barriers can be overcome by knowledgeable and proactive authorities, but they can slow down cases and place an extra burden on judicial authorities – giving criminals time to move assets out of the authorities' reach.

Sanctions

When wrongdoing or non-compliance with AML/CTF standards is uncovered, Recommendation 17 states that countries should apply civil, criminal or administrative sanctions that are "proportionate and dissuasive" (FATF, 2010b). The punitive impact of fines will depend on the size of the financial institutions involved (Box 2.10). Sanctions regimes in OECD countries vary greatly in reach and scope. Some cannot apply sanctions to legal persons; others cannot sanction certain categories of staff (e.g. senior management). Findings from the FATF reports suggest that administrative sanctions could be used more effectively and many countries still have relatively few civil or criminal sanctions. Following the FSA report in 2011, the United Kingdom has moved to sanction a large private bank for failing to maintain AML controls for high-risk customers (FCA, 2013). The US authorities have issued several large fines in recent years, both civil and criminal and new rules are being considered that would hold individuals liable (Reuters, 2013; United States Senate Committee on Banking, Housing and Urban Affairs, 2013a, 2013b). Proposed new EU legislation, if adopted, will significantly increase sanctions for AML-related breaches, including fines up to 10% of annual revenue for institutions and penalties up to EUR 5 million for financial institution staff (Bloomberg, 2013; European Commission, 2013).

Box 2.10. **Sanctions without teeth?**

Despite their record size, fines like those for HSBC (see Box 2.4) and Standard Charter (USD 667 million) made up less than 15% of the banks' pre-tax earnings in the first half of 2012. Both penalties are less than 10% of the banks' market capitalisation gains since the wrongdoings were revealed. The markets do not seem to punish banks for such wrongdoings (Financial Times, 2012). In the absence of more severe sanctions (such as revoking banking licenses or prison terms for senior managers), banks can simply factor such occasional fines into their business model and carry on with business as usual. Given that such cases take time to investigate (the investigation of HSBC has taken five years to conclude), banks could assume that such sanctions will not be frequent. Overall, relatively few countries apply any sanctions at all. Yet, there is no indication that financial institutions in countries that do not apply sanctions are performing any better than those in countries that apply sanctions.

Improvements in core and key recommendations

The FATF third round of AML/CFT mutual evaluations, process and procedures identified six recommendations that trigger follow up ("core recommendations") and ten recommendations that are assessed for follow up ("key recommendations"). These

recommendations are the designated priority areas for sequenced implementation in all countries, although due to the way the follow-up process is designed, progress in many countries is also analysed against all other recommendations. Like all MERs, final follow-up reports (FURs) are publicly available on the FATF's website.

Table 2.7. **FATF core and key recommendations**

Core recommendations		Key recommendations	
1	Money laundering offence	3	Confiscation and provisional measures
5	Customer due diligence	4	Secrecy laws consistent with the Recommendations
10	Record-keeping	23	Regulation, supervision and monitoring
13	Suspicious transaction reporting	26	The Financial Intelligence Unit (FIU)
SR.II	Criminalize terrorist financing	35	Conventions
SR.IV	Suspicious transaction reporting	36	Mutual legal assistance (MLA)
		40	Other forms of co-operation
		SR.I	Implement UN instruments
		SR.III	Freeze and confiscate terrorist assets
		SR.V	International co-operation

Source: FATF (2009), *Third Round of AML/CFT Mutual Evaluations – Process and Procedures*, §37 and 39, FATF/OECD, Paris, www.fatf-gafi.org/media/fatf/documents/process%20and%20procedures.pdf.

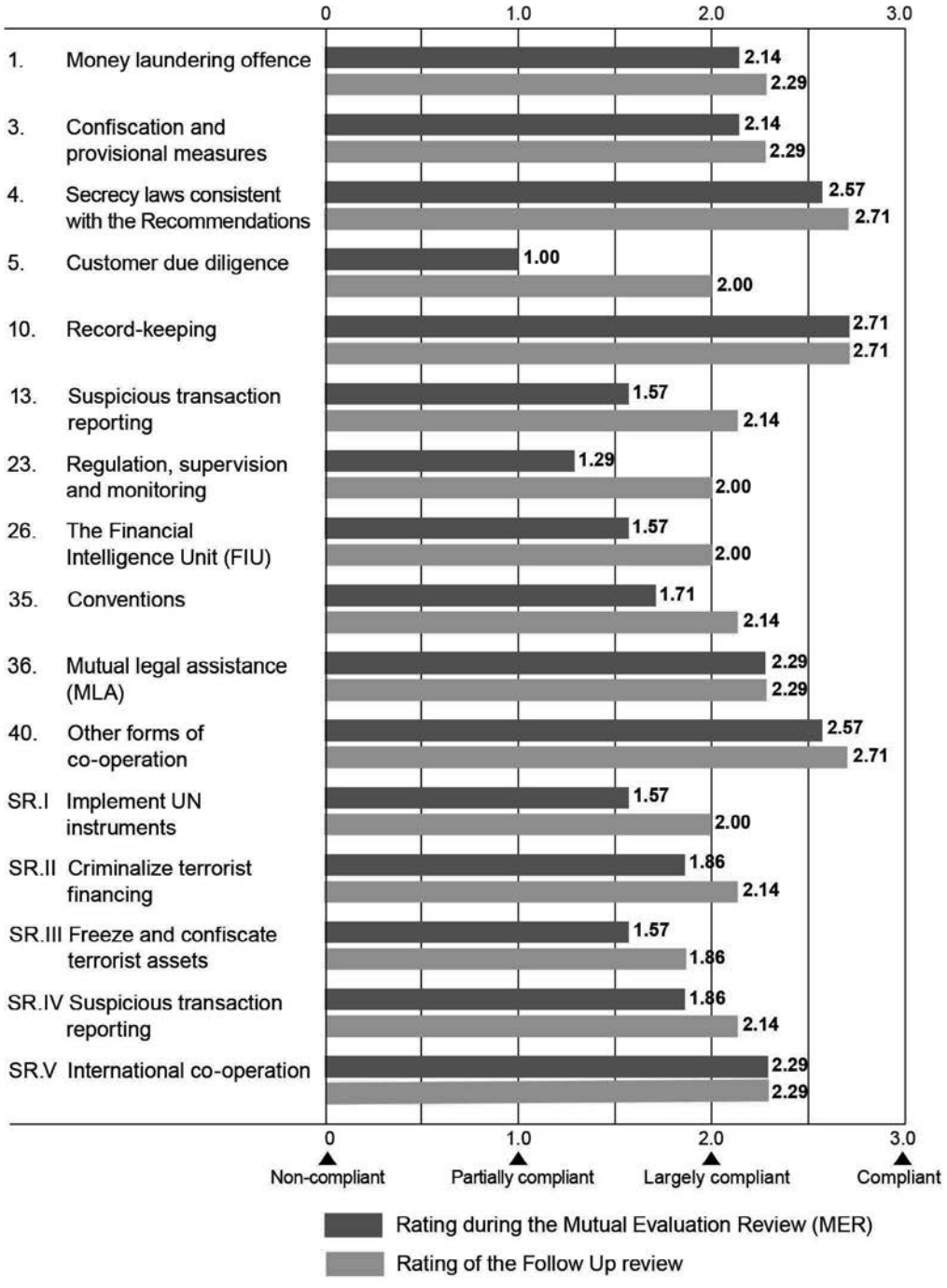
Countries receiving a non-compliant or partially complaint rating on any core recommendation automatically go to a regular follow-up process, or when the plenary so decides. This process involves regular reporting to the FATF on the measures taken to improve compliance. In order to be removed from this follow-up process, countries generally have to be judged compliant or largely compliant with the core and key recommendations. In releasing a country from this follow-up process, the FATF plenary can apply some flexible judgement: even if progress is modest on non-core recommendations, a country can be released from the follow-up process if substantial progress has been made on the overall set of recommendations that have been rated partially compliant or non-compliant. Seven OECD countries were deemed to have strategic deficiencies on these core and key recommendations at the time of their mutual evaluation reviews.

All seven countries improved their scores after follow-up reviews – as determined by the FoRs' equivalency ratings, which are not official re-ratings but rather a desk-based review. Customer due diligence (Recommendation 5) was the area in which most improvements were made, with all seven countries essentially brought up to a level equivalent to the largely compliant rating. Figure 2.8 shows average compliance scores across the seven countries at the time of the Mutual Evaluation Review and after the follow-up reviews.

Key findings and observations

The purpose of this chapter has been to provide a comparative overview of how OECD countries have performed on the 2003 FATF Recommendations, highlighting areas where countries have faced the greatest difficulties in complying with the standard. The main finding is that countries should continue to fully implement the FATF standard, in line with the risk-based approach recommended by the FATF.

Figure 2.8. **Average increase in compliance levels on core and key recommendations for OECD countries subject to increased monitoring**



For detailed country-specific recommendations on how to address shortcomings in the various areas discussed above, countries should refer to FATF reviews (MERs and FURs), FATF documents and other official assessments. Nevertheless, some of the gaps and weaknesses highlighted above yield some general observations.

Strengthen customer due diligence procedures

There is a need to ensure that financial institutions and all other designated non-financial institutions and professions – including trust and company service providers – conduct proper, risk-based, customer due diligence procedures, both when starting a business relationship and throughout the business relationship. Essential elements include:

- obtaining sufficient identity documents – including knowing the ultimate beneficial owner
- determining whether a client might be a politically exposed person (PEP), assessing the level of risk and taking appropriate action
- understanding the source of wealth and funds.

The entire CDD process should be guided by a proper risk profiling of the client based on relevant information. Finally, customer due diligence also requires ongoing monitoring to determine whether transactions correspond with the customer risk profile and to detect possible inconsistencies.

Strengthen beneficial owner requirements

Weak beneficial ownership requirements are perhaps the biggest problem in tackling financial crime and illicit financial flows. Weak beneficial owner requirements make it easier for criminals to misuse corporate vehicles and shell companies to hide ownership, to carry out transactions using illegal funds or to cover up illegal activities.

All jurisdictions should require their financial institutions and DNFBPs to determine the beneficial owner – and to ensure that this information is available to relevant authorities and institutions. Without the requirement to gather, verify, keep and make available information on the ultimate beneficial owners of corporate entities and legal structures, other actors – including banks, trust and company service providers and law enforcement authorities – cannot comply with their CDD requirements. This is also a G8 and G20 priority.

Strengthen regulation and supervision

Many OECD countries have gaps in their regulatory regime for financial institutions and designated non-financial businesses and professions. Also, proper supervision of financial institutions and trust and service company providers could be improved. Strengthening this could have a potentially significant impact given the central role played by TSCPs and their often privileged contact with their clients. Jurisdictions which properly regulate and supervise financial institutions and TCSPs sharply reduce the opportunities for setting up structures controlled by anonymous owners.

A final note

It is worth noting that even the best AML regime would not be able to address all possible money laundering threats. For example, where corrupt individuals at the highest political levels (such as heads of state or government ministers) control the very institutions which are supposed to exert control over them, or when they abuse official channels, like sovereign wealth funds or domestic investment funds, or where they hold a controlling stake in banks, it becomes very difficult for AML systems to identify and stop

these practices. Recent reports confirm how politically connected individuals were able to use state structures to transfer funds for their personal benefit (FATF, 2012a; United States Senate Permanent Subcommittee on Investigations, 2010). However, this makes it even more important for OECD countries to have effective safeguards in place against illicit financial flows.

While this chapter has looked at OECD country performance on the AML standards promoted by the FATF, on the assumption that strong AML regimes in the OECD would deny a safe haven for illicit capital leaving the developing world, it should also be a priority for developing countries to strengthen their own AML systems and institutions. As noted earlier in this report, combating financial crime and illicit flows must start at the source, and the focus over the medium and long term must be on building stronger institutions in developing countries. In the area of money laundering, the FATF regional style bodies have an essential role to play, and there are significant capacity gaps to be filled.

Notes

1. In February 2012, the FATF agreed on a comprehensive revision and update to the 2003 FATF 40 Recommendations. New elements have been added, for example regarding the risk-based approach and the financing of proliferation of weapons of mass destruction. In addition, the Nine Special Recommendations against Terrorist Financing have been merged into the 40 Recommendations. The structure, numbering and order of the 40 Recommendations have therefore now changed. They are now organised into seven broad categories: AML/CFT policies and co-ordination; money laundering and confiscation; terrorist financing and financing of proliferation; preventative measures; transparency and beneficial ownership of legal persons and arrangements; powers and responsibilities of competent authorities and other institutional measures; and international co-operation. Since this chapter summarises compliance levels from publicly available FATF Mutual Evaluation Reports conducted before February 2012, the analysis is based on the 2003 FATF Recommendations. The new 2012 FATF 40 Recommendations are available at www.fatf-gafi.org/recommendations, and contain a table comparing the old and new numbering.

2. The following OECD countries are FATF members: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States. The remaining countries are members of other FATF-style bodies: GAFISUD (Chile); MONEYVAL (Czech Republic, Estonia, Hungary, Israel [observer], Poland, Slovak Republic, Slovenia).

3. All FATF and FSRB reports are published on the FATF website, including the detailed country assessment reports and ratings tables. All data for this chapter have been taken directly from these public sources. None of the analysis that was derived from this publicly available data has been scrutinised or endorsed by the FATF or any FSRB, and any analysis, calculations and interpretation of this data are solely the responsibility of the OECD.

4. Banks often depend on other banks ("correspondent banks") to act on their behalf in areas where they do not have a presence.

5. The term "payable through accounts" refers to correspondent accounts that are used directly by third parties to transact business on their own behalf: see the FATF glossary at www.fatf-gafi.org/pages/glossary/n-r.

6. The FATF has clarified the applicability of this Recommendation as part of its 2012 revision.

7. Available at www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions.

8. The Netherlands reports that none of the 1 727 MLA requests received between 2006 and 2009 have been refused on the basis of dual criminality. The FATF recommends that countries apply the dual criminality condition reasonably (i.e. not requiring the criminal offence of the requesting country to be worded identically to their own offence, so long as the same underlying activity is criminalised), and be able to provide MLA to the greatest extent possible in the absence of dual criminality (FATF Recommendation 36A).

Annex 2.A1
Note on FATF data

In constructing the tables presented in this chapter, publicly available data from FATF peer reviews were relied on. Several challenges arise from using these data. First, there are considerable time lags between peer reviews of individual countries, which means that we are essentially comparing scores from as far back as 2005 with others from 2011. Using older peer review ratings risks missing important changes to certain countries' compliance with FATF Recommendations, including changes which have been made by countries to address the deficiencies noted in the peer review reports. Additionally, many countries are now in the process of implementing the revised 2012 FATF Recommendations, which will necessitate further changes to AML/CFT regimes.

The comparability of the ratings may also be subject to some reservations – and there may be variations within the same ratings, and over time. A largely compliant rating for country A in 2005 might be based on slightly different interpretation of the recommendations or assessment, than the same rating for country B in 2012 – and hence may reflect a different situation. Two equal ratings may therefore be based on different underlying facts.

Also, some of the data for Figure 2.8 is based on follow-up reports rather than full peer reviews. These follow-up reports involve a much lighter process, relying mainly on self-reporting rather than on-site visits. They are required from countries which were partially compliant or non-compliant on core[1] and key[2] FATF Recommendations. Some of these reports include new ratings on all recommendations covered by the follow-up report (for MONEYVAL only), while others only assess if the level of relevant core and key recommendations has been sufficiently raised (without re-rating), since these form the basis for the FATF decision on the frequency of reporting necessary.

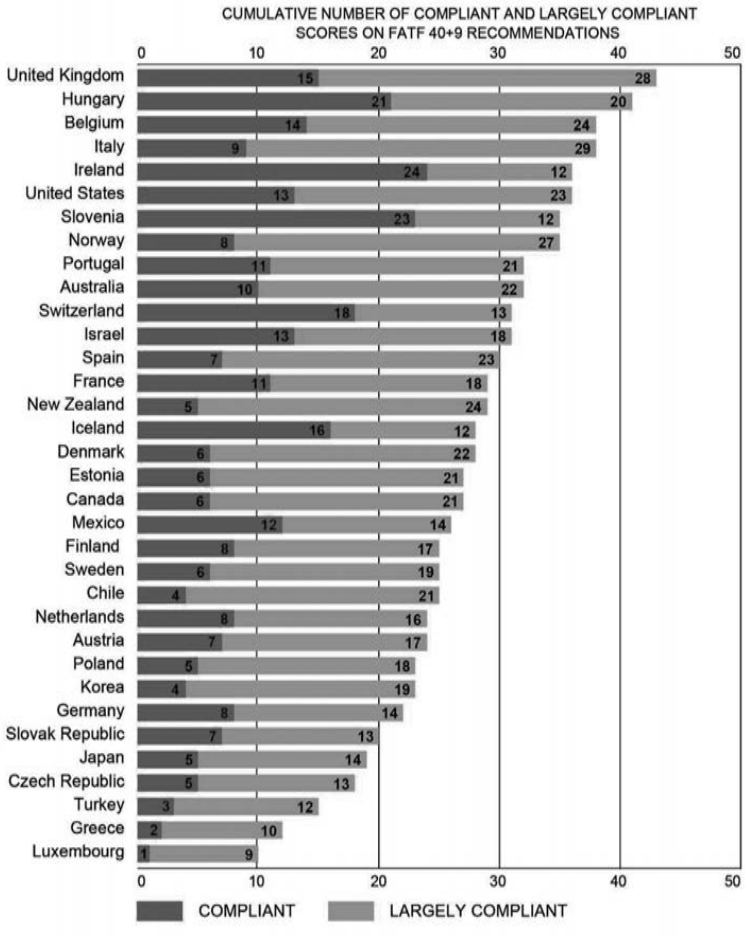
Finally, there is an ongoing debate around when it is appropriate and useful to turn ordinal scales (i.e. non-compliant, partially compliant, largely compliant, compliant) into interval scales (1-2-3). One of the central concerns relates to the fact that the distance between the ordinal categories may not be equal – i.e. the difference between largely compliant and compliant may be different than between largely compliant and partially compliant. Turning these ratings into equally spaced numbers (1, 2, 3, 4) gives the impression that the distances between them are equal. Using a relatively simple four point scale (0, 1, 2, 3) and simple averages should generally not pose any major methodological issues (Knapp, 1990).

