Asia/Pacific Group
on Money Laundering

APG / FATF

ANTI-CORRUPTION / AML/CFT[1]

RESEARCH PAPER

Prepared for the FATF/APG Project Group on Corruption and Money Laundering
by Dr. David Chaikin and Dr. Jason Sharman

September 2007

[1] **Anti-Money Laundering / Combating Financing of Terrorism**

TABLE OF CONTENTS

EXECUTIVE SUMMARY

1. This Report is provided for the FATF/APG Anti-Corruption/AML/CTF Issue Project Group. It investigates the links between corruption and money laundering, which traditionally have been studied in isolation. Although many multilateral organisations and countries have expressed interest on looking at the money laundering-corruption nexus, apart from this Report there is as yet little systematic research on the topic.

2. Corruption generates more than USD 1 trillion of illicit funds annually which are laundered both domestically and increasingly in the international financial system. At the same time corrupt practices undermine AML/CFT systems. This Report was tasked with shedding light on this relationship, and making recommendations on how to enhance the effectiveness of AML/CFT systems by protecting their integrity, and ascertaining the potential contribution of AML/CFT systems to anti-corruption strategies.

3. There are standard corruption prevention measures which can be applied FIUs. But more serious threats to the integrity of the AML/CFT system are posed by corruption in the general criminal justice system, and the presence of unregulated Corporate Service Providers, particularly where anonymous corporate vehicles are available. Corruption among private sector reporting agencies also represents a serious threat to AML/CFT effectiveness, and in general countries should criminalise private sector corruption taking heed of International Chamber of Commerce guidelines and Hong Kong,China's experience.

4. The most serious omission in dealing with PEPs is the failure to apply enhanced scrutiny to domestic PEPs in line with the requirements of the UNCAC. In addition the narrow coverage of the FATF's PEPs definition means that it is no longer best international practice, and has fallen behind standards in the financial services industry.

5. The Report contains a series of recommendations for improving international co-operation in countering corruption and money laundering. Dual criminality in extradition proceedings should be governed by the conduct test, and immunities for public office-holders should be abolished. Asset recovery should compensate the 'victim' country, and officials should avail themselves of the full range of conviction-based, non-conviction-based and civil confiscation methods in recovering assets.

6. Currently the potential of the AML/CFT system to counter corruption is gravely under-exploited. At present the great missed opportunity revealed by this Report is the under-utilisation of AML/CFT systems for anti-corruption purposes. In this area significant gains can be had with little or no extra commitment of resources, especially in developing countries. Through legislation, the establishment of financial intelligence systems, and the creation of specialised anti-money laundering bodies, countries have also provided themselves with potent anti-corruption instruments. At present, however, these instruments generally go unused.

7. This missed opportunity is in large part the result of an excessively narrow conception of the proper function of the AML/CFT system, whereby FIUs generally have little interaction with anti-corruption bodies, and vice versa. The tendency for these two kinds of agencies to remain compartmentalised and operationally isolated from each other persists even in the face of the World Bank's conclusion that for many countries corruption offences are probably the main predicate offence for money laundering. The Report sets out a number of recommendations concerning training and resource gaps to deal with the disconnect between AML/CFT and anti-corruption efforts.

BACKGROUND AND CONTEXT

8. In late 2003 the Asia-Pacific Group on Money Laundering (APG) Typologies Workshop in Kuala Lumpur focused on corruption-related money laundering issues for the first time. The APG Workshop agreed on a program of work, including a survey and typology, with the goal of preparing a Scoping Paper to identify a range of key issues related to the money laundering-corruption nexus in the Asia-Pacific region.

9. As a result of the work undertaken by the 2003 APG Typologies Workshop, Hong Kong,China and Pakistan, under the auspices of the Typologies Working Group, undertook to co-operate with all APG members to prepare a Scoping Paper that would consider:

- Typologies of corruption-related money laundering.
- Current measures to combat corruption-related money laundering.
- Challenges and opportunities for combating corruption-related money laundering.

10. APG members were asked to provide detailed information on existing legislative measures to combat inter-linked instances of money laundering and corruption, further case studies of related typologies, and examples of practical steps to implement effective Anti-Money Laundering/Countering the Finance of Terrorism (AML/CFT) measures. A draft Scoping Paper was prepared in September 2004 on the basis of material provided by member jurisdictions.

11. Subsequently, the Typologies Working Group sought further detailed responses from jurisdictions on the definition of corruption, the type and nature of legislation in place, case studies relating to corruption and money laundering, and issues and challenges facing these jurisdictions. The resulting Scoping Paper provided an analysis of this material and presented key findings relating to methods and trends in corruption-related money laundering.

12. Parallel to this work, at the Joint Plenary Session of the Financial Action Task Force (FATF) and APG in Singapore in June 2005, the two organisations agreed to further jointly explore the relationships between AML/CFT and anti-corruption efforts, with particular reference to how corruption might undermine AML/CFT implementation.

13. The FATF and APG agreed to form a joint Project Group to carry out a study of the links between corruption and money laundering/terrorist financing, consider a range of options, and report back to the February 2006 Plenary meeting and to the APG ‘out of session’.

14. Following interest from a number of countries and organisations, the Project Group currently has the following members: Argentina, Australia, France, Hong Kong,China, India, Indonesia, Korea, Malaysia, Netherlands, Pakistan, South Africa, and Thailand; a number of other FATF-style regional groups (Eurasian Group [EAG], Eastern and Southern African Anti-Money Laundering Group [ESAAMLG], Financial Action Group of South America [GAFISUD], and Middle Eastern and North African Financial Action Task Force [MENAFATF]) as well as the Offshore Group of Banking Supervisors (OGBS), the Organisation for Economic Co-operation and Development (OECD) Working Group on Bribery, United Nations Office on Drugs and Crime (UNODC), the Council of Europe’s Group of States against Corruption (GRECO), and the World Bank.

15. It was decided that references to corruption should cover the following offences as defined in Articles 15-22 of the United Nations Convention Against Corruption (UNCAC):

- Active bribery of national public officials.
- Passive bribery of national public officials.

- Active bribery of foreign public officials and officials of public international organisations.
- Passive bribery of foreign public officials and officials of public international organisations.
- Embezzlement, misappropriation or other diversion of a property by a public official.
- Trading in influence.
- Abuse of functions or position by a public official for unlawful gain.
- Illicit enrichment by a public official.
- Bribery in the private sector.
- Embezzlement of property in the private sector.

16. FATF-XVI.PLEN/22.REV1 suggested that a detailed research paper be commissioned to provide an overview of the link between corruption and money laundering, and provide resource materials for any future work undertaken in this area. In February 2006, the FATF agreed to FATF-XVII.PLEN/38.REV1, which proposed three options for specific work to be undertaken by the Project Group, including the production of a Report studying the links between corruption and money laundering/terrorist financing.

17. In September 2006 tenders were issued for the Report, with a contract being issued to David Chaikin and Jason Sharman in November 2006. Chaikin and Sharman presented an update regarding progress on the Report at the Perth plenary of the APG in July 2007, with the project receiving strong endorsement from members and observers. The final version of the Report will be released at the October 2007 FATF plenary.

18. The main goals of this Report are to provide a better understanding of the links between corruption and money laundering, and to make recommendations on how to enhance the fight against these inter-related crimes.

CHAPTER 1: CURRENT INITIATIVES - MONEY LAUNDERING/ CORRUPTION NEXUS

Introduction and Summary

19. This chapter deals with the following terms of reference:

> 'Identifying existing material (avoiding duplication): Taking stock of previous and current work being undertaken by international and regional anti-corruption agencies in relation to Article 14 of the United Nations Convention Against Corruption (UNCAC), Article 7 of the OECD Convention on the Bribery of Foreign Officials and Article 13 of the Council of Europe Criminal Law Convention on Corruption and those sections of other anti-corruption agreements which relate to the FATF standards and identifying gaps that can be addressed by the Research Paper or by further work.'

20. The first priority identified for the Report was to provide coverage of existing initiatives dedicated to analysing the link between corruption and money laundering. The reasoning behind this was to avoid unnecessary duplication between the findings of this Report and extant literature on the subject. Beyond the need to avoid re-inventing the wheel, this chapter also aims to act as a resource in providing a succinct coverage of parallel, complementary work on the subject. Because of the sprawling and unco-ordinated nature of much of the relevant research and policy development in this area, it is not uncommon for organisations pursuing complementary goals to be unaware of the potential for productive intellectual exchange and cross-fertilisation between them; indeed, this same dynamic may even be observed within different sections of the same organisation.

21. To the extent that it can ameliorate the lack of awareness and co-ordination between different projects by providing a synopsis, it is hoped that this Chapter will assist in assisting the future planned studies of the money laundering-corruption link (discussed below) by eliminating the need to cover old ground. Because of the vast number and disparate nature of organisations and projects dealing with money laundering and corruption individually, however, this chapter does not claim to be exhaustive in dealing with these subjects (see, for example, the World Bank Public Sector Governance section's 131-page annotated bibliography on corruption research, *Literature Survey on Corruption 2000-2005*; notably, only one source contained is focused on the link with money laundering).

22. In terms of the sponsoring organisations, the APG *Scoping Paper on Money Laundering and Corruption* has been an invaluable resource for this Report, with the various findings dealt with in detail in the substantial chapters rather than being summarised here. Similarly, the FATF's work, particularly *Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, has been of great benefit to the authors. Rather than presenting a precis of this paper here, the Report reviews and endorses many of the findings of this paper in Chapter 2.

23. To summarise this chapter, a variety of organisations have declared that research and capacity building in response to the money laundering-corruption nexus is a key priority. Aside from the FATF and the APG, the World Bank, UNODC, APEC, OECD, ABD, ESAAMLG and GIABA have all committed themselves to research and/or capacity building in this area. So far, however, little work has been done on this topic. Aside from this Report, the publication of three reports by the World Bank and two by FATF-Style Regional Bodies on the money laundering-corruption link later in 2007 and early 2008 will greatly assist in helping to close this gap.

World Bank

24. The World Bank is currently conducting the most relevant work on money laundering-corruption linkages. The various component parts of the World Bank Group were instrumental in putting the issue of corruption on the policy agenda in the 1990s, and have produced a prodigious amount of pioneering work on this topic (see *Strengthening World Bank Group Engagement on Governance and Anticorruption* 21 March 2007). By one count, the Group has 11 separate anti-corruption programs.

25. The World Bank, like the International Monetary Fund (IMF), has had an AML/CFT role since late 2001. Rather than being a standard-setter in this area, the World Bank assesses compliance with the FATF 40+9 Recommendations. It does so through such programs as the Report on Observance of Standards and Codes and the Financial Sector Assessment Programs. In addition the World Bank provides technical assistance to its members to implement the Recommendations.

26. The World Bank has noted the close link between money laundering and corruption in very similar terms to the guidelines for this Report:

> 'Corruption and money laundering are a related and self-reinforcing phenomenon. Corruption proceeds are disguised and laundered by corrupt officials to be able to spend or invest such proceeds. At the same time, corruption in a country's AML institutions (including financial institutions regulators, Financial Intelligence Units (FIUs), police, prosecutors, and courts) can render an AML regime of a country ineffective' (*Strengthening Engagement* page 68).

27. Looking back on its anti-corruption and AML/CFT efforts, the World Bank lists the following lessons learned. First that effective customer due diligence under AML/CFT requirements, such as providing details on the client's background, the background of the funds involved, and the identity of the beneficiary, plays an important role in promoting general financial transparency and hindering corruption. Second that close co-operation between FIUs, anti-corruption agencies, law enforcement, and the private sector is essential to maximising the impact the AML regime can have on combating corruption. Lastly, that in many countries law enforcement agencies specify corruption as the main underlying offence generating illegal funds to be laundered, and hence AML policy is to a large extent primarily an anti-corruption tool (*Strengthening Engagement* page 68). This Report confirms each of these three lessons, as discussed in the following Chapters.

28. There are currently three research projects being carried out jointly or individually by the World Bank that directly relate to the core concerns of this Report. At the time of writing, the authors have not had access to any of the three in final form, but have had the chance to meet and/or correspond with the lead researchers of each.