Table 2.A1.1 shows the date for the data used for each OECD country. Column B indicates whether the data comes from a peer review report or a follow-up report.[3] All FATF reports are public and posted on the FATF website, as are those of the regional FATF-style bodies.[4]

Table 2.A1.1. **Data sources for FATF compliance ratings**

Country	Data source	Reviewing body	Date
Australia	Mutual Evaluation Review	FATF	October 2005
Austria	Mutual Evaluation Review	FATF	June 2009
Belgium	Mutual Evaluation Review	FATF	June 2006
Canada	Mutual Evaluation Review	FATF	February 2008
Chile	Mutual Evaluation Review	GAFISUD	December 2010
Czech Republic	Mutual Evaluation Review	MONEYVAL	April 2011
Denmark	Mutual Evaluation Review	FATF	September 2006
Estonia	Mutual Evaluation Review	MONEYVAL	December 2008
Finland	Mutual Evaluation Review	FATF	October 2007
France	Mutual Evaluation Review	FATF	February 2011
Germany	Mutual Evaluation Review	FATF	February 2010
Greece	Mutual Evaluation Review	FATF	June 2007
Hungary	Mutual Evaluation Review	MONEYVAL	September 2010
Iceland	Mutual Evaluation Review	FATF	November 2006
Ireland	Mutual Evaluation Review	FATF	February 2006
Israel	Mutual Evaluation Review	MONEYVAL	July 2008
Italy	Mutual Evaluation Review	FATF	February 2006
Japan	Mutual Evaluation Review	FATF	October 2008
Korea	Mutual Evaluation Review	FATF	June 2009
Luxembourg	Mutual Evaluation Review	FATF	February 2010
Mexico	Mutual Evaluation Review	FATF	October 2008
Netherlands	Mutual Evaluation Review	FATF	February 2011
New Zealand	Mutual Evaluation Review	FATF	October 2009
Norway	Mutual Evaluation Review	FATF	June 2005
Poland	Mutual Evaluation Review	MONEYVAL	November 2007
Portugal	Mutual Evaluation Review	FATF	October 2006
Slovak Republic	Mutual Evaluation Review	MONEYVAL	September 2011
Slovenia	Mutual Evaluation Review	MONEYVAL	March 2010
Spain	Mutual Evaluation Review	FATF	June 2006
Sweden	Mutual Evaluation Review	FATF	February 2006
Switzerland	Mutual Evaluation Review	FATF	October 2005
Turkey	Mutual Evaluation Review	FATF	February 2007
United Kingdom	Fourth Follow-up Report	FATF	June 2007
United States	Mutual Evaluation Review	FATF	June 2006

Figure 2.A1.1. **Cumulative number of different compliance level scores on FATF 40+9 Recommendations**



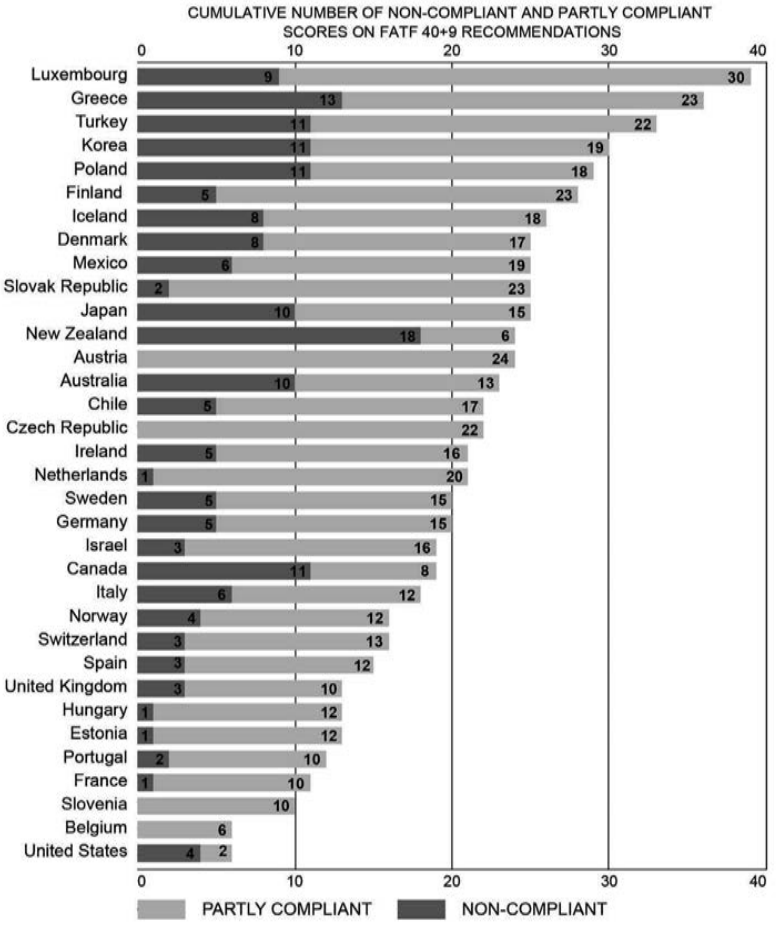


Table 2.A1.2. **OECD FATF ratings by country for 40+9 Recommendations**

Country	1. Money laundering (ML) offense	2. ML offense – mental element and corporate liability	3. Confiscation and provisional measures	4. Secrecy laws consistent with the Recommendations	5. Customer due diligence	6. Politically exposed persons	7. Correspondent banking	8. New technologies and non face-to-face business	9. Third parties and introducers	10. Record-keeping	11. Unusual transactions	12. DNFBP – R.5, 6, 8-11	13. Suspicious transaction reporting	14. Protection and no tipping-off	15. Internal controls, compliance and audit	16. DNFBP – R.13-15 & 21	17. Sanctions	18. Shell banks	19. Other forms of reporting	20. Other NFBP and secure transaction techniques	21. Special attention for higher risk countries	22. Foreign branches and subsidiaries	23. Regulation, supervision and monitoring	24. DNFBP – regulation, supervision and monitoring
Australia	■	■	●	●	○	○	○	○	○	■	■	○	■	●	○	○	■	■	●	●	■	○	■	■
Austria	■	■	■	■	■	■	■	■	●	●	■	■	■	■	■	■	■	●	●	■	■	■	■	■
Belgium	●	●	■	●	■	■	●	●	●	●	●	■	■	●	■	■	■	●	●	●	●	■	■	■
Canada	■	■	■	●	○	○	■	○	○	■	■	○	■	●	■	○	■	■	●	●	■	○	■	○
Chile	■	■	■	■	■	■	■	●	■	■	■	○	■	●	■	■	■	■	●	■	■	■	■	■
Czech Republic	■	■	■	●	■	■	■	■	-	■	■	■	■	■	■	■	■	■	●	■	■	■	■	■
Denmark	■	■	■	●	■	○	○	○	○	●	○	○	■	●	■	■	■	■	■	●	■	■	■	○
Estonia	■	●	■	■	■	■	■	■	■	■	■	■	■	●	■	■	■	■	●	●	○	■	■	■
Finland	■	■	■	●	■	○	○	■	○	●	■	○	■	●	■	■	■	■	●	●	■	■	■	○
France	■	■	■	●	■	■	■	■	■	■	■	■	■	●	■	■	■	●	●	●	■	■	■	○
Germany	■	■	■	●	■	■	■	■	■	■	■	○	■	■	■	○	■	●	●	●	■	■	■	○
Greece	■	■	■	■	■	○	■	■	■	■	■	○	■	●	■	○	■	■	○	■	○	■	■	○
Hungary	■	●	■	●	■	■	●	●	●	■	●	■	■	●	●	■	■	●	●	●	●	●	■	■
Iceland	■	■	■	●	■	○	■	■	■	●	■	■	■	●	■	■	■	●	●	●	■	■	■	○
Ireland	■	■	●	●	■	○	○	■	○	●	■	■	●	●	■	■	■	■	●	●	■	■	■	○
Israel	■	●	■	●	■	■	■	■	-	■	■	○	■	■	■	○	●	■	●	■	■	■	■	○
Italy	●	■	■	●	■	○	○	●	■	●	■	○	■	●	■	○	■	■	●	●	■	■	■	○
Japan	■	■	■	●	○	○	○	■	-	■	■	○	■	■	○	■	■	■	●	●	○	○	■	■
Korea	■	■	■	■	■	○	○	●	○	■	○	○	■	●	■	○	■	■	●	●	○	■	■	○
Luxembourg	■	■	■	■	■	■	○	■	■	■	■	○	■	■	■	○	○	■	■	■	○	■	■	○
Mexico	■	■	■	●	■	■	■	■	■	●	■	○	■	●	■	○	■	■	●	○	■	●	■	○
Netherlands	■	■	■	●	■	■	■	■	○	■	■	■	■	■	■	■	■	●	●	●	■	■	■	■
New Zealand	■	■	■	●	○	○	○	○	○	■	○	○	■	■	○	○	■	○	●	●	○	○	○	○
Norway	■	●	●	●	■	○	○	●	-	●	●	■	■	●	■	■	■	■	●	●	●	■	■	■
Poland	■	■	■	●	○	○	○	■	-	■	■	○	■	■	■	○	■	■	●	●	○	○	■	■
Portugal	■	■	■	●	■	○	■	●	-	●	■	■	■	●	■	■	■	■	●	●	■	■	■	■
Slovak Republic	■	●	■	●	■	■	■	■	■	■	■	■	■	■	■	■	■	■	●	■	○	■	■	■
Slovenia	■	●	■	●	■	■	■	■	●	■	■	■	■	■	■	■	■	■	●	■	●	■	■	■
Spain	■	■	■	●	■	○	○	■	-	●	●	■	■	●	■	■	■	■	●	■	●	■	■	○
Sweden	■	■	■	■	■	○	○	■	-	■	■	■	■	●	■	■	■	■	■	●	■	■	■	○
Switzerland	■	●	●	■	■	■	○	■	■	●	●	■	■	■	■	■	■	■	●	■	■	■	■	■
Turkey	■	■	■	■	○	○	○	■	○	●	○	○	■	■	■	○	■	■	●	●	○	○	■	○
United Kingdom	●	●	●	●	■	○	○	●	■	●	■	■	●	●	■	■	■	■	●	●	■	○	■	■
United States	■	●	■	●	■	■	■	■	■	■	■	○	■	●	■	○	■	●	●	●	■	■	■	■

Table 2.A1.2. **OECD FATF ratings by country for 40+9 Recommendations** (*cont.*)

Country	25. Guidelines and feedback	26. The Financial Intelligence Unit	27. Law enforcement authorities	28. Powers of competent authorities	29. Supervisors	30. Resources, integrity and training	31. National co-operation	32. Statistics	33. Legal persons – beneficial owners	34. Legal arrangements – beneficial owners	35. Conventions	36. Mutual legal assistance (MLA)	37. Dual criminality	38. MLA on confiscation and freezing	39. Extradition	40. Other forms of co-operation	SR.I Implement UN instruments	SR.II Criminalize terrorist financing	SR.III Freeze and confiscate terrorist assets	SR.IV Suspicious transaction reporting	SR.V International co-operation	SR.VI AML/CFT requirements for money/value transfer services	SR.VI Wire transfer rules	SR.VIII Non-profit organisations	SR.IX Cross-border declaration & disclosure
Australia	■	◍	■	◍	■	■	■	■	■	■	■	◍	◍	◍	◍	◍	■	■	■	■	■	■	○	■	■
Austria	■	■	◍	■	■	■	◍	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	◍	■	■
Belgium	■	◍	◍	◍	■	■	■	■	■	-	■	■	■	■	■	◍	■	◍	■	◍	■	◍	■	◍	-
Canada	■	■	■	◍	■	■	■	■	○	■	■	■	◍	■	■	■	■	■	■	■	■	○	○	■	◍
Chile	■	■	■	◍	■	■	■	■	■	○	■	■	◍	■	■	◍	■	■	○	○	■	■	■	○	■
Czech Republic	■	■	■	◍	■	■	■	■	■	-	■	■	◍	■	■	■	■	■	■	■	■	■	■	■	■
Denmark	○	■	◍	◍	■	■	■	■	■	■	■	■	◍	■	■	◍	■	■	■	■	■	■	■	■	■
Estonia	■	◍	◍	◍	■	■	■	■	■	-	■	■	■	■	■	◍	■	■	■	■	■	■	■	■	■
Finland	■	■	■	◍	■	■	■	■	■	-	■	■	◍	■	■	■	■	■	■	■	■	■	■	■	■
France	■	■	■	◍	■	■	■	■	■	■	■	■	◍	■	■	■	■	◍	■	■	■	■	◍	■	■
Germany	■	■	■	■	■	■	■	■	○	○	■	■	■	■	■	■	■	■	■	■	■	■	◍	■	■
Greece	○	○	■	◍	■	○	■	○	○	-	■	■	■	■	■	■	■	■	■	■	■	■	■	○	○
Hungary	■	■	■	◍	◍	◍	◍	■	◍	-	■	■	◍	◍	◍	■	■	■	■	■	■	◍	◍	○	■
Iceland	○	■	■	◍	■	■	◍	○	■	-	■	■	■	■	■	■	■	■	○	■	■	○	○	○	■
Ireland	■	■	◍	◍	■	■	■	■	■	■	■	◍	◍	◍	◍	◍	■	■	■	◍	◍	■	○	■	■
Israel	■	■	■	◍	◍	■	◍	■	■	■	■	◍	◍	■	◍	■	■	◍	■	■	■	■	■	■	■
Italy	■	■	◍	◍	■	■	■	■	◍	■	■	◍	◍	◍	◍	◍	■	■	■	■	◍	■	○	◍	◍
Japan	■	■	■	◍	■	■	■	■	○	○	■	■	■	■	■	■	■	■	■	■	■	■	■	■	○
Korea	■	■	■	■	■	■	■	■	○	○	■	■	◍	■	■	■	■	■	■	○	■	■	■	■	■
Luxembourg	■	■	■	■	■	■	■	■	■	○	■	■	◍	■	■	■	■	■	■	○	■	■	■	■	○
Mexico	■	■	■	■	◍	■	■	■	○	■	■	■	■	■	■	◍	■	■	○	■	■	■	■	■	■
Netherlands	■	■	◍	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	◍	■	■
New Zealand	■	■	◍	◍	○	■	◍	■	■	○	■	■	◍	■	■	■	■	◍	■	■	■	○	○	■	■
Norway	■	■	◍	◍	■	■	■	■	■	-	■	■	■	■	■	◍	■	■	■	■	■	■	○	○	■
Poland	■	◍	■	◍	■	■	■	■	■	-	■	■	■	■	■	■	■	○	■	■	■	○	○	○	■
Portugal	■	■	■	◍	■	■	■	■	■	■	◍	◍	◍	◍	◍	◍	■	■	■	■	■	■	○	■	■
Slovak Republic	■	■	■	◍	■	■	■	■	■	-	■	■	■	■	■	■	■	■	■	■	■	■	◍	○	■
Slovenia	■	◍	■	◍	■	■	◍	■	◍	-	■	■	◍	■	◍	■	■	■	■	■	■	◍	◍	■	◍
Spain	■	■	■	■	■	■	■	■	■	-	■	◍	◍	◍	◍	■	■	■	■	■	■	■	■	■	■
Sweden	■	■	■	◍	■	■	■	■	■	-	■	■	◍	■	◍	◍	■	■	■	■	■	■	○	■	○
Switzerland	◍	■	◍	◍	■	■	■	■	○	-	■	◍	■	◍	■	■	■	■	■	■	■	◍	■	■	○
Turkey	■	■	■	■	■	■	■	■	■	-	■	■	■	■	■	■	■	■	■	■	■	■	○	■	■
United Kingdom	◍	■	◍	◍	■	■	◍	■	■	■	◍	■	◍	◍	◍	◍	◍	◍	◍	◍	◍	■	■	■	■
United States	◍	■	◍	◍	◍	■	■	■	○	○	■	■	◍	■	■	◍	■	◍	■	■	■	■	■	◍	◍

Notes: ● Compliant; ■ Largely compliant; ■: Partially compliant: ○: Non compliant.

Notes

1. The core recommendations as defined in the FATF procedures are: R1, R5, R10, R13, SRII, SRIV.
2. The key recommendations as defined by the FATF procedures are: R3, R4, R23, R26, R35, R36, R40, SRI, SRIII and SRV.
3. See www.fatf-gafi.org.
4. See http://www.gafisud.info/ and www.coe.int/t/dghl/monitoring/moneyval.

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Chapter 3

Tax evasion and illicit financial flows

Effective exchange of information between tax authorities is critical for combating all forms of international tax evasion and avoidance. OECD countries are generally compliant on standards for the effective exchange of tax information as set down by the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum). Cross-border agreements to assist developing countries in collecting taxes could provide critical support in recovering the taxes legally due. Developing countries need to continue to expand their network of agreements with relevant jurisdictions and they will need the technical capacity and political will to actively pursue international tax evasion through exchanging information. While the existing standard is based on exchange on request, the G20 is committed to automatic exchange of information and significant capacity building support for developing countries is needed in this area. Donors should play a role by helping to build the necessary technical expertise in developing countries to comply with international standards and to detect and pursue tax crimes effectively.

Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Tax systems in developing countries

Developing countries face many constraints to building more effective domestic tax systems and ensuring compliance (Box 3.1). Tax systems in developing countries perform poorly due to weak capacity, corruption and the lack of any reciprocal link between tax and public and social expenditures (IMF et al., 2011). Efforts to increase tax collection in developing countries are rightly focused on strengthening their tax administrations' basic capacity to collect taxes such as income tax, excise duty or value-added tax (VAT). Developing countries are currently not fulfilling their tax potential; for example, Sub-Saharan African countries still mobilise less than 17% of their gross domestic product (GDP) in tax revenues, below the minimum level of 20% considered necessary by the UN to achieve the Millennium Development Goals (MDGs) (IMF et al., 2011; UNDP, 2010).

Box 3.1. **Specific challenges for developing countries**

- Weak tax administrations. A well-functioning tax administration is key to mobilising domestic resources in developing countries; the design of the tax system should be influenced by the ability of tax administrations to administer it. Many administrations continue to be staffed with poorly trained and low-paid officials, have structures which do not encourage an integrated approach to different taxes, and are marked by imbalanced service and enforcement functions.
- Low taxpayer morale, corruption and poor governance are often deeply entrenched. High levels of corruption are strongly associated with low tax revenue (indeed corruption functions like a tax itself, and is likely to be a particularly regressive and inefficient form of taxation), as are other indicators of poor governance, such as weak rule of law and political instability. Causation can run both ways, but tax collection is central to the exercise of state power, making the need to address governance issues in tax collection of wider importance.
- "Hard to tax" sectors, including small businesses, small farms and professionals. This is particularly important where both administrative capacity and the incentives to comply are weak. Developing countries have extensive informal sectors – perhaps 40% of GDP on average, up to 60% in many – but arguably this is not in itself the problem. Micro traders may be informal, for instance, but their income and sales are also likely to be well below any reasonable tax threshold; much of the most egregious evasion is by qualified professionals. The issue is perhaps better framed as one of non-compliance. Estimates of non-compliance are scarce, but VAT "gaps" have been put at 50-60% in some developing countries, compared with 7-13% in developed countries.

Source: IMF, OECD, UN and World Bank (2011), "Supporting the development of more effective tax systems: A report to the G20 Development Working Group", OECD, Paris, available at: www.oecd.org/ctp/48993634.pdf.

In addition, as capital becomes more mobile, developing countries are dealing with new international challenges, such as taxing multinational enterprises effectively, building effective transfer pricing regimes, establishing and using information sharing arrangements to obtain tax information about their taxpayers from other countries, and managing tax incentives to attract international investors. How all countries interact on tax matters is of increasing significance, including how the efforts of OECD countries support or impact the developing world.

This chapter looks at the quality of OECD countries' legal and regulatory framework on key international tax matters, where metrics are available. It covers, in particular, exchange of tax information efforts led by the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), the number of exchange of tax information (EOI) agreements between OECD countries and developing countries (including those that meet the international standard agreed by the Global Forum), and the extent to which agreements between countries allow for assistance in the collection of taxes. Finally, this chapter looks briefly at how OECD countries are supporting developing countries by promoting a whole-of-government approach to combating financial crimes and tax crimes through the Oslo Dialogue process.

Curbing international tax evasion

Exchange of information

In order to combat international tax evasion, tax authorities must be able to access and exchange relevant information about individuals' and companies' activities, assets or incomes in foreign jurisdictions. Since 2009, the environment for tax transparency has changed dramatically with the OECD and G20 providing leadership on actions to combat tax evasion.

The Global Forum on Transparency and Exchange of Information for Tax Purposes has been the driving force behind the universal acceptance of international standards for tax transparency and the exchange of tax information and is charged with ensuring their implementation. The Global Forum was restructured in 2009 to create an inclusive, truly global organisation where all members participate on an equal footing. It now has 119 jurisdictions and the European Union as members, including 50 developing countries and territories. A multitude of international and regional tax organisations participate as observers in the Global Forum. The transparency and exchange of information standard is set down in the terms of reference, agreed by the Global Forum in 2010.

Box 3.2 lists the requirements for meeting the international exchange of information standard.

The ten essential elements of the Global Forum standard of exchange of information on request are grouped into three broad components: availability of information, access to information and exchange of information itself. The Global Forum ensures that high standards are met through a comprehensive, rigorous and robust peer review process conducted by expert assessors from its member countries and overseen by a 30-member Peer Review Group.

The peer review process

The strength of the Global Forum lies in its peer review process. It is tasked with conducting two phases of peer reviews of all member jurisdictions, as well as relevant non-member jurisdictions. Phase 1 reviews each jurisdiction's legal and regulatory framework, while Phase 2 assesses its practical implementation of the standards. All members have committed to using the results of these peer reviews to guide changes and improvements in their tax transparency and information exchange processes. Peer-reviewed countries are required to provide updates on progress towards addressing the recommendations made in the published reports within a fixed time period.

Box 3.2. **The ten essential elements of transparency and exchange of information for tax purposes**

Availability of information

1. Ownership and identity information: Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to the competent authorities.
2. Accounting information: Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements.
3. Bank information: Banking information should be available for all account holders.

Access to information

4. Powers to access information: Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information agreement from any person within their territorial jurisdiction who is in possession or control of such information.
5. The rights and safeguards that apply to persons in the requested jurisdiction should be compatible with effective exchange of information.

Exchanging information

6. Effective exchange: Exchange of information mechanisms should provide for effective exchange of information.
7. Network of agreements: The jurisdictions' network of information exchange mechanisms should cover all relevant partners.
8. Confidentiality: Jurisdictions' mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received.
9. Rights and safeguards: Exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties.
10. Timely exchange: The jurisdiction should provide information under its network of agreements in a timely manner.

Source: OECD (2013), "The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief", OECD website, www.oecd.org/tax/transparency/global_forum_background%20brief.pdf.

Once enough jurisdictions have undergone Phase 2 peer reviews to allow appropriate comparisons to be made, each country will be given a rating as to whether it is "compliant", "largely compliant", "partially compliant" or "not compliant" with the standards. The ratings for the 50 jurisdictions that will have undergone a Phase 2 review by October 2013 were expected to be decided by the Global Forum by the end of the year.

Table 3.1 shows how OECD countries perform on ten elements of the Global Forum standard as a result of the peer review process as well as the overall country rating. In general, OECD countries are compliant with the Global Forum standard, and are able to

Table 3.1. **Summary of Global Forum peer review determinations for OECD members**

Country	Type of review	Availability of information			Access to information		Exchange of information (EOI)				Overall rating
		Ownership	Accounting	Bank	Access power	Rights and safeguards	EOI instruments agreements	Network of confidentiality	Rights and safeguards	Timely EOI	
Australia	Combined	●	●	●	●	●	●	●	●	●	●
Austria	Phase 1 + Phase 2	■	●	●	■	■	■	■	●	●	■
Belgium	Phase 1+ Supplementary+ Phase 2	●	●	●	●	●	●	●	●	●	●
Canada	Combined	■	●	●	●	●	●	●	●	●	●
Chile	Phase 1	■	●	●	■	■	●	●	●	○	○
Czech Republic	Phase 1	■	●	●	■	●	●	●	●	○	○
Denmark	Combined	■	●	●	●	●	●	●	●	●	●
Estonia	Phase 1+ Supplementary	■	●	●	●	●	●	●	■	●	■
Finland	Combined	●	●	●	●	●	●	●	●	●	●
France	Combined	●	●	●	●	●	●	●	●	●	●
Germany	Combined	■	●	●	●	●	●	●	●	■	■
Greece	Combined	■	●	●	●	●	●	●	●	■	■
Hungary	Phase 1	■	■	●	■	■	■	●	●	○	○
Iceland	Combined	●	●	●	●	●	●	●	●	●	●
Ireland	Combined	●	●	●	●	●	●	●	●	●	●
Israel	Phase 1	■	■	■	■	●	■	■	●	○	○
Italy	Combined	●	●	●	●	●	●	●	●	■	■
Japan	Combined	●	●	●	●	●	●	●	●	■	●
Korea	Combined	■	●	●	●	●	●	●	●	●	●
Luxembourg	Phase 1 + Phase 2	■	●	●	■	●	■	●	●	■	■
Mexico	Phase 1	■	■	●	●	●	●	●	●	○	○
Netherlands	Combined	■	●	●	●	●	●	●	●	●	■
New Zealand	Combined	■	●	●	●	●	●	●	●	●	●
Norway	Combined	●	●	●	●	●	●	●	●	●	●
Poland	Phase 1	■	●	●	●	●	●	●	●	○	○
Portugal	Phase 1	■	●	●	●	■	●	●	●	○	○
Slovak Republic	Phase 1	■	●	●	■	●	●	●	●	○	○
Slovenia	Phase 1	●	●	●	●	●	●	●	●	○	○
Spain	Combined	●	●	●	●	●	●	■	●	●	●
Sweden	Combined	●	●	●	●	●	●	●	●	●	●
Switzerland	Phase 1	■	●	●	■	■	■	■	●	○	○
Turkey	Combined	■	●	●	■	●	■	●	●	■	■
United Kingdom	Combined + Supplementary	■	●	●	●	●	●	●	●	●	■
United States	Combined	■	■	●	●	●	●	●	●	●	■

Notes: ● the element is in place; ■ the element is in place, but certain aspects of the legal implementation of the element need improvement; ■ the element is not in place; ○ not assessed. *Source* OECD (2013), "Tax transparency 2013 report on progress", OECD, Paris, http://www.oecd.org/tax/transparency/; and published peer review reports.

collect and share information with partners. The weakest area of compliance concerns the availability of information on ownership and identity for entities and arrangements (e.g. companies, partnerships, trusts). The particular issue of beneficial ownership and general information about ownership information has emerged as a key element of the financial crime and illicit flows agenda, given the tendency of criminals to hide behind various corporate or legal structures in order to launder money. Being able to identify the beneficial owner of a corporate or other legal entity is an essential element in combating financial crime, and many institutions need access to such information, from financial institutions carrying out customer due diligence, to judicial or tax authorities carrying out investigations. Compliance with the Financial Action Task Force (FATF) standards with regards to beneficial ownership is also particularly low as outlined in Chapter 2. Given its importance, the issue of beneficial ownership has recently been identified by the G8 and G20 as a key priority action frontier.

One of the key elements of effective EOI is a robust network of agreements for exchange of information with relevant partners. At the bilateral level, all OECD member countries have signed some information exchange agreements with developing countries. Since the launch of the Global Forum in 2000, OECD member countries have continued signing information exchange agreements with developing countries at a steady rate, as shown in the cumulative data in Figure 3.1. As of September 2013, a total of almost 1 300 such agreements had been signed with developing countries and more are on the way. For example, Kenya is negotiating tax information exchange agreements (TIEAs) with nine other jurisdictions with which Kenyan taxpayers have significant transactions.

Figure 3.1. **Exchange of information agreements signed between OECD countries and developing countries up to 2013**

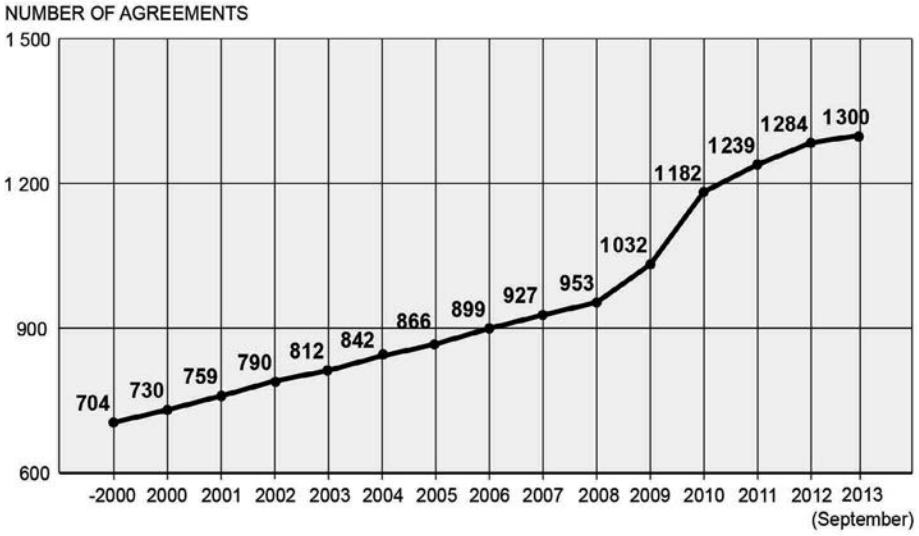
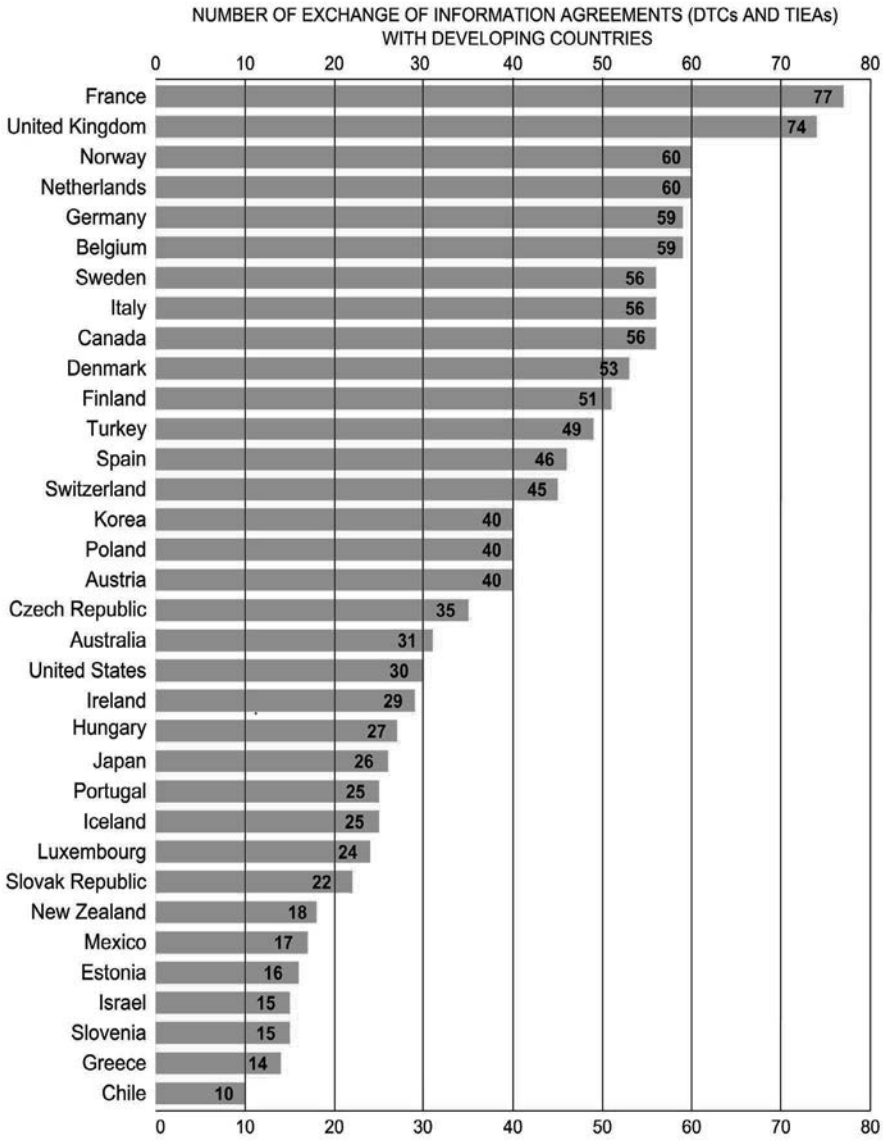


Figure 3.2 shows the number of bilateral agreements each OECD member country has signed with developing countries up to 2013. As the figure shows, some OECD member countries have been more active than others. The top countries have signed more than 50 information exchange agreements with developing countries, while 7 have signed fewer than 20.

Figure 3.2. **Total number of bilateral agreements signed between OECD countries and developing countries up to 2013**



Notes: DTC: Double Tax Convention; TIEA: tax information exchange agreement.

Box 3.3 lists the criteria for exchange of information on request under the international standard.

In 2005, the international standard was significantly strengthened to make it harder for countries to refuse requests for information. The OECD Model Tax Convention (a primary source of the international standard) was updated with the addition of two paragraphs to ensure that countries do not refuse to provide information on the grounds that they themselves do not need it for their own domestic purposes or that the information is held by banks, other financial institutions, nominees or agents. Many countries however, already exchanged (and continue to exchange) such information even in the absence of the two new paragraphs from their agreements. Older agreements that

do not explicitly include this standard may thus meet it in practice. The Global Forum incorporated this strengthened OECD standard into the international standard agreed upon its restructuring in 2009.

Box 3.3. **Exchange of information on request**

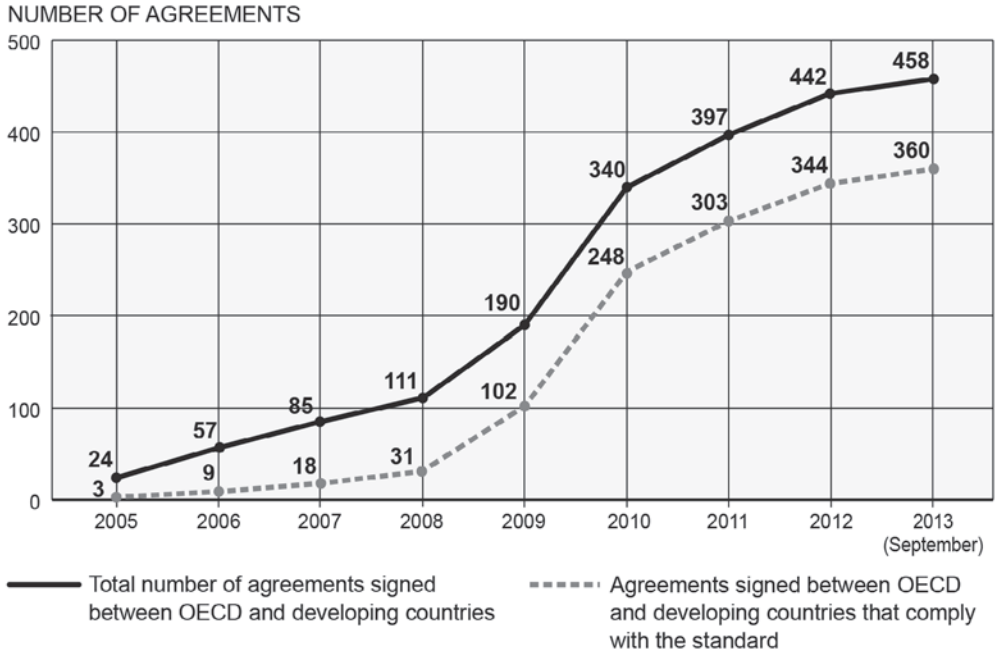
The standard provides for exchange of information on request where the information is foreseeably relevant to assessing the taxes of individuals, entities or arrangements that are liable to tax in the requesting party's jurisdiction (including bank and fiduciary information regardless of a domestic tax interest). In order to comply with the Global Forum standard, EOI agreements should:

- allow for exchange of information on request where it is foreseeably relevant[1] to the administration and enforcement of the domestic tax laws of the requesting jurisdiction[2]
- provide for exchange of information in respect of all persons (e.g. not be restricted to persons who are resident in one of the contracting states for purposes of a treaty or a national of one of the contracting states)
- not permit the requested jurisdiction to decline to supply information solely because the information is held by a financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person[3]
- provide that information must be exchanged without regard to whether the requested jurisdiction needs the information for its own tax purposes[4]
- not apply dual criminality principles to restrict exchange of information
- provide exchange of information in both civil and criminal tax matters
- allow for the provision of information in the specific form requested (including depositions of witnesses and production of authenticated copies of original documents) to the extent possible under the jurisdiction's domestic laws and practices
- be in force; where agreements have been signed, jurisdictions must take all steps necessary to bring them into force expeditiously
- be given effect by the enactment of legislation necessary for the jurisdiction to comply with the terms of the mechanism.[5]

Notes: 1. See Articles 1 and 5(5) of the OECD Model TIEA and accompanying commentary. It is incumbent upon the requesting state to demonstrate that the information it seeks is foreseeably relevant to the administration and enforcement of its tax laws. Article 5(5) of the OECD Model TIEA contains a checklist of items that a requesting state should provide in order to demonstrate that the information sought is foreseeably relevant. 2. See Article 1 of the OECD Model TIEA, §5.4 of the Revised Commentary (2008) to Article 26 of the UN Model Convention and §9 of the Commentary to Article 26 of the OECD Model Convention. 3. OECD and UN Model Tax Conventions, Art. 26(5); OECD Model TIEA, Art. 5(4)(a). 4. OECD and UN Model Tax Conventions, Art. 26(4); OECD Model TIEA, Art. 5(2). 5 OECD Model TIEA, Art. 10.

Figure 3.3 shows the number of agreements signed between OECD countries and developing countries since 2005. The figure shows that of the 458 agreements signed between 2005 and 2013, 360 (or 78%), include the standard language of the updated OECD Model Tax Convention. There was further improvement after the adoption of this standard by the Global Forum in 2009, with 96% (258 out of 268) of agreements between OECD countries and developing countries signed since that date meeting the standard.

Figure 3.3. **Number of exchange of information agreements between OECD countries and developing countries which meet the Global Forum Standard, signed between 2005 and 2013**



Relatively little information exists on how well OECD countries exchange tax information with developing countries as this will be covered in the Phase 2 reviews being carried out by the Global Forum which are still underway. Thus far, 15 stand-alone Phase 2 peer reviews have been completed (there have also been 26 combined Phase 1 and 2 reviews).