29. The first of these projects, hosted by the Financial Market Integrity Unit, looks at the use of anti-money laundering information for anti-corruption purposes. It is comprised of a study of 15 anti-corruption agencies around the world, selected on the basis of geography, size, type and whether or not there is an Egmont Group FIU present in the jurisdiction. The study is based on a survey sent out to these 15 agencies in mid-2007. The survey focuses on the legal and institutional framework of the anti-corruption system, the anti-money laundering regime, training programs, collaboration with other state agencies, exchange of information, and experience in using AML tools for anti-corruption. The end product will be a report outlining whether and how countries' anti-corruption agencies employ AML data in fighting corruption. In turn, this information will be used to assist other countries in combating corruption, as well as in assisting them to recover the proceeds of corruption. There may also be training seminars based on the findings of the report.

30. The second project is being conducted jointly by the World Bank and the Egmont Group regarding the governance of FIUs, as part of the World Bank's wider review and re-drafting of its governance and anti-corruption strategy. Once again the project is survey based, and has initially been focused on 15 Egmont Group FIUs. Surveys for the pilot study were sent out in January 2007. The scope of the survey and project was then to be revised in light of the feedback received. The main concern of the project is to assess and improve the governance of FIUs. The knowledge from this exercise will then be utilised by the World Bank and Egmont group to strengthen corruption prevention in FIUs.

31. The third World Bank-sponsored project relating to the money laundering-corruption link covers grand corruption and money laundering. The end product is to comprise 25 case studies of grand corruption by Politically Exposed Persons drawing on court documents and press material. In particular the study will examine the instruments and methods used in the laundering of the proceeds of corruption, whether the proceeds were kept on or offshore, and how the activities were detected, investigated and prosecuted. It is being conducted by Richard Gordon and Braddock Stevenson of Case Western Reserve University. A short initial draft was circulated in early 2007 among an internal review group, with the full version of the study to be released later in 2007. The study will be used to stimulate further discussion and as a training module for FIUs. The study may also recommend further work on particular topics, for example the misuse of corporate vehicles.

32. At the time of writing, the authors have not had access to any of the three in final form, but have had the chance to meet and/or correspond with the lead researchers of each. In addition, in September 2007 the World Bank and UNODC released an outline of a far-reaching joint program to assist the recovery of the proceeds of grand corruption, the Stolen Assets Recovery (StAR) Initiative.

33. In April 2007 it was announced that the World Bank and UNODC would launch the StAR Initiative, devoted to returning assets expatriated by corrupt political leaders. The outline of this project released in September 2007 once again highlights the close relationship between money laundering and corruption (Chapter 3). It lists the main goals of this exercise as encouraging the ratification of the United Nations Convention Against Corruption, extending technical assistance to developing countries to enhance their recovery efforts, and advocating for developed countries to extend full co-operation in returning stolen assets.

United Nations Office on Drugs and Crime

34. The UNODC is the guardian of the various UN treaties relevant to financial crime: the 1988 Vienna Convention, the 1999 Convention on the Suppression of Terrorist Financing, the 2000 Palermo Convention on Transnational Crime, but especially the 2003 UN Convention Against Corruption. The UNODC has recognised the close links between money laundering and corruption. In its Anti-Corruption Tool Kit, for example, the UNODC states at page 20:

> 'There are important links between corruption and money-laundering. The ability to transfer and conceal funds is critical to the perpetrators of corruption, especially large-scale or "grand corruption". Moreover, public sector employees and those working in key private sector financial areas are especially vulnerable to bribes, intimidation or other incentives to conceal illicit financial activities. A high degree of co-ordination is thus required to combat both problems and to implement measures that impact on both areas.'

35. UNDOC subsequently states at page 432:

> 'Money-laundering statutes can contribute significantly to the detection of corruption and related offences by providing the basis for financial investigations. Identifying and recording obligations as well as reporting suspicious transactions, as is also required by the UN

Convention against Transnational Organised Crime and the United Nations Convention against Corruption, will not only facilitate detection of the crime of money-laundering but will also help identify the criminal acts from which the illicit proceeds originated. It is therefore essential to establish corruption as a predicate offence for money-laundering.'

36. The UNODC Global Program on Money Laundering plays a vital role in extending AML technical assistance to the developing world. It also hosts the International Money Laundering Information Network (IMoLIN) website of AML resources. The Global Program on Money Laundering lists the money laundering-corruption nexus as one of its priority areas for research, building on past achievements in this area.

37. One of the most notable achievements in this regard is the 1998 report *Financial Havens, Banking Secrecy and Money Laundering* which identified many common threads between money laundering and corruption. This work also emphasised the risk posed by un- or under-regulated Corporate Service Providers and anonymous corporate vehicles, conclusions reiterated in this Report in Chapter 2.

38. The 1988 Vienna Convention (the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances) first put the issue of money laundering on the global agenda. It calls upon signatories to criminalise the proceeds of drug crimes (Article 23).

39. The 2000 Palermo Convention (the United Nations Convention against Transnational Organised Crime) identifies one of its goals as facilitating the fight against money laundering and corruption in the preamble. It calls on parties to criminalise money laundering (Article 6). Article 7 emphasises the need for customer due diligence and suspicious transaction reporting. The Convention further encourages parties to set up FIUs and follow the recommendations of international anti-money laundering bodies.

40. The UNCAC once again lays out the close links between anti-corruption and anti-money laundering requirements and strategies, beginning from the second clause of the preamble. Some of the most germane Articles include:

- Article 14, which specifies that signatories must set up AML supervisory arrangements, including customer due diligence and establishing beneficial ownership, and a suspicious transaction reporting system; that parties should consider setting up arrangements to monitor the cross-border movement of cash and negotiable instruments; that they should include relevant transaction information on electronic transfers; parties are also called upon to follow the standards of existing AML bodies; and ensure international co-operation among law enforcement, judicial and financial regulatory agencies.

- Article 23 specifies that parties must criminalise money laundering.

- Article 52 holds that parties must ensure their financial institutions apply enhanced scrutiny to accounts opened or sought by public officials (domestic as well as foreign) who are or have been carrying out prominent public functions, as well as their families and close associates. Furthermore parties should draw up criteria for the kinds of natural and legal persons to whom this enhanced scrutiny should be applied. Parties should consider setting financial disclosure systems for public officials, including foreign financial accounts, with penalties for non-compliance.

- Article 58 encourages parties to set up FIUs to receive, analyse and disseminate relevant information.

41. Implementation of the UNCAC is a matter of significant concern. The first Conference of Parties for the UNCAC was held in Amman, Jordan in December 2006, with the second to be held in Indonesia in early 2008.

Organisation for Economic Co-operation and Development

42. Aside from the 2003 United Nations Convention Against Corruption, the most important international anti-corruption document is the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the OECD Anti-Bribery Convention), which grew out of the work of the Working Group on Bribery in International Business Transactions, itself founded in 1994. With the signature of South Africa in June 2007, 37 countries have now committed to the Convention. Six APG members, Australia, Canada, Japan, South Korea, the United States and New Zealand are members of the Working Group.

43. The Convention contains relevant AML clauses. In particular, Article 7 calls upon signatories who have made the offence of bribing a domestic official a predicate offence for money laundering to do so on the same terms for bribery of foreign public officials.

44. Of the extensive work done by the OECD on corruption, in the Working Group on Bribery, in other sections like the Public Management Committee on government procurement and the Committee on Fiscal Affairs with regards to the tax treatment of bribes, and the various regional co-operative ventures (noted below), some has particular relevance for this Report. Of special note is the peer review and monitoring mechanism developed within the Working Group which may act as a model for UNCAC monitoring, as well as related regional programs.

45. In May 2006 the Working Group released the *Mid-Term Review of Phase 2 Reports*, a compilation of 21 individual country reviews for Phase 2, which is to be completed in 2008. The section of the Mid-Term Review most relevant to money laundering (that dealing with Article 7, 85ff), begins by noting that there is an absence of standard data collection techniques among the individual country reports. The resulting lack of comparable data means that it is difficult to draw robust conclusions about common trends among signatories. The OECD Review calls for greater efforts to standardise data collection in this area, a call which this Report strongly endorses. The OECD Review also calls for more information on how parties treat the laundering of the proceeds of bribery by the briber, rather than just the bribe itself (page 86).

46. The OECD Review at page 87 concisely states a supposition at the heart of the rationale for this Report:

> '[A] better measure in evaluating the effectiveness of the Convention is whether suspicious transaction reporting systems have led to the discovery of foreign bribery and related money laundering cases. If one assumes that foreign bribery is a prevalent phenomenon, and that the crime frequently involves money laundering (of the bribe or the proceeds of bribery), then one could reasonably expect reporting systems to detect foreign bribery cases regularly.'

47. However, the OECD Review immediately goes on to note that in actual fact the results have been 'disappointing' as 'Suspicious transaction reports (STRs) have not led to bribery investigations in most of the examined Parties' (page 87). The Review notes the various countries with bribery or other corruption related STRs, both foreign and domestic, (18 in Greece, 10 in Luxembourg) and the number of corruption investigations as a result of STRs (7 in Germany, 2 in Mexico, 6 in Greece, none in Luxembourg, 6 in France, 12 in Belgium) (pages 87-88; additional figures are provided in individual country reviews). The Review does not note any corruption convictions stemming from STRs.

48. As an important aside, it is worth noting that if results have been disappointing among those countries with the most experience and expertise in countering corruption and money laundering, the results are very unlikely to be more heartening outside the Convention signatories. As such it must be assumed that the failure of Suspicious Transaction Reports to lead to bribery investigations (let alone convictions) to date is a generalised failure, rather than just confined to signatories of the Convention.

49. The more important question posed by the OECD Review, then, is why the results have been so disappointing, a failure described as 'particularly vexing'. The Review discounts the arguments that either there are too few or too many STRs (ie that FIUs are swamped with a larger volume of STRs than they are able to analyse and process) (page 88). More pertinent, the Review notes, is that very few of these STRs relate to bribery (and by extension other forms of corruption).

50. The OECD Review speculates that these low totals of corruption-related STRs may reflect the fact that when FIUs issue typologies they may not include foreign bribery examples. FIUs themselves and reporting entities thus may not be adequately aware of the money laundering-corruption link. On the basis of interviews conduct for this Report, the authors would endorse this reasoning. Very few FIUs issue corruption-related examples in their typologies (Belgium and the United States are notable exceptions), and as such reporting entities are much less likely to consider passing on reports of activity that may be suspicious on the grounds of corruption, a point developed further in Chapter 6 of this Report.

51. In September 2007 the OECD produced a paper "Potential Obstacles to the Detection of Bribery of Foreign Public Officials by AML Systems", a copy of which is at Annex 3. This paper examines 'three common features of foreign bribery which differentiate the offence from many other predicate offences, (and) might significantly impact on its detection through AML systems:1. the generation by the offence of two types of illicit funds – the bribe payment and the proceeds of bribery; 2. the occurrence of the offence abroad; and 3. the relative newness of the offence.' The OECD paper highlights the problem of detecting the proceeds of bribery which are concealed through normal commercial transactions, the dual criminality obstacle in international co-operation (Chapter 4) and need for training and money laundering typologies (Chapter 6) to increase awareness of the relatively new foreign bribery offence.

52. Many of the individual country reports for the Phase 2 Review process give additional statistics on numbers of corruption-related STRs and money laundering investigations with bribery as the predicate offence. However, judging from interviews, many of the most important details on individual countries' investigations involving international co-operation in fighting corruption-related money laundering offences have been omitted. Rather than reflecting the need for operational security this seems to reflect political sensitivities which, while understandable, hamper efforts to disseminate knowledge about successful efforts to counter this sort of crime.

53. The OECD also has a number of regional out-reach networks dedicated to fighting corruption. From 1998 these include the OECD Anti-Corruption Network for Eastern Europe and Central Asia. More recently the OECD has begun co-operation with the Organisation of American States, which established the Inter-American Convention Against Corruption in 1996. In April 2007 the two organisations signed a memorandum of understanding deepening their co-operation in this and other areas.