Multilateral mechanisms

An increasing number of developing countries have joined the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Of the 56 signatory countries, 19 are developing countries[1] and more were due to join in 2013. They stand to benefit from a growing global network of information exchange agreements with other adherents to the convention. This followed amendments in 2010 which brought the convention in line with current international standards on exchange of information for tax purposes and opened it up to countries outside the OECD and the Council of Europe. The convention provides for a range of information exchange methods, including the option of automatic information exchange among parties as well as for information exchange to be on request or spontaneous.[2] The incentives for developing countries to join the convention were given a significant boost in 2013 by the G8 meetings which resulted in many of the United Kingdom's overseas territories and Crown dependencies opting to join the convention.

Recognition that some countries lack the resources to effectively negotiate bilateral exchange of information treaties has led to attempts to co-ordinate the treaty negotiation processes, such as through a multilateral negotiations process. These processes use a single negotiating team representing the interests of the Global Forum members to reach agreement on the terms of an exchange of information agreement with other jurisdictions

or a group of jurisdictions. Once agreed, each of the involved jurisdictions then signs separate bilateral agreements (OECD, 2010a). In 2009, the Global Forum assisted a number of developing countries in a multilateral negotiation process with several offshore centres which resulted in several new agreements being signed between these centres and developing countries.

Automatic exchange of information: A solution for developing countries?

Exchange of information can take several forms: information exchange upon request, automatic exchange of information (AEOI) and spontaneous exchange of information.

There is currently a trend to move towards AEOI among OECD countries, and both the G8 and the G20 in 2013 endorsed the OECD's work to set a new single global standard for this form of exchange of information. In September 2013, G20 leaders endorsed the OECD proposal for a truly global model for AEOI. With the recent encouragement of both the G20 and the G8 this will also extend over time to developing countries. AEOI generally involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income received by its resident taxpayers (individuals or companies), such as dividends, interest, royalties, salaries, pensions (OECD, 2012b). AEOI can also be used to transmit information on the purchase of property, value-added tax refunds, and other information about purchases or investments which can be used to assess the net worth of an individual to see if their reported income reasonably supports the transaction. The potential benefits of AEOI are many. AEOI can provide information on non-compliance even in cases where there is no previous indication of non-compliance. AEOI also has important deterrent effects which increase voluntary compliance, encouraging taxpayers to report all relevant information (Box 3.4).

Box 3.4. **The FATCA: A game changer**

The Foreign Account Tax Compliance Act (FATCA) is a recent US initiative to improve tax compliance involving foreign financial assets and offshore accounts. Under FATCA, US taxpayers (individuals and companies) with specified foreign financial assets above certain thresholds must report those assets to the Internal Revenue Service (IRS). Failure to report will result in an initial penalty of USD 10 000 – and up to USD 50 000 for continued failure following IRS notification. In addition, FATCA will require foreign financial institutions (FFIs) to report information directly to the IRS about financial accounts held by US taxpayers, or held by foreign entities in which US taxpayers hold a substantial ownership interest. FFIs will also have to withhold and pay to the IRS 30% of any payments of income from US sources or proceeds from the sale of securities generating US source income made to non-participating FFIs, individuals who fail to provide information on whether they are US persons, or foreign entity (companies, trusts, etc.) account holders that fail to provide information about the identity of their US owners. The FATCA is a response to difficulties in obtaining such information through other methods, including standard EOI agreements.

Source: IRS (Internal Revenue Service) (n.d.), "Foreign Account Tax Compliance Act (FACTA)", IRS website, available at: www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA).

However, for AEOI to be successful, countries must be in a position to apply the relevant technical standards and safeguards to transmit, receive and protect confidential information. This is not currently the case for many developing countries, and there are unmet technical assistance needs.

In September 2013, G20 leaders called on the OECD to develop a roadmap showing how developing countries can overcome obstacles to participating in the emerging new standard on AEOI. Many of the basic constraints facing developing countries are those identified in the opening section of this chapter. What matters most is that countries are able to use the information obtained from the agreements signed. Over time, more data is expected on the use of agreements.

Cross-border assistance in the collection of taxes

Taxpayers may own assets and receive income from sources throughout the world, and exchange of information agreements help tax authorities to determine and assess the correct amount of tax. However, tax authorities usually cannot go beyond their borders to collect taxes due (OECD, 2007). This limitation can be overcome by establishing an appropriate bilateral or multilateral legal framework whereby foreign tax authorities can assist in the collection of taxes of other countries. As it has become easier for taxpayers to move assets abroad, countries are increasingly willing to enter into such arrangements, provided certain conditions are met (see below). In addition to the recovery of claims, the ability to collect taxes across borders has an important deterrent effect, which in some countries may be even higher than the benefit of the actual tax debts recovered.

Until recently, assistance in tax collection has mostly involved neighbouring countries with strong economic and political ties and which are bound by bilateral or multilateral agreements, such as the 1952 Benelux Mutual Assistance Treaty or the 1972 Nordic Convention on Mutual Assistance in Tax Matters.

Assistance with tax collection on the basis of bilateral tax conventions was rather limited and the OECD Model Convention did not include an article on assistance in the collection of taxes (assistance provision) until 2003. The 1976 EU Directive on mutual assistance for the recovery of claims only covered certain levies, duties and taxes but not VAT or direct taxes.

In 2003, the OECD Council approved the inclusion of a new article on assistance in tax collection in its update of the OECD Model Convention. This article (Article 27) is optional and may be included in a bilateral convention where each country concludes that it can agree to help in the collection of taxes levied by the other country. The decision will be based on a number of factors, including the importance of their cross-border investment, reciprocity, the ability of their respective administrations to provide such assistance and the similarity of the level of their legal standards, particularly the protection of the legal rights of taxpayers. Some countries' laws may not allow this type of assistance.

Of the 222 treaties signed between OECD countries and developing countries between 2007 and 2012, 20 included a provision for assistance in tax collection (between 11 developing countries and 13 OECD countries). These OECD countries have the legal basis for collecting taxes on behalf of their developing country treaty partners if requested to do so. This is a potentially significant option for developing countries wishing to enhance their ability to combat international tax evasion and ensure payment of taxes legally due by their citizens or companies. It also offers a very practical way for OECD countries to provide meaningful assistance to developing countries in mobilising domestic resources.

Key findings and observations

The tax agenda as it relates to illicit financial flows is complex. This chapter has mainly focused on different elements of EOI between OECD countries and developing countries, because EOI is a critical element in fighting international tax evasion and exchange of information agreements are one of the few metrics currently available.

The main findings emerging from this analysis are:

- Tax information exchange agreements are a critical tool for fighting cross-border tax evasion in developing countries.
- OECD countries should continue to fully implement the international standards on exchange of information, further expand their network of EOI agreements with developing countries, exploring possible automatic exchange of information where appropriate, and increase their efforts to build capacity in developing countries to exchange information.
- Developing countries could benefit from expanding their network of agreements with relevant countries and jurisdictions, and should seek to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.
- Developing countries need to proactively strengthen their institutions and systems to prevent tax evasion, and to investigate and prosecute offenders.
- Developing countries could benefit from of a whole-of-government approach to fighting tax crimes and other illicit flows and could strengthen their ability to detect and pursue such crimes.

Notes

1. Developing countries are defined as those eligible to receive Official Development Assistance as per the DAC list: www.oecd.org/dac/stats/daclistofodarecipients.htm.
2. The convention allows for a number of other things, such as simultaneous tax examinations, tax examinations abroad, assistance in recovery and measures of conservancy, and the service of documents. It can also facilitate joint audits.

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Chapter 4

International bribery and illicit financial flows

An estimated USD 1 trillion is paid each year in bribes, and bribery in the developing world may amount to the equivalent of 15-30% of all official development assistance. Reducing bribery reduces the opportunities for illicit gains and hence illicit financial flows. The OECD Anti-Bribery Convention is the first and only legally binding instrument to focus on tackling the supply side: the bribe payers. Progress in implementing the convention has been mixed among OECD member countries. Monitoring of the convention is encouraging improved compliance amongst signatories through a phased system of peer reviews. Reviews highlight both examples of good practice that could be adopted by other member countries and some common concerns. All signatories to the convention should signal that the fight against bribery is a political priority and put the mechanisms in place to uncover it, including effective protection for whistleblowers. Penalties should be harsh enough to form an effective deterrent and signal to the entire business community that bribery is no longer an option.

Introduction

The most widely accepted estimate of global bribery puts the total at around USD 1 trillion each year (World Bank, 2004). In the developing world, bribery amounts to around USD 20 billion to USD 40 billion a year – a figure equivalent to 15-30% of all Official Development Assistance (World Bank, 2007). This chapter focuses on OECD country efforts to combat bribery, and in particular the implementation of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the Anti-Bribery Convention). Bribes paid by OECD member country-headquartered companies to foreign public officials to secure contracts or obtain other advantages have damaging effects, especially in developing countries. Corruption in awarding business contracts has social, political, environmental and economic costs which no country can afford. Serious consequences result when public officials take bribes when awarding contracts to foreign businesses for public services such as roads, water or electricity. A USD 1 million dollar bribe can quickly amount to a USD 100 million loss to a poor country through derailed projects and inappropriate investment decisions which undermine development.

Some acts of bribery involving developing country officials may not involve financial transfers in or out of developing countries. However, illicit gains obtained through the bribery of foreign officials, including the contracts or investment deals and subsequent profits or tax breaks, will, at least partially, translate into outflows. The commitment of OECD countries to fighting foreign bribery and their performance on their commitments under the Anti-Bribery Convention is therefore highly relevant in the fight to reduce illicit financial flows from developing countries.

The OECD Anti-Bribery Convention was adopted in November 1997 and came into force in February 1999. It is the first and only legally binding instrument to focus on the supply side of bribery – the bribe payers – as opposed to criminalising foreign public officials who demand bribes.[1] The Convention has 40 signatory countries: the 34 OECD member countries plus Argentina, Brazil, Bulgaria, Colombia, the Russian Federation and South Africa. Implementation is overseen by the Working Group on Bribery (WGB), which is made up of the signatories. The members of the Working Group account for nearly 90% of global outward flows of foreign direct investment (FDI) (OECD, 2012a).

The convention requires signatory parties to: *i)* make bribery a criminal offence; *ii)* prosecute individuals and companies who offer, promise or give bribes to foreign public officials; and *iii)* subject offenders to effective and proportionate penalties, including fines or imprisonment.

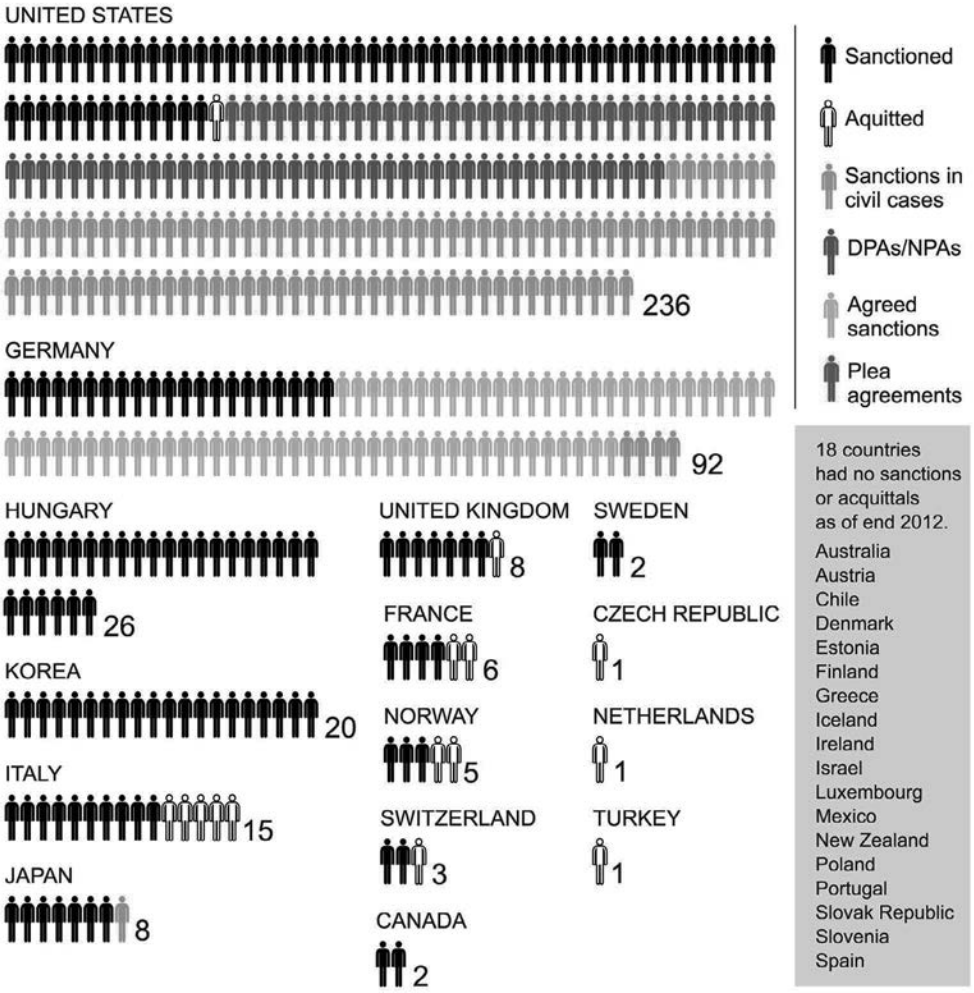
This chapter focuses on how well the signatories to the OECD Anti-Bribery Convention have managed to institute and enforce anti-bribery legislation. It presents comparative data across OECD member countries and discusses common shortcomings, as well as good practice, in enforcing anti-bribery legislation effectively at the country level.

Comparing the fight against bribery across OECD member countries

The simplest way to measure a country's progress on implementing the convention is to look at the country's level of law enforcement activity, such as the number of criminal investigations and proceedings as well as the related administrative and civil proceedings which, although insufficient in themselves to implement the convention, provide additional information.

Figures from the OECD Working Group on Bribery show that 216 individuals and 90 legal entities (companies, trusts, non-governmental organisations, etc.) were sanctioned through criminal proceedings for foreign bribery in 13 OECD countries from 1999, when the convention came into force, to the end of 2012 (Figure 4.1).[2] At least 83 of the sanctioned individuals were given prison terms for foreign bribery. Another 44 individuals and 95 legal entities in 3 signatory countries have been sanctioned in criminal, administrative and civil cases for other offences related to foreign bribery, such as money laundering or false accounting. There were 67 agreed sanctions for individuals and 48 deferred prosecution agreements (DPAs) or non-prosecution arrangements (NPAs) with legal persons. Around 320 investigations are still ongoing in 24 countries, and criminal charges have been filed against 166 individuals and entities in 15 countries.

Figure 4.1. **Total number of individuals and legal persons sanctioned or acquitted related to foreign bribery, 1992-2012**



Note: Belgium has reported several convictions; however, data on domestic and foreign bribery cases have not, to date, been counted separately. DPA= deferred prosecution agreement; NPA= non-prosecution agreement.

Source: Adapted from OECD (2012), "OECD Working Group on Bribery: 2013 Annual Report", OECD, Paris, available at: www.oecd.org/daf/anti-bribery/AntiBriberyAnnRep2012.pdf.

A few countries, notably Germany and the United States, have seen a considerable amount of judicial activity with regard to foreign bribery cases. Hungary, Italy and Korea have also been active in enforcing their anti-bribery legislation. However, roughly half of OECD member countries (18 countries) had no sanctions or acquittals by the end of 2012 (Figure 4.1). The OECD Working Group on Bribery has expressed concerns about this low level of enforcement, and a joint OECD/World Bank stock-take on implementation of OECD anti-corruption commitments noted that "parties to the OECD Anti-Bribery Convention have largely implemented their obligations, but enforcement is generally in its early stages" (OECD and the International Bank for Reconstruction/World Bank, 2011).

Judicial activity alone must be used with caution as an indicator – over time an effective enforcement system could lead to high compliance levels and therefore fewer prosecutions. Also, a country's enforcement activity must be weighed against the size of its economy and exposure to international business, companies doing business and signing contracts in other countries, etc. This means that cross-country comparisons must also be done cautiously. For example, it is to be expected that with an annual gross domestic product (GDP) of around USD 15 trillion, the United States would have significantly more activity than, for example, Iceland with an annual GDP of USD 311 billion (a factor of 30). Nevertheless, it is difficult to imagine that countries with any significant economic activity and foreign business exposure would have not uncovered any cases of foreign bribery if they have an effective anti-corruption regime in place.

Rather than measuring the number of prosecutions (a measure of effort at combating bribery), Transparency International measures the frequency of bribery in its *Bribe Payers Index* (Transparency International, 2011). The index, which has been published five times since 1999, ranks a number of leading exporting countries by the likelihood that their multinational businesses will use bribes when operating abroad. The ranking is calculated from responses by businesspeople to the following question from the World Economic Forum's Executive Opinion Survey: "In your experience, to what extent do firms from the countries you have selected make undocumented extra payments or bribes?" Answers were given on a scale of 1 (bribes are common or even mandatory) to 10 (bribes are unknown). Figure 4.2 shows how 15 OECD member countries were ranked in the 2011 *Bribe Payers Index*.

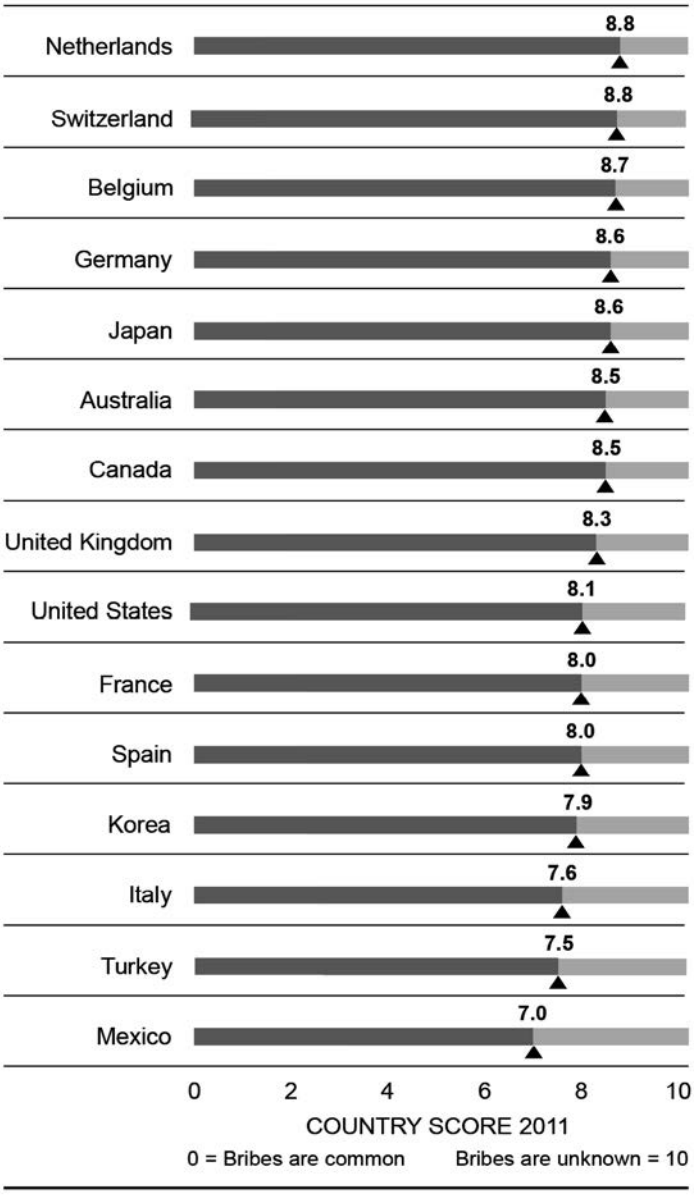
While neither the Netherlands nor Switzerland have carried out many bribery-related prosecutions, their companies are ranked as the most unlikely to engage in bribery in foreign markets. On the other hand, Italy has had comparatively more judicial activity, but fares poorly in the *Bribe Payers Index*. It is worth noting that the 2011 *Bribe Payers Index* shows no significant improvement over the previous index in 2008.