54. The most relevant regional collaborative exercise involving the OECD is the Anti-Corruption Initiative for Asia and the Pacific (summarised below), developed in conjunction with the Asian Development Bank. Aside from the obvious geographical relevance to the APG, this Initiative has also announced an interest in investigating the money laundering-corruption link based on the findings of this Report.

Asian Development Bank/OECD Anti-Corruption Initiative for Asia and the Pacific

55. The joint ADB/OECD Anti-Corruption Initiative for Asia and the Pacific was established in 1999. It currently includes 27 countries, and its activity has been centred on the Anti-Corruption Action Plan for Asia and the Pacific adopted in December 2000. This joint enterprise aims to further the cause of anti-corruption by facilitating member dialogue, enabling the exchange of best practice, co-ordinating technical assistance, engaging in policy analysis, and providing a database of anti-corruption practices.

56. Given the pronounced overlap in the membership of the Initiative and the APG, its activities are highly congruent with the aims of this Report. Furthermore, the 2007-08 Work Plan expresses the intention to collaborate with the APG in investigating the links between corruption and money laundering in the region:

> '[T]he Initiative will endeavor to undertake a thematic review jointly with the Asia-Pacific Group on Money Laundering in the framework of the recently launched FATF/APG Project Group on the links between anti-corruption and anti-money laundering and terrorist financing... The thematic review would focus on strengths and vulnerabilities to corruption of member countries' anti-money laundering mechanisms and make suggestions for improvement. This thematic review will be carried out jointly by APG and the ADB/OECD Initiative to complement the research analysis planned by the FATF/APG Project Group. A joint workshop on protecting anti-money laundering institutions and in particular Financial Intelligence Units against corruption would complement the review, and a joint capacity building program with APG would be considered to address the identified challenges' (ABD/OECD 2007: 6).

57. Beyond the co-operation outlined for 2008 (page 15), the Initiative also indicates that one of its priorities for capacity building throughout this period will be to counter deficiencies in anti-money laundering institutions whose performance has been degraded by corruption (ADB/OECD 2007: 10). In addition, the APG peer review/mutual evaluation mechanism is provided as an example for reviewing members' anti-corruption strategies (page 5).

58. Relating to corruption specifically, one of the most useful outputs of the Initiative for this Report is *Mutual Legal Assistance, Extradition and Asset Recovery of Proceeds of Corruption in Asia and the Pacific* (see Chapter 4 on Best Practice and International Co-operation). Related to the possible complementarities between anti-corruption and anti-money laundering standards are possible substitutes for mutual legal assistance in the recovery of the proceeds of corruption. For example, instead of asking for formal mutual legal assistance or beginning civil proceedings in the foreign jurisdiction, the state in question might ask its foreign counterpart to lay domestic money laundering charges (page 57). This approach is a much simpler and therefore cheaper option than formal mutual legal assistance, and thus potentially of great interest to developing member states. Also contained is the significant example of the conviction of a former Prime Minister of Pakistan for corruption-related money laundering in Switzerland, with the assets ordered forfeited to Pakistan (though the case is now under appeal) (page 57).

59. Relating to the same theme, one section from *Denying Safe Haven to the Corrupt and Proceeds of Corruption* identifies co-operation between FIUs as one of the most effective alternatives to formal mutual legal assistance. The value of FIUs in this context stems from their powers to gather detailed financial intelligence and their contacts in the public and private sectors (pages 18-21). Inter-FIU co-operation is particularly enhanced by the use of Memoranda of Understanding (page 16). The increasing use of the Egmont Group's secure website may be expected to bring further benefits in this area.

Commonwealth

60. The Commonwealth has done a great deal of innovative and relevant work on the money laundering-corruption nexus. This work has taken place among the Economic Affairs, Governance, and Legal and Constitutional Affairs divisions of the Secretariat. This effort has built from the 1999 commitment of Commonwealth Heads of Government to the Framework for Commonwealth Principles on Promoting Good Governance and Combating Corruption.

61. In 2005 the Commonwealth published a major report by the Commonwealth Expert Working Group on Asset Recovery, based both on earlier Commonwealth declarations and research from 2003, and the provisions of the United Nations Convention Against Corruption. Some relevant key recommendations include:

- Immunities from criminal prosecution for heads of state, government and other political figures should be removed.
- Enhanced scrutiny needs to be applied to both domestic and foreign PEPs.
- The Commonwealth should establish a mechanism for dealing with corruption by serving heads of state and government.
- Countries need to have in place effective conviction-based, non-conviction-based, and civil confiscation measures, usually as part of AML laws.
- Bilateral treaties should not be necessary in order to render assistance in this area.
- Asset registries for public officials are an effective preventive tool, especially when verified with reference to tax information.

62. In April 2006 the Commonwealth and Chatham House jointly held a major international conference, 'The UN Convention Against Corruption Implementation and Enforcement: Meeting the Challenges', which resulted in a substantial published proceedings. The Conference participants welcomed the UNCAC, and particularly its attention to money laundering, but also expressed disappointment that a variety of vital provisions had been made discretionary rather than mandatory. The conference also featured national officials who had taken a leading role in combating corruption and the related money laundering activities in their home countries, including Vanuatu, Nigeria, Kenya and Lesotho.

63. It has subsequently been noted that since 2005 progress in implementing the recommendations of the Commonwealth Working Group on Asset Recovery has been slower than hoped for. This is said in part to reflect the complexity and resource-intensiveness of working through asset recovery cases. But it is also said to reflect a lack of political will, and as such to achieve the goals set forth in the report it is necessary for Commonwealth member governments to make good on their commitments in this area.

Asia-Pacific Economic Co-operation

64. Another initiative that is relevant both on geographic and thematic grounds is APEC's investigation of money laundering and corruption under the general priority of promoting transparency. Under the Busan Declaration APEC leaders:

> '[A]greed that the implementation by our relevant economies of the principles of the United Nations Convention against Corruption (Article 14 Measures to prevent money-laundering, Article 23 laundering of proceeds of crime, Article 23 Concealment) can have a positive impact in advancing our commitment towards a cleaner and more honest and transparent community in the Asia Pacific region.'