Monitoring implementation

The OECD Working Group on Bribery in International Business Transactions is responsible for monitoring the implementation and enforcement of the OECD Anti-Bribery Convention, as well as later additions to the convention (the 2009 Recommendation[3] on Further Combating Bribery of Foreign Officials in International Business Transactions and the 2010 *Good Practice Guidance for Companies*; OECD, 2009, 2010a). It does so through a peer review monitoring system. In the first phase, initiated in 1999, the peer reviewers conducted in-depth reviews to see how each country's national laws reflected the requirements of the convention. The second phase,

initiated in 2002, looked at the effectiveness in practice of signatory parties' legislative and institutional anti-bribery frameworks. The third phase, which started in 2010, looks at implementation of the convention, concentrating on enforcement action at country level. It is expected that the third round of evaluations will last until the end of 2014. Other phases may follow. Compliance is enhanced by requiring each country to provide a written follow-up report on steps taken to implement the recommendations made by the working group in each phase.

Figure 4.2. **How OECD member countries score on Transparency International's Bribe Payer's Index, 2011**



Note: Missing data for Austria, Chile, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Iceland, Ireland, Israel, Luxembourg, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia and Sweden and the non-OECD member parties to the convention.

Source: Transparency International (2011), *Bribe Payers Index 2011*, Transparency International, Berlin.

The OECD Working Group on Bribery (WGB) is not mandated to formally punish countries who fail to adequately implement the OECD Anti-Bribery Convention but the convention (Article 12) provides for a systematic monitoring and promotion of the full implementation of the convention in the context of which a strong peer pressure is exercised by all parties to the convention.

Figure 4.3 shows how countries had implemented the recommendations from Phase 2 reviews at the time of the follow-up reports.[4] For the purposes of comparison, Phase 2 reviews have been used rather than Phase 3 ones as not all countries have been through their Phase 3 evaluation. Out of a total of 623 recommendations issued to all OECD countries, 282 (45%) were satisfactorily implemented, 179 (29%) partially implemented and 143 (23%) were not implemented.

In addition to reviews and follow-up reports (provided in the WGB-agreed procedures or decided on an *ad hoc* basis), the Working Group on Bribery may, if needed, apply strong pressure to rectify identified problems. It may do so by, for example, carrying out an additional formal review, sending a high-level mission to the country in question, sending a letter to the country's relevant ministers, or issuing a formal public statement.

The 40 countries which are parties to the convention have an ambitious programme of progress evaluation, with over ten evaluations per year and the same number of written follow-up reports starting in 2012. In addition to monitoring the implementation of the convention by the countries which more recently joined the convention (Phase 1 and 2 evaluations), the working group is maintaining strong peer pressure on all countries (as provided under Article 12 of the convention). This demanding monitoring process has been evaluated as the gold standard by Transparency International.

This pressure is not only exercised by the parties to the convention among themselves and for themselves; it is also a pre-requisite to demonstrate the continuing relevance of the convention and the working group to the key economic players that have not yet joined the convention and with whom the working group is constantly working to develop or strengthen existing ties. The working group has recently welcomed two new members: Colombia and the Russian Federation. In 2011 and 2012, the People's Republic of China, India, Indonesia, Malaysia, Peru and Thailand participated in the working group meetings and continued to be associated with the working group's work in 2013.

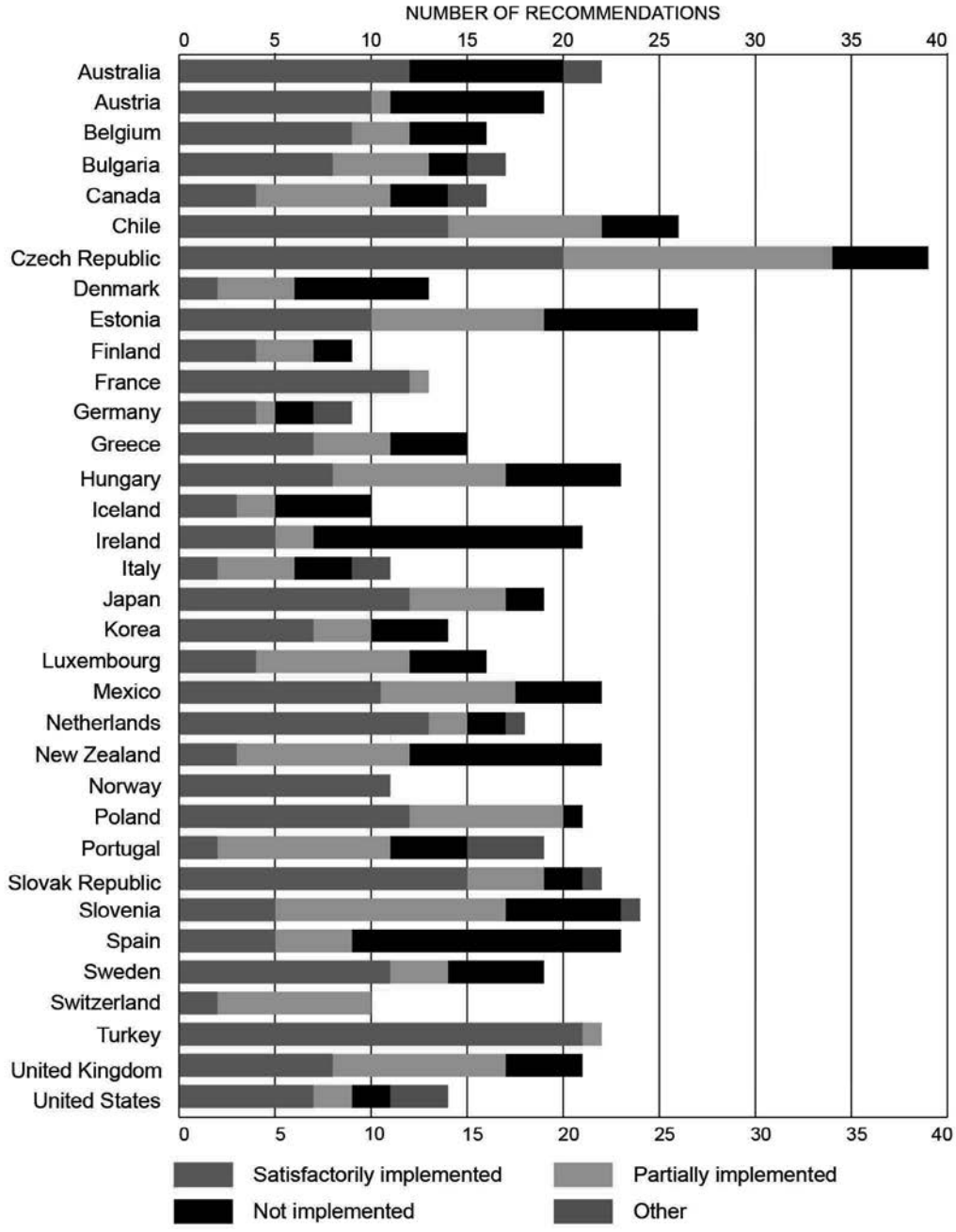
Enforcing anti-bribery legislation: Lessons from the peer reviews

In 2010, the OECD Working Group on Bribery's peer review mechanism launched its third phase. As of June 2013, reviews for 22 OECD member countries had been published.[5] This section provides a very brief summary of some common concerns brought up in the peer review reports, as well as some examples of good practice. Countries are named with a view to illustrate the issue or best practice described, not to provide a complete inventory of countries that implement a certain best practice.[6]

The legal framework

At a general level, the legal framework for combating foreign bribery is the starting point for an anti-bribery regime. The way that laws are developed and interpreted can either facilitate or hinder effective anti-corruption efforts. A number of weaknesses and gaps in OECD countries' legal frameworks may prevent the effective application of their anti-bribery regimes. These include issues such as overly narrow interpretations of

Figure 4.3. **Status of implementation of the Working Group on Bribery Phase 2 recommendations**



Note: Progress made by parties to the convention on weaknesses identified in Phase 2 (which gave rise to Phase 2 recommendations) were assessed two years after the adoption of each country's Phase 2 report. At the time of drafting this chapter, these are the only available data which allow a cross-country comparison among all parties to the convention as not all parties have yet completed their Phase 3 evaluation. It should, however, be noted that these may not reflect the latest steps taken by each country to implement the Anti-Bribery Convention and the 2009 Recommendations to further combat foreign bribery.

Source: based on data in Working Group on Bribery country reports.

foreign bribery – for example, promises or payments to third parties such as charities owned by a relative of a foreign official, or political parties, might not fall under the definition of bribery – or the imposition of an impractical burden of proof, such as the requirement to prove the direct and successful intervention by a public official in the award of a contract following a bribe (e.g. France, Germany; OECD, 2011b, 2012b). A very narrow definition or interpretation of "foreign public official" could also be an obstacle (e.g. Finland; OECD, 2010b). Finally, some countries require a prior identification and/or conviction of the relevant people (natural persons) with control of the companies in order to start judicial proceedings against companies or other legal structures (legal persons), while others may not sanction state-owned or state-controlled companies for offences committed in a foreign jurisdiction and/or through an intermediary. Others have limited options for sanctioning legal persons (e.g. Mexico; OECD, 2011c), or can only apply limited fines (e.g. Sweden; OECD, 2012c).

In some countries, a short statute of limitations can be an obstacle, given the length of time required to bring these often complex cases through court. In Italy, for example, the statute of limitations is capped at 7.5 years for all stages of a trial including appeals, suspensions and interruptions (OECD, 2011d). This has led to the vast majority of cases being dismissed for having run out of time. Countries should ensure a sufficient statute of limitations and ensure that mechanisms for extending the limitation period are sufficient and reasonably available (e.g. Finland; OECD, 2010b).

Some countries still let other strategic issues influence the decision of whether or not to pursue bribery cases. These include the national interest, the effect that cases may have on relations with another country, or the identity of the natural or legal persons involved. While Article 5 of the convention explicitly states that investigation and prosecution for bribery of a foreign official shall be subject to the applicable rules and principles of each party, the latter strategic issues are explicitly forbidden.

Several peer review reports, notably Canada, Germany, Sweden and Switzerland, note that sanctions are too low to be an effective deterrent for engaging in foreign bribery (OECD, 2011b; 2011e; 2011f; 2012c). A recent joint report by the OECD and World Bank specifically focuses on how to ensure that monetary sanctions are harsh enough to deter companies from engaging in bribery (OECD/The World Bank, 2012). It notes that the proceeds derived by the company offering the bribe are often many times higher than the amount of the bribe paid. If these additional benefits are not taken into account when fines are given, the company, even if convicted for bribery, may still walk away with much of its ill-gotten proceeds (OECD/The World Bank, 2012). This is highlighted in Norway's peer review report, which notes that the law enforcement authorities do not rely on powers to seize and confiscate the proceeds of bribery potentially gained by companies (OECD, 2011g). This is also the case for France (OECD, 2012b).

Issuing monetary fines is not the only way a country can effectively punish corporate wrong-doing. Another mechanism highlighted and commended in a number of peer review reports, notably Korea and Norway, is to debar companies from receiving public money – through export credit, Official Development Assistance or public procurement contracts – if found guilty of a foreign bribery offence (OECD, 2011g; 2011h). To make debarment as efficient as possible, the Working Group on Bribery suggests that it becomes a centralised resource for different agencies to gain information on companies sanctioned for foreign bribery.

Effective prevention and detection of foreign bribery

On a very practical level, there is a direct relationship between the amount of resources – human and financial – being dedicated to an issue and concrete results. It is clear that fewer specialised prosecutors and investigators will mean fewer successful cases (Canada and Mexico; OECD, 2011c; 2011e). Countries must ensure that sufficient numbers of staff are dedicated to foreign bribery cases and that they have the necessary expertise or access to relevant training and guidance to handle foreign bribery cases, which are often technically complex.

In the case of Norway, the peer review team noted that its success is "primarily owing to the experienced and well-resourced investigators and prosecutors situated in the specialised Anti-Corruption Teams within Norway's National Authority for Investigation and Prosecution of Economic and Environmental Crime, as well as a general determination by Norway to proactively seek out, investigate and prosecute corruption at all levels, be it domestic or foreign bribery, in the public or private sector" (OECD, 2011g).

The United States also received much praise, especially for its recent proactive stance in enforcing its anti-bribery legislation, such as industry-wide sweeps (Box 4.2).

Box 4.2. **Industry-wide sweeps: Good practice from the United States**

Industry-wide sweeps, involving assessments and audits of many companies in the same industry/sector, are a proactive way of effectively enforcing anti-bribery legislation as they enable authorities to develop specialised expertise in identifying illegal conduct and to carry out prosecutions involving various industries. Moreover, because of cross-connections between various members of the same industry, an investigation into one company may produce leads about other companies, including those in the supply chain. Industry-wide sweeps may be initiated by sending "sweep letters" requesting co-operation from industry members on a voluntary basis. The United States has recently conducted several industry-wide sweeps including in the oil and gas industry, the pharmaceutical/medical device industry, and most recently, the financial services industry. A successful example of such industry-wide sweeps is the investigation into the United Nations' Oil-for-Food programme which resulted in more than 15 companies being charged (OECD, 2010c).

The peer review reports frequently highlight the need to have in place effective mechanisms and procedures for obtaining and processing knowledge about foreign bribery cases. Certain countries have set up specialised agencies with responsibility to handle bribery cases. This has generally been commended by the peer review teams.

Another mechanism which has been shown to help uncover wrongdoing is to encourage "whistleblowing", i.e. informing relevant authorities about misconduct in the public or private sector. In fact, as noted in the peer review report on Norway, several foreign bribery cases have come about as a result of whistleblower reports (OECD, 2011g). An issue which is frequently mentioned in the peer review reports concerns the protection of whistleblowers in the private as well as public sectors (Box 4.3). The peer review report on Finland, for example, includes a recommendation to "introduce mechanisms to ensure that public and private sector employees who report in good faith and on reasonable grounds are protected from discriminatory or disciplinary action" (OECD, 2010b).

Box 4.3. Monetary rewards combined with increased protection for whistleblowers in the United States

The United States has improved the protection of whistleblowers in foreign bribery cases. Under the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act, qualified whistleblowers – those who bring forth accurate and original information – will be awarded 10-30% of the monetary sanctions imposed and collected. In addition to the direct financial incentive to reveal information on foreign bribery, the statute also provides protection for individual whistleblowers by barring employers from retaliating against them. The US authorities believe that this new legislation will increase the number of foreign bribery offences (OECD, 2010c). Nevertheless, certain concerns about these new whistleblower provisions have been voiced. By basing rewards on the receipt of original information, employees may be encouraged to bypass their companies' internal reporting systems and go directly to the authorities. In addition, the reward structure may induce a "lottery mentality" where employees flood regulators with formal complaints in the hope of receiving a windfall (Diaz et al., 2011). These concerns are valid and should be acknowledged and any potential harm mitigated.

Voluntary disclosure systems can allow companies to self-report in exchange for more lenient sanctions. Such voluntary disclosure options could lead to increased reporting by companies. However, the working group carefully looks at the impact of such disclosures on the level of sanctions which should remain efficient, proportionate and dissuasive.

Together with providing effective mechanisms for bringing foreign bribery cases forward, people in the private as well as the public sectors must be made aware of the legislations and institutions in place. A number of peer review reports state concerns about countries' poor awareness-raising efforts (e.g. Greece, Hungary, Sweden; OECD 2012d; 2012e; 2012c).

A number of peer reviews also highlight good awareness-raising practices, for example in Germany, where efforts have been made to raise awareness in both the public and private sectors (OECD, 2011b). In addition, special training into the foreign bribery offence has been provided to judges, prosecutors, the police and other relevant public officials. The peer review report on the United Kingdom commends the country for having effectively raised awareness of foreign bribery alongside the passing of its new Bribery Act (OECD, 2012f).

Tax inspectors can play an important role in uncovering bribery and corruption, given their role in auditing the accounts of companies. Indeed, many corruption cases have been uncovered during tax audits. Many countries have issued guidelines for tax inspectors to help them identify which types of expenses may be considered as suspicious transactions likely to constitute bribes. Many have also made it mandatory for tax administration officials to report cases of suspected foreign bribery, although some countries are still lagging behind on this issue (e.g. Finland; OECD, 2010b). In other countries, auditors' duty of confidentiality can prevent them from reporting suspected acts of foreign bribery (e.g. Germany; OECD, 2011b).

Finally, countries should encourage companies to establish effective internal control, ethics and compliance systems that include clear reference to company policy against such practices, including the consequences of engaging in corrupt practices, and channels for bringing such activities to the attention of management (e.g. Germany; OECD, 2011b).

Key findings and observations

In summary, whilst acknowledging that some countries still have some way to go before reaching the expected enforcement standards of their anti-bribery legislation, the peer review reports nevertheless contain many examples of good practice from which other countries can learn:

- Signalling that the fight against foreign bribery is a political priority. This can be done by increasing investigatory and prosecutorial efforts as well as by investing in expertise and resources in the agencies handling these types of cases. Particularly good practice in this sense is to take a proactive and publicly visible stand.
- Having the institutional and regulatory mechanisms in place to bring forth information about foreign bribery cases. In terms of institutions, those countries that deploy specialised agencies or task forces have generally been commended for doing so.
- Having effective whistleblower protection in place – this can increase the amount of information brought to the responsible authorities.
- Communicating first and foremost to those in a position to either break or enforce the law, but also to the general public, the political will to enforce legislation, as well as the existence and functions of the institutional mechanisms and regulations. This helps to raise the profile of the fight against bribery.
- Setting harsh enough penalties to be an effective deterrent for companies doing business abroad and to signal to the entire international business community that bribery is no longer an option.

Notes

1. According to the Anti-Bribery Convention, bribing a foreign public official is defined as "intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business" (Article 1 of the Anti-Bribery Convention: OECD, 2011a).

2. The only non-OECD country party to have been sanctioned is Bulgaria (one individual).

3. Recommendations reinforce the framework of the convention – or complement the conventions.

4. The follow-up reports are self-assessment reports submitted to the WGB by parties to the convention. The follow-up reports are generally submitted within two years of the reviews. Several countries have now undergone Phase 3 reviews and will have advanced even further on implementing the recommendations from the Phase 2 reviews than this figure shows.