65. To further information exchange and policy development in this area the APEC Anti-Corruption and Transparency Experts Task Force (ACT) was set up in 2005. The Anti-corruption and Transparency Capacity-Building Program has provided for workshops and training programs to be developed, including in areas dealing with investigatory and prosecutorial techniques, judicial reform, anti-money laundering, asset forfeiture and recovery, and the APEC Transparency Standards.

66. An example of activity in this area was an ACT workshop held in Bangkok 20-22 August 2007 on the money laundering and corruption nexus. Hosted by the Thai National Counter Corruption Commission, the workshop saw an exchange of examples of best practice in combating money laundering and corruption with particular reference to the international recovery of assets.

67. In September 2007 APEC further announced that two Codes of Conduct to prevent corruption in the public and private sector would be developed. This commitment came in the wake of two APEC reports, 'Enhancing Investment Liberalisation and Facilitation in the Asia-Pacific Region' and 'Transparency and Trade Facilitation in the Asia-Pacific'.

FATF-Style Regional Bodies

68. Aside from the APG, two other FATF-Style Regional Bodies (FSRBs) have expressed a particular interest in investigating the corruption-money laundering link. The authors met and subsequently corresponded with representatives of both bodies.

Inter-governmental Action Group against Money Laundering in West Africa (GIABA)

69. GIABA has as of early 2007 committed to undertaking a highly relevant study focusing on the corruption-AML linkage, 'Corruption and Money Laundering in West Africa: Assessment of Problem Status and the Effectiveness of National and Regional Control Initiatives'. GIABA lists the aims of the study as follows:

> *i)* Determine, as accurately as possible, the volume, prevalence, types, dominant character, cost and trend of corruption and money laundering in West Africa as well as the pattern of the relationship.
>
> *ii)* Estimate the proportion of corruption funds which goes into laundering and for what purposes.
>
> *iii)* Determine the usual direction of the money laundering flow.
>
> *iv)* Find out the extent and category of population involvement.
>
> *v)* Construct a valid and reliable socio-economic profiles of known offenders.
>
> *vi)* Find out the ratification/implementation status of various anti-corruption and money laundering instruments among the West African States.
>
> *vii)* Examine legislation and enforcement organs specifically targeted against corruption and money laundering to determine their levels of statutory appropriateness and operational efficiency as well as identify problems and constraints.
>
> *viii)* Identify 'best practices' in combating corruption and money laundering in the region, making allowance for national or cultural peculiarities.

ix) Determine the relationship, if any, between socio-economic and political conditions on the one hand and the incidence/prevalence/character/trend of the problem on the other.

x) Find out the role and impact of donor partnerships and transnational corporations in aiding or combating corruption and money laundering in the sub-region.

xi) Account for the observed magnitude, character and trend of the problem in the sub-region as well as for the observed level of effectiveness of existing legislation and enforcement organs over time based on the findings of the survey.

xii) Provide suggestions for the enhancement of the level of effectiveness and efficiency of the fight against corruption and money laundering in the sub-region, again based on the findings of the survey.

Eastern and Southern African Anti-Money Laundering Group (ESAAMLG)

70. The ESAAMLG 2005-2008 Strategic Plan lists as one of its main priorities the integration of AML/CFT efforts with national anti-corruption strategies (ESAAMLG 2005: 5). The ESAAMLG Secretariat is also considering the feasibility of setting up a dedicated AML/CFT and corruption regional training centre.

71. In general the Strategic Plan stresses the need for a greater appreciation of the corruption-money laundering link:

> 'Another problem within the region is that the issue of money laundering is misunderstood and regarded as a separate, "stand alone" entity. This is evidenced by the fact that some member countries have developed financial sector reform strategies and anti-corruption strategies that have failed to address the FATF recommendations... Country policy makers should be aware that AML/CFT measures are essential to financial sector development and that money laundering is the flip side of corruption and other criminal activity. Corruption is one of the predicate offences for money laundering. Cutting off the means to use the proceeds of crime is a major deterrent. The ability to investigate and repatriate the proceeds of corruption could provide member countries with "many millions of dollars" in returned revenue. It is therefore of paramount importance that AML/CFT programmes are integrated not only within national development plans but also within financial sector reform and anti-corruption programmes' (ESAAMLG 2005: 12).

72. Beyond the Strategic Plan, ESAAMLG has also committed as of June 2007 to producing a research report on 'The Impediments that Corruption Causes to the Implementation of AML/CFT in the ESAAMLG Region,' with the expected completion date being March 2008.

Group of States against Corruption (GRECO)

73. Within the context of the Council of Europe, GRECO's monitoring of its 46 members' implementation of the Criminal and Civil Conventions on Corruption has once again demonstrated the necessity of taking into account money laundering concerns in fighting corruption.

74. For example, in its Second Round evaluations GRECO has urged members to amend criminal codes to allow money laundering prosecutions where corruption offences have been committed abroad. GRECO has also urged closer international co-operation relating to the repatriation of the proceeds of crime. More generally, successive evaluation rounds have emphasised the need for corruption prevention measures that relate directly to AML concerns. These include the need for

proper regulation of financial intermediaries and gatekeepers, adequate company registration systems, the need to be able to penetrate bank secrecy in criminal investigations, and the role of tax administrators in detecting corruption-related financial crimes.

Gaps in the Literature and Future Research

75. In conclusion, since 2005 if not earlier, a large number of anti-money laundering and anti-corruption international organisations have stated that the money laundering-corruption nexus is both important and significantly under-researched. Judging by the state of the field, this conspicuous gap in our knowledge remains. Fortunately, however, by early 2008 a good deal will be done to help remedy this intellectual deficit with the publication of five separate reports on the money laundering-corruption link: the three World Bank studies (on using AML information for anti-corruption purposes, the governance of FIUs in collaboration with the Egmont Group, and grand corruption and money laundering), and the two regional studies by ESAAMLG and GIABA. Some or all of the World Bank reports may also prompt follow-up work by the Bank.

76. Since none of these reports is available to the authors at time of writing, it is not possible to definitively identify directions for future research. Clearly, before further work on the relationship between money laundering and corruption is commissioned, the review of the field conducted above would need to be updated taking into account the findings and conclusions of these studies to assess the remaining lacunae and shortcomings.

77. Nevertheless, it is possible to make some tentative suggestions regarding productive directions for future research with particular reference to the Asia-Pacific region. A typologies exercise on the money laundering-corruption nexus in the Asia-Pacific, building on the work of the APG Scoping Paper, would be a very valuable addition to the literature. This would be of significant benefit to FIUs, anti-corruption agencies, STR reporting entities, and perhaps judicial and law enforcement bodies as well.

78. As is discussed in Chapter 6, the lack of such typologies is one of the key shortcomings hampering efforts to break the money laundering-corruption relationship. Two of the World Bank studies and the ESAAMLG and GIABA work may included some examples incidentally, but they are not typology exercises. Although the World Bank study on grand corruption is a dedicated typologies exercise, there is a need to go beyond open sources (media and court reports) and the particular class of grand corruption.

79. Such a typology exercise would be beneficial if undertaken at a global level, but would perhaps be even more beneficial if it reflected the particular priorities and circumstances in the Asia-Pacific. This would also be a good fit with the interest expressed in money laundering and corruption by the ADB/OECD Anti-Corruption Initiative and the APEC Anti-Corruption and Transparency group, among others.

80. Three more focused topics also suggest the need for further research. The first would be an investigation of the potential for using money laundering law in corruption-related international asset recovery. Although excellent studies on asset recovery have been produced by the ADB/OECD and the Commonwealth, such is the complexity of this area that a dedicated treatment of the role of AML/CFT law in this area would be a significant contribution.

81. A further priority area for research is on domestic PEPs regulations. Given the new responsibility that countries have taken on to compile a domestic PEPs list by ratifying the UNCAC (Article 52.1), the lack of awareness concerning this commitment, and the paucity of countries that have so far fulfilled this obligation (Brazil and Mexico), much work needs to be done. The Report discuss issue of domestic PEPs in greater detail in Chapter 3.

82. Finally, given the emphasis placed on the use of asset registries underpinned by AML/CFT intelligence (and possibly tax information as well) as an anti-corruption measure, it would be helpful to have a dedicated study comparing different countries' experiences with asset registries, and how existing practices could be improved.

CHAPTER 2: VULNERABILITIES OF AML/CFT REGIMES TO CORRUPTION

Introduction and Summary

83. This chapter deals with the following terms of reference:

> 'Understanding vulnerabilities to corruption in AML/CFT institutions (including law enforcement, investigative, prosecutorial and judicial bodies). Studying the structures of organisations that are central to an effectively implemented AML/CFT regime and identifying vulnerabilities to corruption.'

84. There is a general presumption among practitioners that corruption and money laundering are similar in that relatively few of those committing these crimes are convicted for their activities, and only a very small proportion of the money involved in each is seized. For example, many APG members are yet to record a single conviction for money laundering, but it is unlikely this is because there is no money laundering going on. Similarly, as pointed out by the OECD Secretary-General, the fact that countries like the UK and Australia have yet to record a single conviction for the bribery of foreign officials is probably not because no such bribery has occurred.

85. There are a number of important issues. To what extent could the increased use of intelligence, laws and institutions of the AML/CFT regime enhance efforts to counter corruption? To what extent is the fight against money laundering being held back by corruption? If there are problems in these areas, what can be done to ameliorate them? This Chapter is largely devoted to investigating the second issue: examining vulnerabilities to corruption in the AML/CFT system, and proposing remedies.

86. Before turning to a detailed investigation of the impact of corruption on the AML system, a few caveats are in order. In developing countries especially the AML system has a short track record, and thus a lack of convictions, or small assets seizures is much more likely to reflect the comparative novelty of the AML/CFT regime rather than improper influence. Among those interviewed from the various international organisations by the authors, the degree of political support, resource constraints and relations with law enforcement and prosecutors were all held to have a much greater influence in facilitating or impeding efforts to fight money laundering than corruption.

87. As such, even where the AML/CFT system has been in place for some time, modest results in countering money laundering are much more likely to be a result of these kind of factors rather than corruption. Corruption prevention as applied to the AML/CFT system thus is more likely to have a modest positive impact on effectiveness rather than producing a radical improvement. This probability should be kept in mind, together with the expense, when discussing improving corruption prevention in AML/CFT.

88. In addition, in recommending reforms to make bodies within the AML/CFT system broadly conceived more resistant to corruption, the authors have sought to keep the circumstances of low capacity countries in mind. Many developing countries are already struggling to fulfill the 40+9 Recommendations in an environment where there are many other competing demands on public funds. Given this fact, promoting expensive, complex solutions may be unrealistic and perhaps even counter-productive.

89. The vulnerabilities below are not just a list of legislative deficiencies, as interview sources have stressed the importance of proper implementation beyond legislation. To the extent that APG and FATF members have not ratified and legislated the provisions of the various international conventions on money laundering and corruption this represents a shortcoming that should be corrected. Certainly there are some glaring problems as a result of incomplete legislation noted in this Report, for example the failure to make corruption a predicate offence for money laundering purposes (UNODC Anti-Corruption Tool Kit page 66). But it seems probable that even 'state of the art' legislation will do little to reduce inter-linked instances of corruption and money laundering in the absence of effective implementation.

90. This Chapter begins by summarising the main points of the 2005 APG Scoping Paper relating to common trends in corruption-related money laundering, as well as common points of vulnerability to corruption in the AML/CFT system. The next section reviews international best practice in corruption prevention with an eye to FIUs. To the extent that such best practices have not been adopted by FIUs, this tends to indicate points of vulnerability to improper influence. In keeping with the broad view of the AML/CFT system, the following section looks at susceptibility to corruption in the judiciary, among prosecutors and in law enforcement. The next task is to examine the trade-off between FIU independence and capacity.

91. In the private sector, the presence of unregulated Corporate Service Providers not captured within the STR reporting system represents a major point of vulnerability to corrupt influence. The final major point of vulnerability is the disconnect or compartmentalisation that tends to undermine potential synergies in the fight against money laundering and corruption.