5. These countries are: Australia, Austria, Canada, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, Norway, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom and United States.

6. The examples used and countries mentioned are for illustrative purposes and are the responsibility of the authors.

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Chapter 5

Freezing, recovering and repatriating stolen assets

Progress on recovering and repatriating stolen assets to developing countries has been modest. OECD countries can do more to signal that asset recovery is a political priority and to put in place the necessary legal and institutional framework to repatriate assets. This means dedicating more resources to legal and technical expertise to handle complex and costly cases involving developing countries. It also means adopting legal best practice, such as allowing for rapid freezing of assets when requested to do so by a foreign jurisdiction; directly enforcing foreign confiscation orders; allowing for non conviction-based asset confiscation; recognising foreign non conviction-based forfeiture orders; allowing foreign countries to initiate civil actions in domestic courts; and where appropriate, allowing compensation, restitution or other damages to benefit a foreign jurisdiction. In turn, developing countries must make it a priority to engage in effective mutual legal assistance, provide the necessary information to investigating authorities with which they co-operate, and proactively pursue and sanction their nationals implicated in corruption cases.

Introduction

What can be done once stolen funds have left the developing world? As the previous chapters have shown, the systems in place to prevent illicit financial flows from leaving the developing world and entering OECD countries are not yet watertight. One way to counter illicit financial flows is to recover and repatriate stolen assets to their jurisdiction of origin. Recovering assets stolen by corrupt leaders and their associates can serve three distinct purposes. First, it has the potential to provide additional resources to developing country governments and thereby help spur development. Second, by signalling that there are consequences to corruption and that corrupt money will not be easily hidden, it can have a deterrent effect on corruption and theft among political figures. Lastly, asset recovery can signal to victims that justice has been done.

Recognising these potential benefits, OECD countries have committed themselves to repatriate stolen assets to their jurisdiction of origin. The United Nations Convention against Corruption (UNCAC) – ratified by all but four OECD countries – has an entire chapter dedicated to asset recovery (Chapter 5, UNODC, 2004). In addition, many OECD member countries have reaffirmed their commitment to asset recovery through other major fora and political processes, such as the G8 and G20. OECD countries have also highlighted asset recovery as a core development issue in aid effectiveness. As part of the Busan Partnership for Effective Development Co-operation, signatories committed to "strengthening national and international policies, legal frameworks and institutional arrangements for the tracing, freezing and recovery of illegal assets" (OECD, 2011).

The aim of this chapter is to take stock of how OECD member countries are performing on their commitments to recover assets obtained through corruption. It measures the volume of money frozen and returned, and shows some of the main features of the legal and institutional structures in place to deal with asset recovery. This chapter is based on two reports by Stolen Asset Recovery (StAR) and OECD from 2011 (*Tracking Anti-Corruption and Asset Recovery Commitments*) and 2013 (*Tracking Asset Recovery Commitments*, Part 2 forthcoming) While this chapter focuses primarily on efforts by OECD countries, it is important to stress that asset recovery is not a one-way street. On the contrary, effective collaboration across jurisdictions, including developing countries, is at the heart of successful asset recovery efforts.

Asset recovery efforts by OECD member countries: Taking stock

In preparing for the Fourth High-Level Forum on Aid Effectiveness in Busan, Korea (December 2011), the OECD and the Stolen Asset Recovery (StAR) initiative surveyed OECD countries to take stock of their commitments on asset recovery. The survey measured the amount of funds frozen and repatriated to any foreign jurisdiction between 2006 and 2009. It found that during this time, only four countries (Australia, Switzerland, the United Kingdom and the United States) had returned stolen assets, totalling USD 276 million, to a foreign jurisdiction. These countries, plus France and Luxemburg, had also frozen a total of USD 1.225 billion at the time of the survey.

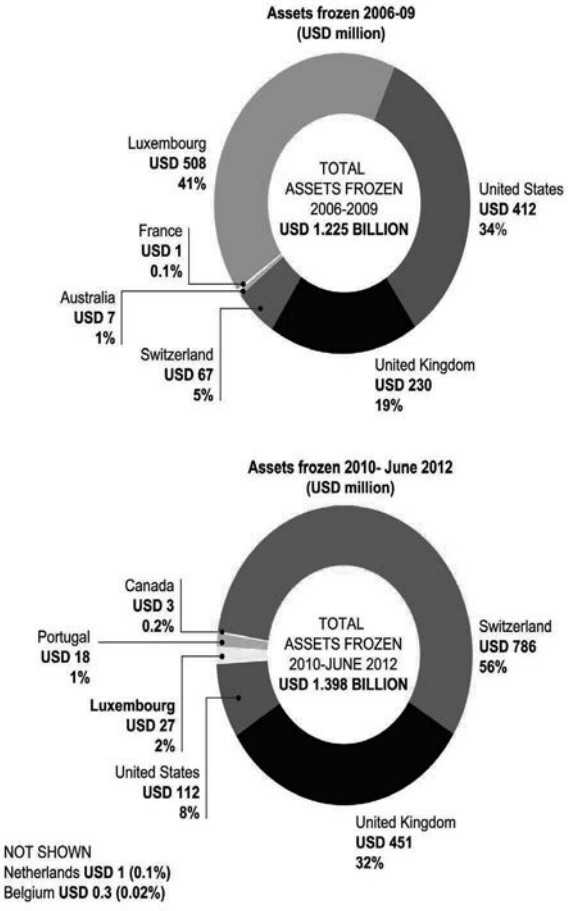
In 2012, the OECD and StAR launched a second survey measuring assets frozen and returned between 2010 and June 2012. In this time period, a total of approximately USD 1.4 billion of corruption-related assets had been frozen. In terms of returned assets, a total of USD 147 million were returned to a foreign jurisdiction in the 2010-June 2012 period. This is a slight decrease from the USD 276 million recorded from the last survey round.

Also, during 2010-June 2012, the majority of returned assets and 86% of total assets frozen went to non-OECD countries while in the 2006-09 period asset recovery mainly benefited OECD countries.

Freezing stolen assets

Figure 5.1 shows the volume of frozen assets during the two survey periods for OECD countries.[1] During the latter period (2010-June 2012), Switzerland accounted for the largest volume of frozen assets (56%), followed by the United Kingdom (32%) and the United States (8%). These countries all have large financial centres and have made asset recovery a political priority. Belgium, Canada, Luxembourg, the Netherlands and Portugal had also frozen some assets during this period. Many OECD countries have not frozen any corruption-related assets to date. While this may be due to legal and policy obstacles, it may also be that few illicit assets had been placed in these countries to start with.

Figure 5.1. **Which OECD countries have frozen stolen assets***
(reported in the OECD and StAR surveys)



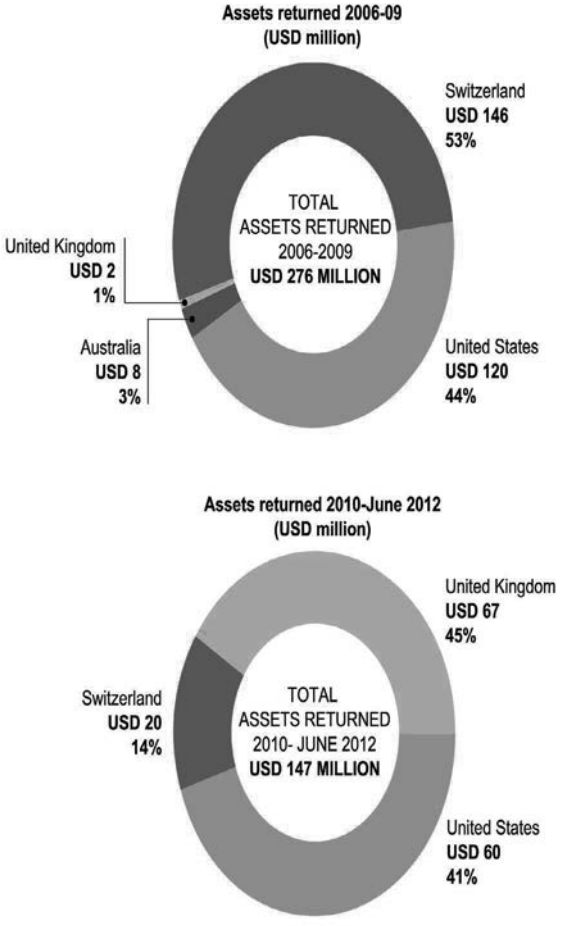
Note: * These assets relate to proceeds of corruption. The 2010-June 2012 StAR-OECD study is expected to be released in early 2013.

Source: OECD and the International Bank for Reconstruction and Development/The World Bank (2011), *Tracking Anti-Corruption and Asset Recovery Commitments: A Progress Report and Recommendations for Action*, OECD and the International Bank for Reconstruction and Development/The World Bank, Paris, available at: www.oecd.org/dac/governance-development/49263968.pdf.

Recovered stolen assets

Figure 5.2 examines the USD 147 million in stolen assets that were returned to a foreign jurisdiction between 2010 and June 2012, and the USD 276 million returned between 2006 and 2009. From 2006 to 2009, four OECD member countries reported the return of corruption-related assets. More than half (53%) was returned by Switzerland, and another large share (44%) by the United States, while Australia (with 3%) and the United Kingdom (with 1%) accounted for much smaller returned amounts. Only three OECD countries had returned corruption-related assets between 2010-June 2012: the United Kingdom (45% of total assets returned) followed by the United States (41%) and Switzerland (14%).

Figure 5.2. **Recovered stolen assets* (reported in the OECD and StAR surveys)**



Note: * These assets relate to proceeds of corruption. The 2010-June 2012 StAR-OECD study was expected to be released in January 2013.

Source: OECD and the International Bank for Reconstruction and Development/The World Bank (2011), *Tracking Anti-Corruption and Asset Recovery Commitments: A Progress Report and Recommendations for Action*, OECD and the International Bank for Reconstruction and Development/The World Bank, Paris, available at: www.oecd.org/dac/governance-development/49263968.pdf.

Asset recovery in the context of the Arab Spring

The Arab Spring has helped focus attention on international asset recovery. As long-standing governments began to tumble in Egypt, Libya and Tunisia in early 2011, banks and governments the world over started freezing billions of dollars held by these countries' previous leaders and their associates. For example, a mere hour after Egypt's ex-president Hosni Mubarak stepped down in February 2011, the Swiss government ordered its banks to freeze his assets held in Switzerland on suspicion that they were the proceeds of corruption. Other OECD member countries followed suit. The European Union ordered an EU-wide freeze of assets linked to Tunisia's ex-president Zine El Abidine Ben Ali in January 2011, and of assets linked to ex-President Hosni Mubarak in March the same year.

Despite the heightened attention to asset recovery following the Arab Spring, relatively few assets have to date been returned to the affected countries, and the process of recovering the stolen assets is proving to be both long and cumbersome (Cadigan and Prieston, 2011). The main obstacle to returning stolen assets to these countries is being able to provide solid enough proof that the assets were gained through corruption.

As a response to these challenges, several OECD member countries have aided the process of bringing forth asset recovery cases and delivering such proof. Switzerland has sent judicial experts to both Egypt and Tunisia; US investigators and prosecutors have visited Egypt, Libya and Tunisia to work directly with their requesting country officials; and Canada has provided assistance on asset recovery to Tunisian officials.

Box 5.1. **The international freeze of Libyan assets**

Asset recovery in the context of the Libyan uprising and consequent regime change has not followed the path of mutual legal assistance requests or criminal cases initiated by OECD countries. In addition, the Libyan assets that have been frozen are not necessarily proceeds of corruption. They have therefore not been included in Figure 5.1, which reports the results of the OECD/StAR Survey. The special case of recovering Libyan assets nonetheless deserves some attention because of the large volume of assets involved and the way in which the international community has acted through international legislation.

The 2010-12 survey showed that four OECD countries had frozen a total of almost USD 26 billion of Libyan assets. The United Kingdom froze almost USD 20 billion in this period, followed by the Netherlands (USD 4 billion), Sweden (USD 1.6 billion) and Switzerland (USD 400 million). Other countries, such as Australia and Canada, made efforts at freezing Libyan assets.

These assets were frozen following resolutions passed in the United Nations Security Council (UNSC). In February 2011, a UNSC Resolution (1970) was passed which ordered the freezing of Muammar Gaddafi's regime's assets held internationally. This UNSC Resolution was followed by UNSC Resolution 1973 in March, which reinforced the asset freeze. The UNSC-instituted asset freeze covered 13 Libyan individuals and 6 entities. Switzerland, the United Kingdom, the United States and the European Union went further and ordered the freezing of assets held by a larger number of individuals and entities associated with President Gaddafi (Rubenfeld, 2011). In September 2011, another UNSC Resolution (2009) was passed, allowing some Libyan assets to be unfrozen so as to benefit Libya's National Transitional Council. Returning stolen assets to countries lacking a stable government, such as in the Libyan case, highlights the question at the heart of asset recovery: how to ensure that returned assets are used for development and poverty reduction?[1]

Note: 1. For a discussion of this issue, see StAR (2009).

In addition, some governments have taken steps to strengthen domestic inter-agency co-operation. For example, in 2012 the United Kingdom launched a cross-government task force on asset recovery to Arab Spring countries. To date, the multi-agency task force has visited Cairo to forge links with their counterparts in the Egyptian authorities, and has posted a Crown Prosecution Service prosecutor and a Metropolitan Police Financial Investigator to Egypt. In the near future, the United Kingdom will post a regional asset recovery adviser to the region to assist the authorities in Egypt, Libya and Tunisia (United Kingdom Parliament, 2012). In November 2012, the European Union announced that its member countries had amended legislation to facilitate the return of the frozen assets formerly belonging to former presidents Mubarak and Ben Ali and their associates to Egypt and Tunisia respectively. The new legislative framework authorises EU member countries to release the frozen assets on the basis of judicial decisions recognised in EU member countries. It also facilitates the exchange of information between EU member countries and the relevant Egyptian and Tunisian authorities to assist in the recovery of assets to these countries (European Commission, 2012).

The experience of returning assets in the context of the Arab Spring has highlighted the need for effective legal frameworks as well as international co-operation and support. In 2011, the G8 launched the Deauville Partnership with Arab Countries in Transition, which included an Action Plan on Asset Recovery (G8, 2012). This action plan commits G8 members to promote co-operation and case assistance, support efforts in asset recovery through technical assistance and capacity building, and publish national guides on asset recovery. Other initiatives related to this action plan include the announcement by the United States that it will appoint two Department of Justice attorneys to specialise exclusively in the recovery of illicitly acquired assets from the region. Finally, the Action Plan on Asset Recovery has introduced the Arab Asset Recovery Forum, a collaborative regional initiative involving G8 and Arab countries in transition, as well as certain countries – such as Switzerland – which are playing an active part in repatriating assets in the region.

Improving the effectiveness of asset recovery across OECD member countries

Asset freezing, recovery and repatriation involves a slow and complex legal process. Respecting due legal process, and its sometimes heavy burden of proof, is essential. There are a number of legal, institutional and organisational matters that need to function smoothly in order to convince a judge or a jury that certain assets are the proceeds of corrupt activities, and that these funds may be confiscated and returned to their jurisdiction of origin. Apart from delivering satisfactory proof that assets are linked to criminal conduct, the process of recovering assets stolen by corrupt leaders faces other obstacles too, including insufficient legal precedent, lack of co-operation from financial centres and governments, and domestic political interference (Vlasic and Cooper, 2011).

The first OECD/StAR survey on asset recovery, an OECD and International Bank for Reconstruction and Development/The World Bank publication, *Tracking Anti-Corruption and Asset Recovery Commitments*, found that political will is the most important attribute in the quest to recover stolen assets. The report states that "strong and sustained political leadership backed by necessary laws is directly linked to actual progress on foreign corruption and asset recovery" (OECD and the International Bank for Reconstruction and Development/The World Bank, 2011). Indeed, those countries showing the greatest results on asset recovery have all adopted and implemented comprehensive policies that identify asset recovery as a priority, and have committed the tools and resources necessary for results. The report made five recommendations for OECD DAC member

countries, development agencies in donor countries, and co-operation agencies of developing countries (Box 5.2). The following section will discuss current practices across OECD member countries and analyse the extent to which these practices correspond to the recommendations made in the OECD/StAR report.

Box 5.2. **Recommendations for OECD member countries from the 2011 OECD and International Bank for Reconstruction and Development/The World Bank report, *Tracking Anti-Corruption and Asset Recovery Commitments***

1. Adopt and implement comprehensive strategic policies to combat corruption and recover assets.
2. Ensure that laws effectively target corruption and asset recovery, and provide the necessary powers to rapidly trace and freeze assets.
3. Implement institutional reforms that encourage the active pursuit of cases, build capacity, and improve trust and co-operation with foreign counterparts.
4. Ensure adequate funding for domestic law enforcement efforts and foster international co-operation in kleptocracy cases.[1]
5. Collect statistics to measure results.

Note: 1. Kleptocracy is a form of political and government corruption where the government exists to increase the personal wealth and political power of its officials and the ruling class at the expense of the wider population, often without pretense of honest service. This type of government corruption is often achieved by the embezzlement of state funds.

Source: OECD and the International Bank for Reconstruction and Development/The World Bank (2011), *Tracking Anti-Corruption and Asset Recovery Commitments: A Progress Report and Recommendations for Action*, OECD and the International Bank for Reconstruction and Development/The World Bank, Paris, available at: www.oecd.org/dac/governance-development/49263968.pdf.

Adopt and implement comprehensive strategic policies

Having a clear asset recovery policy and strategy in place is a good way to signal political commitment. Institutions often align their efforts according to such political priorities. A policy has the potential to empower authorities to take rapid action on this very complex agenda. As such, policies serve as platforms for further legislative and institutional developments. In addition to G8 countries adopting the Action Plan on Asset Recovery, several OECD member countries have comprehensive policies on asset recovery.

- The United States Kleptocracy Asset Recovery Initiative was implemented in 2010 to target and recover assets stolen by foreign officials and hidden in the United States. The initiative reaches across three sections of the criminal division of the United States Department of Justice.
- Switzerland's policy on asset recovery for the Arab Spring countries (see above), which designates Special Points of Contact in Egypt and Tunisia, and sends magistrates to help draft mutual legal assistance requests for these countries.
- The Netherlands' national programme launched in 2011 to further international asset recovery. Known as Afpakken, the policy provides EUR 20 million annually for law enforcement authorities to pursue asset confiscation, and aims to confiscate EUR 100 million by 2018.
- The United Kingdom is developing a new policy on asset recovery.

Ensure effective laws on asset recovery

Recent years have seen the development of international law on the recovery of assets stolen through corruption. As mentioned above, the UNCAC includes provisions for the freezing, seizure, confiscation and recovery of assets obtained through corruption. State parties to this convention must make provisions in their own legislation in accordance with those stated by the convention. The 2000 United Nations Convention against Transnational Organized Crime (UNTOC) also contains provisions for mutual legal assistance in investigating and prosecuting corruption offences. All but three OECD member countries have signed and ratified the UNTOC. Becoming parties to these two international conventions is an important step in ensuring a sound domestic legal framework for asset recovery.

Several OECD member countries have enacted new laws or amended existing ones on asset recovery in recent years. Some recent legal innovations are worth highlighting. For example, the Swiss Federal Restitution of Illicit Assets Act 2011 deals with returning stolen assets when they cannot be returned through mutual legal assistance channels due to failures in the victim state's judicial system. In these cases, the act shifts the burden of proof to the allegedly corrupt official, who must be able to show that the assets that have been frozen are legitimate. If the official cannot provide such proof, the assets can be confiscated by the Swiss state. A similar take on dealing with the often difficult task of proving corruption can be found in Australia's "Unexplained Wealth Law" of February 2010. Under this law, a court can demand that a person provides proof of the origin of his or her wealth if there are reasonable grounds to suspect that it exceeds what could have been lawfully acquired. This law concerns criminal monies in general and not only those originating from corruption. France has similar legislation, making it an offence if a person cannot show sufficient income to correspond to his or her lifestyle.

The StAR initiative, the G8 and the G20 have recommended a number of best practices concerning asset recovery laws which OECD member countries should aspire to implement. These concern the rapid freezing of assets, non conviction-based confiscation, foreign confiscation orders, civil action in asset recovery cases and compensation in cases involving asset recovery. Table 5.1 shows to what extent current practices across OECD member countries correspond to this international best practice. This information is available for 20 of the OECD member countries that responded to the joint StAR/OECD survey (2010-June 2012).

To start with, domestic laws should facilitate the rapid tracing, freezing and return of stolen assets. Speed is of the essence when it comes to tracing and freezing liquid assets, as criminals can quickly transfer funds out of the authorities' reach or even dispose of property if they receive signals that the authorities are after them. One useful way is to allow for non conviction-based asset confiscation or forfeiture, which allows authorities to confiscate funds in the absence of a criminal conviction. This is particularly useful when the suspect is deceased, has fled or is immune from prosecution. Another approach is to allow authorities to freeze funds if requested to do so by a foreign jurisdiction. When a domestic freezing order requires a criminal charge to be initiated first, this can delay the process significantly and compromise the ability to seize assets.

Another important avenue for repatriating stolen assets to a foreign jurisdiction is to allow the victim country to initiate civil action in their own courts. Civil actions generally operate on a lower standard of proof than criminal actions and often carry less stringent statutes of limitations rules. Finally, many countries lack laws that allow them to order compensation, restitution or damages to a foreign jurisdiction. This is obviously a major

barrier to recovering stolen assets, and those countries that have such limitations should urgently address them.

Table 5.1. **How do OECD member countries perform against legal best practice?**

	Ratified or acceded to UNCAC	New asset recovery laws	Rapid freezing (48 hours)	Direct enforcement of foreign confiscation orders	Non-conviction based confiscation law	Recognise foreign Non-conviction based confiscation orders	Foreign countries can initiate civil action in domestic courts	Courts can order compensation, restitution or other damages to a foreign jurisdiction
Australia	●	●	●	●	●	●	■	■
Belgium	●	■	●	■	■	■	●	
Canada	●	●	●	●	●	●	●	●
Denmark	●	■	●	■	■	■	●	●
France	●	●	■	■	■	●	●	●
Germany	■	■	●	■	■	■	●	●
Israel	●	●	■	●	●	●	●	●
Italy	●	●	■	●	●	●	●	●
Japan	■	■	■	●	■	■	●	■
Luxembourg	●	■	●	■	■	■	■	●
Netherlands	●	●	●	■	■	■		
New Zealand	■	■	■	●	●		■	●
Norway	●	■	●	●	■	●	●	●
Portugal	●	●	●	●	●	●	●	●
Slovak Republic	●	●	●					
Spain	●	■	■	■	■	■	●	●
Sweden	●	■	■	■	○	■	●	●
Switzerland	●	●	●	●	●	●	●	●
United Kingdom	●	■	■	●	●	●	●	●
United States	●	●	■	■	●	●	●	●

Note: ●: yes ; ■: no ; ○: limited ; ■: EU only. This table is based on responses to the StAR/OECD questionnaire. Responses were not received from the Czech Republic (also has not ratified the UNCAC), Estonia, Finland, Greece, Hungary, Iceland, Ireland, Korea, Mexico, Poland, Slovenia, Turkey.

Source: OECD/StAR 2012 survey of OECD member countries.

In addition to national laws, new EU-wide legislation on asset recovery is in the process of being formulated. In March 2012, the European Commission proposed a new directive on asset recovery, introducing minimum rules to which EU member countries must adhere. The proposed directive aims to make it more difficult for criminals, including corrupt political leaders, to hide assets in EU countries. It will, for example, allow confiscation of criminal assets where a criminal conviction is not possible because the suspect is deceased or has fled (limited non conviction-based confiscation). It will also ensure that authorities can temporarily freeze assets that risk disappearing if no action is taken (precautionary freezing). Moreover, it calls for the systematic collection of data on asset confiscation and recovery.

Effective institutional frameworks for asset recovery

From an operational perspective, nothing can be achieved without having sufficient technical and legal expertise in place to handle asset recovery cases. Such cases are complex and require highly specialised investigative and legal expertise, which is often scattered across different agencies. Countries are recommended to put in place specialised units with trained practitioners and adequate resources to focus on pursuing corruption and international asset recovery cases.

The institutional frameworks for asset recovery are set up in a number of different ways across OECD member countries. Some countries have established specialised multi-agency units for investigating, tracing and recovering stolen assets. Australia, for example, has set up the multi-agency Criminal Asset Confiscation Taskforce, which investigates corruption and international asset recovery cases. The taskforce combines the resources and expertise of the federal police, crime commission, taxation office and public prosecutions. This enables a confiscation strategy to be tailored to each individual case, whether through proceeds action, tax remedies, civil debt recovery or recovery through international co-operation with foreign law enforcement and anti-corruption agencies.

In other countries, asset recovery efforts are placed in one location, such as the Department of Justice's Asset Forfeiture and Money Laundering Section in the United States, which has a team of attorneys and investigators focused on investigating and recovering assets linked to international corruption.

In some OECD member countries, specialised units can be found across several institutions. Germany, for example, has specialised units for asset recovery in the Federal Office of Justice, the Federal Criminal Police Office, the prosecution offices, and the police forces (both federal and state), and in other services (e.g. customs). These are all resourced by an Asset Recovery Fund.

Other member countries have separate teams dealing with corruption and asset recovery. In the Netherlands, asset recovery falls under the remit of the Criminal Asset Deprivation Bureau Public Prosecution Service, while corruption is fought by the National Public Prosecutor's Office, the National Police Internal Investigation Department and the Fiscal and Economic Intelligence and Investigation Service. In Sweden, a National Anti-Corruption Unit has been placed within the prosecution authority and a National Corruption Group is situated within the national police authority. Finally, in the United Kingdom, the Proceeds of Crime Unit is placed in the Serious Fraud Office, and two specialised investigative units focusing on corruption in developing countries are based in the Metropolitan Police Service and the City of London Police. The United Kingdom also has a specialised prosecution unit based in the Crown Prosecution Service.

Having in place specialised and designated units for asset recovery is also a good way of tackling one of the greatest challenges to recovering stolen assets: effective international co-operation. At the multilateral level, several policies and initiatives have been enacted to facilitate international co-operation in asset recovery (Box 5.3).

Box 5.3. **Initiatives for international co-operation on asset recovery**

Recognising the need for efficient international co-operation and rapid exchange of information between countries in the European Union, a 2007 European Council decision requires all EU countries to establish a national Asset Recovery Office (ARO).[1] These AROs are designated points of contact responsible for exchanging information and best practices, both upon request and spontaneously, between EU countries. G8 members have also recently pledged to promote effective international co-operation on asset recovery. Through the Action Plan on Asset Recovery, G8 members are obliged to designate or appoint an office or person responsible for inquiries, guidance or other investigative co-operation permitted by law (G8, 2012).

International networks on asset recovery also facilitate international co-operation. The Global Focal Point Initiative on Asset Recovery, created by StAR and INTERPOL, was established in 2009. It is an international pooling of resources and expertise for asset recovery with up to two focal point experts for each of INTERPOL's members. Another international network in the area of asset recovery is the Camden Assets Recovery Interagency Network (CARIN), an informal inter-agency network represented by a law enforcement officer and judicial expert from each of its members. All but five OECD member countries are either members or observers of this network.

Note: 1. Council Decision 2007/845/JHA of 6 December 2007.

Adequate resources for asset recovery

Effective asset recovery requires sufficient investment, both financially and in staff. The needs vary by country, but generally include training for law enforcement officers and others working on asset recovery, adequate dedicated staff with sufficient expertise and funding to carry out the work effectively. The actual investment made in asset recovery efforts is a clear reflection of political will. According to the 2010-June 2012 OECD/StAR survey, most OECD member countries have invested in training, staffing and funding. Other investments include the establishment of an information-sharing platform on foreign bribery in Japan, and anti-corruption training organised by British embassies for companies and embassy staff. In some countries, such as the Netherlands, foreign corruption-related asset recovery is part of wider efforts to recover assets from international crimes, making it difficult to gauge the resources invested in recovering stolen assets.

Since asset recovery efforts are generally quite expensive, some countries have come up with innovative ways of financing them. For example, the United Kingdom's Proceeds of Crime Unit in the Serious Fraud Office – dedicated to identifying the extent and whereabouts of criminal benefit – has for the past two years been funded by the Asset Recovery Incentivisation Scheme. This scheme is a government strategy to improve activity and performance in tackling proceeds of crime work within the criminal justice system. The beneficiaries of the scheme include investigation agencies, prosecutors and the court. The scheme is financed from receipts of recovered assets, net of compensation to victims and costs incurred in enforcement (both conviction and non conviction-based forfeiture orders).

The costly nature of asset recovery also requires discussion about cost-sharing mechanisms. Developing countries may have few additional resources to dedicate to this issue, given their tight fiscal situation, and a discussion about proper cost-sharing arrangements may be timely.

Collect statistics to measure results

To ensure that asset recovery policies, laws and institutions are effective and that international commitments are fulfilled, countries should collect information and statistics on corruption and asset recovery. Developing a set of metrics for measuring progress in asset recovery efforts is a good idea as it can aid communication between the financial centre and government authority. In the first OECD/StAR survey (2006-09), most OECD member countries acknowledged they were having difficulty gathering data on asset recovery cases with an international component. In the second OECD/StAR survey (2010-June 2012), most countries reported that they still did not have a system in place for the systematic collection of data on international asset recovery cases, although some reported that they are working on it. Several countries reported that while data on asset recovery exist, it is not possible to distinguish cases linked specifically to corruption. For example, while the United Kingdom has a single database for asset recovery cases, it is not possible to differentiate corruption cases from other cases in the database because the offence for which corrupt individuals is convicted may not, in itself, indicate that it is an overseas corruption case.

What steps can developing countries take?

As with the issues covered in the other chapters of this report, asset recovery will only be effective with the proactive co-operation and leadership of developing countries. For a start, developing countries must take the lead in investigating and initiating the search for stolen funds and then request for and effectively engage in mutual legal assistance. Asset recovery will not work if destination countries are somehow expected to be responsible for the entire asset recovery process, from case initiation to investigation and return of assets. Authorities in developing countries also have to show a real commitment to fighting corruption and to bringing to justice their nationals found guilty of corruption and theft of funds. Finally, a debate needs to be held on the best way of managing repatriated funds. Given the important symbolic effect of repatriating stolen assets, authorities have an interest in demonstrating that returned funds are spent in a way that ensures the maximum benefit for their populations.

Key findings and observations

For OECD countries

- Adopt clear, comprehensive, sustained and concerted strategies and policies for asset recovery. This will signal political commitment and empower authorities to take action and create legislation.
- Put in place adequately resourced and trained specialised units for international asset recovery.
- Ratify the UNCAC and the UNTOC, if not already done, and ensure effective legal frameworks for asset recovery.
- Strive to adhere to international legal best practices for the rapid tracing, freezing and return of stolen assets; to allow non conviction-based asset confiscation/ forfeiture; to permit authorities to freeze funds based on a request from a foreign jurisdiction; to allow foreign countries to initiate civil actions in their courts; and

to permit courts to order compensation, restitution or damages to the benefit of a foreign jurisdiction.

- Invest in human resources and capacity building.
- Collect information and monitor progress on matters concerning international corruption and asset recovery.
- Enhance communication on asset recovery with other jurisdictions and actively participate in international fora on asset recovery.
- Provide technical assistance, capacity-building support and case assistance to help other countries effectively deal with asset recovery.

For developing countries

- Request and engage in mutual legal assistance and demonstrate visible commitment to combating corruption, bringing to justice those found guilty of corruption and theft of public resources.
- Examine, in collaboration with source countries, the best options for managing returned funds, keeping in mind the important signalling effects to the public.
- Discuss with developed countries proper cost-sharing arrangements for asset recovery cases.

Notes

1. Exchange rates are based on averages (2008-12) for all currencies except for the euro, which is based on an average exchange rate over 2010/11. Sources: World Bank, http://data.worldbank.org/indicator/PA.NUS.FCRF and Internal Revenue Services, www.irs.gov/Individuals/International-Taxpayers/Yearly-Average-Currency-Exchange-Rates.

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Chapter 6

Role for development agencies in combating illicit financial flows from developing countries

Combating illicit financial flows (IFFs) from developing countries is an increasingly important area of work for development agencies. This chapter highlights current initiatives by bilateral development agencies to tackle corruption and money laundering, reduce tax evasion and avoidance, and support civil society efforts to deal with IFFs. The scale of donor support is relatively modest and development agencies are not exploring the full range of options for supporting this complex agenda. Development agencies could play a greater role mainly on the ground in developing countries where they must continue to help build technical expertise and the capacity to negotiate and use exchange of information agreements, tackle abusive transfer pricing and investigate economic crime. They should also support civil society organisations in holding governments to account and generating pressure for reforms. They could also support further research into illicit financial flows, maintain political momentum within OECD countries to ensure that current reforms have a development dimension and undertake proper risk assessment to target aid to where it is most needed.

Introduction

International economic and financial crime has not traditionally been a priority area of work for development agencies. However, this is changing with the heightened focus on IFFs and their adverse effect on developing countries. Several development agencies have recently entered the IFF policy space, and have done so in a variety of ways.

This chapter gives a snapshot of recent and current action to tackle illicit financial flows being undertaken by bilateral development agencies and others, financed through Official Development Assistance (ODA). It does not attempt to provide an exhaustive catalogue of all support, rather it aims to show some innovative ways in which development agencies have helped shape this agenda and it outlines options for a scaled-up role for development agencies on the IFF agenda in the future. Many multilateral agencies are also active and sometimes take the lead in some parts of the IFF agenda.

The 2011 OECD/StAR progress report on asset recovery recommends all development agencies to "think outside the box" and consider innovative ways to support their own domestic efforts to advance the IFF policy agenda (OECD and the International Bank for Reconstruction and Development/The World Bank, 2011). This is also the purpose of the "International Drivers of Corruption" analytical tool, which asks donors to step outside of their comfort zone and use a wider range of levers to combat corruption (OECD, 2011). This chapter proposes some ways development agencies can bring a development angle to a policy issue that is primarily led by other actors.

How is official development assistance being used to fight illicit financial flows?

Tackling corruption and money laundering

Since development agencies turned their attention to the importance of good governance in the 1990s, ODA has been used to fight corruption in a number of ways, from supporting research and advocacy efforts to ensuring that aid itself is not subject to leakages. The more recent IFF agenda adds a fresh layer to the traditional anti-corruption packages provided by donors by turning attention to issues which require action on the part of both developed and developing countries – and effective international co-operation between the two. Some experience shows that investing in anti-corruption efforts can have positive effects. OECD DAC donor experience suggests that for each USD 1 spent on investigating the proceeds of corruption originating from the developing world and transferred to OECD countries, up to USD 20 has been tracked and frozen, with a significant proportion of that sum repatriated to the treasury of the developing country in question – an impressive rate of return.

A number of DAC development agencies finance projects in developing countries to help law enforcement institutions improve how they deal with cross-border crime, corruption and money laundering. In some cases, development assistance is used to support specialised expertise from other agencies in the donor country. For example, the United States' Kleptocracy Initiative – implemented by the Department of Justice and funded by the United States Agency for International Development (USAID) – places US prosecutors in prosecuting authorities in developing countries (Holder, 2012). Similarly, the United Kingdom has used funding from its Department for International Development (DfID) to finance institutions responsible for fighting corruption in several developing countries. In Nigeria, for example, DfID has allocated over GBP 5 million over 7 years to Justice for All, a project to increase investigation and prosecution capability in the

Nigerian justice sector, including its anti-corruption agencies.[1] A project titled "Fight Against Organized Crime and Corruption: Strengthening the Prosecutors' Network" supports prosecutors in the Western Balkans.[2] This project was financed by the German Federal Ministry for Economic Co-operation and Development (BMZ), channelled through the EU Instrument for Pre-Accession Assistance, and implemented by the German Agency for International Co-operation (GIZ) as the lead organisation. By seconding prosecutors from various EU member countries, the project has helped develop capacity for fighting organised crime and corruption in the Western Balkans and has also helped to improve cross-border co-operation within the region.

Another approach has been for development agencies to bring corruption champions together to share ideas and experiences. The Corruption Hunter Network was founded in 2005 with the help of the Norwegian Agency for Development Co-operation (Norad). The network comprises investigators and prosecutors from different countries, who meet twice a year to share experiences (Davis, 2010). In 2010, the World Bank hosted the first meeting of the International Corruption Hunters Alliance, bringing together more than 200 anti-corruption officials from over 130 countries (International Corruption Hunters Alliance, 2010). This event is scheduled to take place every two years and has been financed by development assistance from Australia, Denmark and Norway. A second meeting took place in 2012.

A recent innovation is to use development assistance to strengthen donor country institutions to fight corruption and money laundering in developing countries (Box 6.1).

Despite these initiatives, donor support for combating fraud and corruption, including complex issues of economic and financial crime is relatively modest. One reason for this is that many recipient countries do not yet prioritise such issues, although this is starting to change. There is no accurate way of measuring the exact levels of ODA support for combating the various economic and financial crimes which make up the illicit flows phenomenon and there is also no ideal level of support that donors should aspire to. What matters is whether donors look for opportunities to support this agenda and are willing to use aid in smart ways to address issues that will have a positive impact on developing countries, and whether they are responsive when recipient governments indicate such issues as priorities.

Numbers from DAC statistics can help illustrate how donors spend ODA funds on IFF-related programmes. The sector "Government and Civil Society" in the DAC sector classification captures ODA targeting governance work, including support to fighting IFF. In 2011, total support to this category reached USD 14.2 billion (approximately 11% of total ODA). Figure 6.1 shows the breakdown by sub-category and their relative weight. Donors have been reporting support to anti-corruption organisations and institutions as a sub-category since 2009.

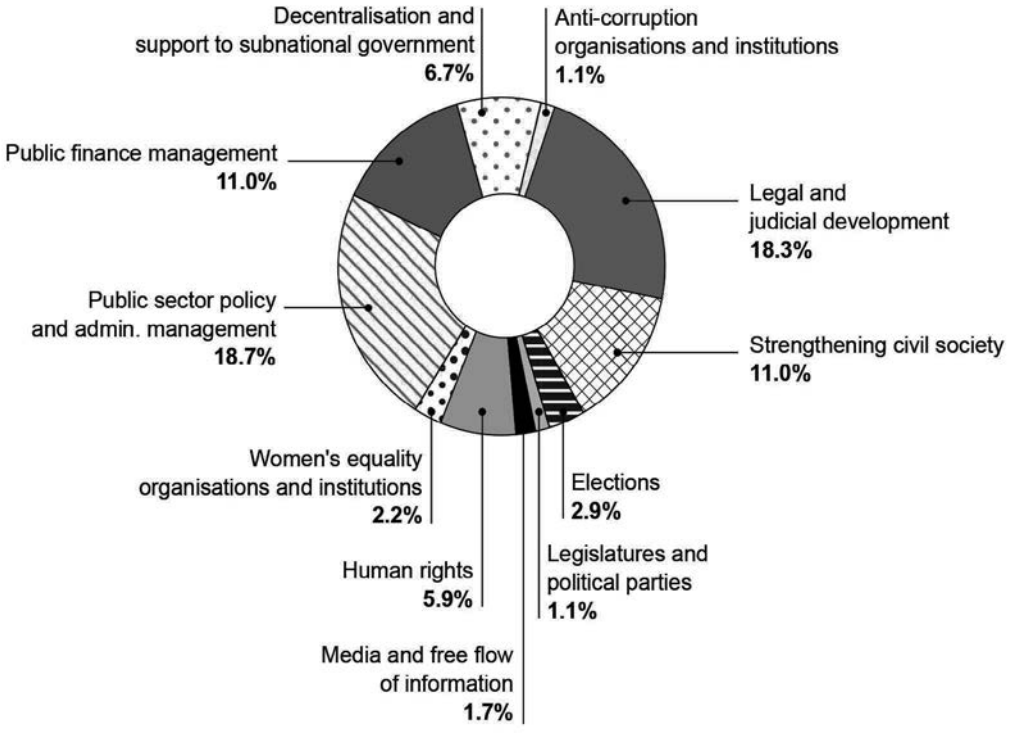
In 2011, USD 188 million was spent on anti-corruption organisations and institutions (1.1% of total spending in the governance category). Public financial management (USD 1.9 Bn/11% of total spending in the governance category) is another sub-category that would capture some IFF-related support, through the strengthening of public financial management (PFM) systems, including in some cases bank supervision, anti-money laundering-related issues, customs and border controls, strengthened tax systems, etc. Support to legal and judicial development (USD 3.2 Bn/18.3% of total spending in the governance category) helps to build the capacity of judicial authorities to investigate and prosecute economic and financial crimes. Finally, support to civil society (USD 1.9 Bn and 11% of total spending in the governance category) and the media

(USD 305 Mn/1.7% of total spending in the governance category) can also help national actors to investigate illegal activities and advocate for reforms.

Reducing tax evasion and avoidance

Recent research on taxation and development has shown that many developing countries are unable to respond to tax evasion and tax avoidance effectively, and are weak at negotiating exchange of information agreements and establishing effective transfer pricing legislation (see Chapter 3 for definitions, plus Leite, 2012; EuropeAid, 2011). Development agencies have a role to play in this area, both in financing projects in developing countries and in backing up the IFF agenda in their home countries. Experience shows that the return on tax-related investment, in terms of benefits for developing countries, is significant. Although not specifically targeted at IFF, donor support worth USD 5.3 million between 2004 and 2010 to improve tax collection in El Salvador led to increased revenues of USD 350 million per year. Approximately USD 15 000 of support for capacity building in the area of transfer pricing by the OECD Tax and Development Programme to Colombia led to an increase in revenues from USD 3.3 million in 2011 to USD 5.83 million in 2012 (a 76% increase). This is a rate of return of approximately USD 170 of revenue per USD 1 spent.

Figure 6.1. **Official Development Assistance support to the sector "Government and civil society" in the DAC sector classification (2011 data)**



To date, several development agencies have provided technical assistance and other support to developing countries' tax authorities. For example, in 2011 Norway launched the Taxation for Development Programme, which capitalises on Norway's own experiences with natural resource governance to help resource-rich developing countries improve their tax collection. Apart from technical assistance, the programme also focuses on providing research, spurring public debate and improving co-operation at the

international level in the areas of taxation and capital flight.[3] In Tanzania, for example, Norway has funded an in-depth study on IFF conducted by the country's central bank. In Zambia, Norway is supporting the renegotiation of contracts between the Zambian government and large multinationals in the mining sector. In the Zambian case, Norwegian development assistance has, among other things, financed the audits of three mining companies to determine whether their transfer pricing practices are in line with international standards.[4] Norway has also helped set up a financial intelligence unit in that country. According to the Zambian authorities, each of the transfer pricing audits has led to adjustments in taxable income by the companies. Again, although not strictly targeted at combating IFFs, these make a compelling case for ODA to be used as a catalyst for institutional development in the tax field.

Canada has financed a project in Bolivia to ensure that natural resource revenues stay in the country. In this case, the Canadian International Development Agency (CIDA) financed the project while the Canada Revenue Agency provided assistance to establish a specialised unit in Bolivia responsible for collecting and managing taxes paid by oil and gas companies.[5]

Norway is also leading the field in using development assistance to support the IFF policy agenda at home. Following its 2009 report, "Tax havens and development", the Norwegian government established a working group and a forum of vice ministers to address IFF issues. In addition, it launched the dialogue project Capital and Development and provided grants to organisers of public debates on IFF and development (Fiskaa, 2011).

Finally, apart from financing specific projects, a number of donors have supported the IFF agenda more indirectly by funding various organisations specialised in providing assistance. For example:

- the German government is one of several donors which has used development assistance to finance the International Tax Compact (ITC)[6]
- several donors have contributed extensive financial support to the African Tax Administration Forum (ATAF)[7]
- the research-based International Centre for Tax and Development (ICTD)[8] has been financed by DfID and Norad.

While these examples show that development agencies have been active in tackling tax evasion in developing countries on many fronts, as with support to anti-corruption and money laundering, the level of donor support remains low. Data from DAC statistics suggests that only about 0.1% of total ODA goes to tax-related activities. However, the exact scale of this type of assistance is difficult to estimate because tax is not specifically identified in the DAC sector classification (the Creditor Reporting System or CRS). Thus any tax-related activities that are part of broader projects may not be reported as tax-specific activities. In addition, since most bilateral development agencies run tax projects out of country or regional offices, there is usually none within the agencies with an overview of all the tax projects in which that agency is involved (Michielse and Thuronyi, 2010).

A recent study by the ITC found just 157 entries in the OECD/ DAC's CRS database relating to taxation (out of 200 000 entries) for 2009 (International Tax Compact, 2011a). It is difficult to know whether these 157 entries include existing activities in taxation, especially if tax is just part of a broader donor project, such as public sector reform. The

International Tax Dialogue's *Technical Assistance Database* may help (www.itdweb.org).

Supporting civil society efforts in tackling illicit financial flows

In addition to the sort of direct donor interventions described above, many development agencies have also chosen to engage in the IFF agenda by funding civil society organisations active in knowledge development and advocacy around IFF issues.[9] One of the most visible of these organisations is Global Financial Integrity (GFI). Its work on trying to measure the scale of IFF has encouraged others to respond with their own attempts at complementing or refuting these findings. The Task Force on Financial Integrity and Economic Development is a coalition of non-governmental organisations (NGOs) and more than 50 governments which advocate on a number of targeted IFF issues. In particular, it focuses on country-by-country reporting for companies, improved enforcement against trade mispricing, automatic exchange of information and harmonising predicate offences (i.e. underlying or related crimes such as drug trafficking) for money laundering. Global Witness has published extensively on issues related to corruption and natural resource management, as has the U4 Anti-Corruption Resource Centre. Finally, the Tax Justice Network, Christian Aid, Oxfam and Action Aid are some of the more active NGOs on the IFF agenda.

There are also some NGOs with specialised technical and legal expertise. Switzerland, for example, works proactively on the recovery of illicit assets from developing countries through the International Centre for Asset Recovery (ICAR).[10] ICAR is part of the Swiss-based Basel Institute on Governance and specialises in strengthening the capacities of countries to recover stolen assets.

Finally, many donors support civil society efforts to curb corruption and economic crimes in developing countries. Some support goes to international NGOs with local branches in developing countries. Transparency International is perhaps the best-known international organisation in the fight against corruption. With over 100 local branches, it combines local anti-corruption action with international research and advocacy. Various international organisations with a presence in developing countries focus especially on promoting accountability and fighting corruption in the extractive industries. Publish What You Pay, for example, has national affiliated campaigns in 35 countries, and the Revenue Watch Institute provides financial and technical support to more than 50 partner organisations. The International Budget Partnership is another international NGO, which assists a large network of civil society organisations (CSOs) around the world in fighting corruption through reforming government budget systems.

There are also an increasing number of capable and respected local CSOs and media actors in developing countries. Local CSOs – such as the Angolan organisation Maka Angola,[11] which collects and investigates claims by Angolan citizens of corruption and abuse of power – have in-depth local knowledge. This makes them important allies in raising issues of corruption and economic crimes on domestic policy agendas. Pressure for reform in developing countries is likely to come from local voices supported by international CSOs, which may be more visible on the agenda at the international level.

Supporting transparency initiatives

Finally, DAC donors support a number of transparency initiatives (Table 6.1). By advocating for greater transparency and better standards for reporting relevant financial

information, these initiatives can play an important part in curbing illicit finance. Some of these initiatives focus on enhancing transparency in specific sectors, such as the extractive industries. Other initiatives, notably the Oslo Dialogue on Tax and Crime and the Group of States Against Corruption, are issue-based initiatives working to curb tax crimes and corruption respectively. Finally, the Open Government Partnership and the Global Forum on Transparency and Exchange of Information for Tax Purposes are broad-based international initiatives bringing governments together to agree on international best practice on transparency and to monitor compliance with set standards.

Table 6.1. **Overview of DAC support to leading transparency initiatives**

Country	Oslo Dialogue	EITI	GF	OGP	KP	IAITI
Australia	●	●	●	■	●	●
Austria	●	■	●	■	●	■
Belgium	●	●	●	■	●	●
Canada	●	●	●	●	●	●
Denmark	●	●	●	●	●	●
Finland	●	●	●	●[2]	●	●
France	●	●	●	■	●	■
Germany	●	●	●	■	●	●
Greece	●	■	●	●	●	■
Ireland	●	■	●	■	●	●
Italy	●	●	●	●	●	■
Japan	●	●	●	■	●	■
Korea	●	■	●	●	●	■
Luxembourg	●	■	●	■	●	■
Netherlands	●	●	●	●	●	●
New Zealand	●	■	●	■	●	●
Norway	●	●[1]	●	●	●	●
Portugal	●	■	●	■	●	■
Spain	●	●	●	●	●	●
Sweden	●	●	●	●	●	●
Switzerland	●	●	●	■	●	●
United Kingdom	●	●	●	●	●	●
United States	●	●	●	●	●	●
	● Yes					
	■ No					
Source:	Launch Closing Statement	EITI Website	OECD Website	OGP Website	KP Website	IAITI Website

Notes: 1. Norway is also an EITI Compliant Country. 2. Finland is developing commitments. Oslo Dialogue: the Oslo Dialogue on Tax and Crime. EITI: Extractive Industries Transparency Initiative. GF: Global Forum on Transparency and Exchange of Information. OGP: Open Government Partnership. KP: Kimberley Process for combating conflict diamonds. IATI: International Aid Transparency Initiative.

Multilateral initiatives to tackle illicit financial flows

Aside from the efforts of bilateral development agencies which are the focus of this section, multilateral development agencies are playing an important role in combating illicit flows from developing countries. The World Bank, the International Monetary Fund, several UN agencies including the UNODC, the UNDP and UNECA, as well as the European Commission, are all actively involved in different aspects of the illicit financial flows agenda. Multilaterals have helped to move the policy agenda forward significantly. Their activities span a broad range, including academic contributions to the research and

knowledge agenda on illicit financial flows and technical assistance on topics such as money laundering, transfer pricing and corruption. In addition, several OECD groups and divisions work on different aspects of illicit financial flows, including the Working Group on Bribery, the OECD Centre for Tax Policy and Administration, and the DAC Anti-Corruption Task Team. South-South co-operation is organised by organisations such as the Inter-American Center for Tax Administration (CIAT) or the Africa Tax Administration Forum (ATAF).

What next for development agencies?

Now that political momentum has been built, the next step is to implement the IFF agenda on an operational level. This will require action by both OECD and developing countries. Part of the immediate action needs to happen in OECD countries, led by institutions responsible for the implementation of the relevant global standards, such as ministries of justice, tax authorities and central banks. While development agencies do not generally take the lead in this work, their role can nevertheless be useful if well targeted, as the DfID experience in supporting home-based anti-corruption institutions shows (Box 6.1). In some cases, agencies will need to provide specialised and targeted advice and expertise to accompany developing countries through the process of requesting or providing mutual legal assistance (i.e. legal co-operation between countries).

Box 6.1. **The International Corruption Group**

The United Kingdom uses ODA to finance the International Corruption Group (ICG), made up of the City of London Police, the Metropolitan Police and the Crown Prosecution Service. The aim is to strengthen the capacity of these three institutions to bring corruption cases to prosecution. The targets here are United Kingdom citizens and companies active abroad, as well as foreign politically exposed persons active in the United Kingdom. While the inter-agency collaboration under the ICG ensures that investigative and judicial resources are channelled to fighting corruption, the financial contributions from DfID ensure that fighting international corruption does not compete with resources earmarked for fighting crime in the United Kingdom. In addition to financing the ICG, DfID also takes part in the United Kingdom government's cross-departmental Politically Exposed Persons Strategy Group, which works to improve coherence across government departments on issues concerning money laundering.

Source: Fontana, A. (2011), "Making development assistance work at home: DfID's approach to clamping down on international bribery and money laundering in the UK", *U4 Practice Insight*, No. 2011:5, U4 Anti-Corruption Resource Centre, Bergen, Norway, available at www.u4.no/publications/making-development-assistance-work-at-home-dfid-s-approach-to-clamping-down-on-international-bribery-and-money-laundering-in-the-uk.

Development agencies are likely to play a greater role on the ground in developing countries, where they must continue to help build specific technical expertise and capacity.

- Building up relevant capacities in development agencies: Relatively few development agencies have staff with knowledge of economic and financial crimes, although some have recently built up some capacity on the taxation side. Donors wishing to increase their engagement on this agenda may want to hire staff with relevant technical skills, as this is a crucial and perhaps obvious step for

engaging with other institutions at home and in developing countries. Having staff that understand money laundering and other economic/financial crime issues in some depth is necessary in order to effectively engage in current debates around illicit flows and to maintain a balanced and objective view.

- Building investigative capacities to tackle economic crime in developing countries: Combating illicit flows and corruption in all its forms must start in developing countries. The capacity of law enforcement authorities to investigate and prosecute economic criminality is often quite limited. Building or making such capacity available to developing countries is essential for engaging in mutual legal assistance with OECD countries when investigating, prosecuting and sanctioning all forms of economic crime, whether it is tax evasion, money laundering or corruption.
- Building political commitment to combat economic and financial crimes in developing countries: Combating illicit flows from developing countries requires serious commitment to reform and strengthen key institutions and systems. Yet governance weaknesses in many developing countries mean that the level of commitment varies greatly over time and amongst institutions. Donors can help build political commitment by supporting committed institutions and actors, raising relevant issues in their political dialogue with partner countries, and supporting the capacity of the increasingly capable and vocal CSOs in developing countries. These have been central to holding leaders to account.
- Developing exchange of tax information agreements: Chapter 3 shows that although exchange of information is an important element in fighting tax evasion and recovering funds, relatively few developing countries have a network of treaties or exchange of information (EOI) agreements in place, and many are new to applying global standards on exchange of information for tax purposes. Development agencies can help developing countries build capacity in the use of existing instruments, working with the Global Forum on Transparency and Exchange of Information for Tax Purposes.
- Building transfer pricing capacity: Developing countries generally have an insufficient legislative and regulatory framework on transfer pricing (TP) and limited capacity to audit multinational companies. Transfer pricing is a grey area between avoidance and evasion. Where there is concern about potential abusive transfer pricing, development agencies can help develop or improve the national legislative and regulatory framework, and build the necessary technical expertise. Donors can provide helpful technical support to countries for carrying out audits and support tax authorities in preparing cases. The OECD's Tax and Development Programme work on TP in collaboration with the World Bank, the European Commission and other DAC donors is showing real results. The proposal for Tax Inspectors Without Borders (TIWB) is another important development.
- Research on illicit financial flows: The magnitude and relative importance of the various types of illicit flows as well as the channels and methods used are still poorly understood. There is a need to move the knowledge frontier forward, especially at the country level. Some country case studies are underway but further work is needed. In particular, academic institutions could inject additional

methodological rigour into this process, which has until now been dominated by CSOs, and donors should consider providing more support to them.

- Maintaining political momentum within OECD countries: Advocacy CSOs and coalitions will continue lobbying OECD governments to do more to tackle IFFs, but development agencies engage in internal policy dialogue within their own countries. OECD country-specific risk assessments/reports could be one option, whereby countries would provide an assessment of their risk profile as recipients of illicit flows, including data on estimates where this exists, and possible counter measures. Development agencies could team up with universities, think tanks and other ministries to engage in such work.
- Ensuring a development dimension in current efforts: Many of the reforms proposed on issues such as asset recovery and money laundering are necessary and beneficial for OECD countries but their benefits for developing countries may be undermined by limited capacity and by subsequent difficulties in engaging in effective international co-operation. This has been the case for asset recovery – where there has been some general progress but where until recently very few cases involved developing countries. The decision by DfID to finance additional legal and technical expertise in institutions in the United Kingdom has produced results for developing countries. Other donors may want to look at this model for inspiration.
- Undertaking proper risk assessments in developing countries: Finally, at the country level, policy priorities should be based on a comprehensive risk assessment which examines the prevalence of an entire set of economic and financial crimes, including their likelihood and impact. Such analysis should then determine appropriate responses, assigning scarce resources to those issues that matter most.

Notes

1. For more details see http://projects.dfid.gov.uk/project.aspx?Project=114161.
2. For more information see the GIZ website: www.giz.de/en/mediacenter/3506.html.
3. For more information see the ICTD website: www.ictd.ac/en/news/norway-tax-programme.
4. See the Norad Report "Tax for Development" for additional information: www.norad.no/en/tools-and-publications/publications/norad-reports/publication?key=396280.
5. For details see: www.acdi-cida.gc.ca/CIDAWEB/cpo.nsf/vWebProjByStatusSCEn/014B99C2BF3725CF8525713F0008A894.
6. www.taxcompact.net.
7. www.ataftax.net.
8. www.ids.ac.uk/project/international-centre-for-tax-and-development.
9. www.ids.ac.uk/project/international-centre-for-tax-and-development.
10. www.assetrecovery.org/kc.
11. http://makaangola.org/?lang=en.

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