APG Scoping Paper

92. Since 2003 the APG has collected a range of case studies of methods of laundering the proceeds of corruption through a questionnaire to members and from discussions during typologies workshops. Seventeen countries provided information: Australia, Canada, Chinese Taipei, Fiji, Hong Kong,China, Indonesia, Japan, Macao-China, Malaysia, Mongolia, New Zealand, Pakistan, Palau, Philippines, South Korea, Thailand and the United States. The Scoping Paper noted the following methods for laundering the proceeds of corruption:

1. Cash is very commonly used for bribes, with proceeds of corruption remaining in cash form and concealed in homes and on business premises. This was noted as particularly common in predominantly cash economies (Thailand, South Korea, Mongolia).

2. Cash proceeds of corruption are being exchanged into foreign currency, often to be smuggled abroad or deposited into domestic banks (Indonesia).

3. Cash couriers are used to smuggle proceeds of corruption within and out of a jurisdiction to be subsequently integrated into the formal financial sector of the other jurisdiction. Such smuggled cash may be returned to the country of origin through the formal financial system (Thailand).

4. Structuring or "smurfing" proceeds of corruption into bank accounts is occurring through the use of multiple deposit transactions of small amounts (Macao-China).

5. Many cases reported simple placement of corrupt proceeds in domestic banks (Indonesia).

6. Third parties are commonly used, including family members or affiliated companies to receive corrupt payments in a variety of forms and to subsequently deposit proceeds of corruption into financial institutions. Such third parties may be employees or other

accomplices. Typologies include proceeds of corruption being falsely loaned back to the bribe recipient (New Zealand, Indonesia, South Korea, Macao-China).

7. False identities and false documentation are extensively used to hide the true beneficial ownership of financial assets deriving from proceeds of corruption. Typically names of dependents and personal employees were used (South Korea).

8. For accounts opened using false identities, proceeds of corruption are being transacted through internet banking or telephone banking to avoid face to face transactions.

9. Wire transfers are being used to remit proceeds of corruption overseas and/or to relatives or third parties.

10. The use of offshore bank accounts and offshore shell companies was common, with corrupt proceeds sent via wire transfers. This was undertaken to reduce the risk of detection, to avoid asset tracing to complicate evidentiary trails (Pakistan).

11. Alternative remittance systems being used to transfer proceeds of corruption to foreign jurisdictions. Such funds may be laundered overseas and used as seemingly legitimate loans granted to local entities connected to the corrupt person (Pakistan).

12. Repatriation of laundered proceeds of corruption is occurring through the use of wire transfers and false declarations of dividends of non-existent foreign investments (Macao-China).

13. Gatekeepers, including accountants and lawyers, are utilized to conceal the origin of corrupt payments, including the disguising of such payments as consultancy fees (South Korea, Pakistan).

14. Corrupt payments have been received directly in the form of valuable assets and luxury goods.

15. Gaming, including horse racing, is used through using proceeds of corruption to pay for winning tickets at a premium to disguise the origin of funds.

16. Negotiable instruments such as bearer bonds and negotiable certificate of deposits (CDs) are purchased with proceeds of corruption in the private loan market to hide the beneficial owner (South Korea).

17. Gatekeepers are used to manage the subsequent investment of corrupt funds into assets including real estate, stocks, bonds or mingling within legitimate businesses (Pakistan).

18. A number of cases highlighted laundering proceeds of corruption through investment in insurance products and financial market securities, often using third parties to obscure the beneficial owner (Indonesia).

19. Cases highlighted proceeds of corruption being spent on luxury vehicles, jewellery and other luxury items.

20. Proceeds of corruption are laundered using false business transactions or deliberately loss making transactions with a company owned by a relative of the corrupt official (South Korea, Macao-China).

21. Assets from corruption money are accumulated in commercial and residential real estate,

often with the involvement of corruption officials or gatekeepers (Pakistan).'

93. Summarising the narrative responses by jurisdiction, the Scoping Paper at pages 9-10 identifies nine common vulnerabilities:

'1. The low pay and poor conditions of those in the public sector which produces a systematic vulnerability to corruption.

2. There is a lack of financial expertise in identifying corruption typologies.

3. The members with cash-based economies face great difficulties in distinguishing money from legitimate and illegitimate sources.

4. The absence of a dedicated anti-corruption body and a lack of vigorous media scrutiny.

5. The need for more political will from senior managers and the government in developing a robust anti-corruption culture.

6. Concerns that PEPs may block AML investigations, impede the suspicious transacting reporting system, and undermine good governance standards.

7. The difficulty of keeping investigations secret in small jurisdictions where tipping off is a constant danger.

8. Law enforcement and prosecutors are often more interested in pursuing the predicate crime rather than money laundering or corruption offences.

9. Finally, because corruption-related money laundering often necessitates international action, such investigations tends to be complex, time-consuming, expensive and require considerable expertise.'

General Anti-Corruption Measures

94. The following section outlines best practice in general corruption prevention for public bodies with an eye to enhancing the integrity and effectiveness of FIUs. This version of best practice is drawn from information provided by the Hong Kong,China Independent Commission Against Corruption, the New South Wales (Australia) Independent Commission Against Corruption, and the Queensland (Australia) Crime and Misconduct Commission.

95. Different countries will need to adapt these generalised guidelines to local circumstances. Some of the measures recommended below are more expensive than others. Developing countries may thus have to perform a careful calculation as to the relative merits of corruption prevention in FIUs and enhancing other aspects of the AML/CFT system, or advancing other public priorities more generally.

96. FIUs aiming to strengthen its corruption resistance should start with undertaking a risk assessment to identify corruption risk areas. The identified areas and ways of managing corruption risk in the agency should be incorporated in a corruption prevention plan. For that purpose, the FIUs may wish to consider the following set of policies and procedures.

Code of Conduct

97. A Code of Conduct provides written guidelines to the employees of an organisation as to how to operate and perform their duties according to the organisation's standards of behaviour and ethical principles. It further outlines the disciplinary measures that will be taken against an employee if a breach of the Code of Conduct occurs. Those FIUs interested in such a measure should develop and implement their own Code of Conduct tailored to the specific structure, role and ethical culture of the agency (the provision for such a code is expressed in UNCAC in a discretionary measure, Article 7d).

98. A Code of Conduct assists in establishing the 'organisational framework that helps to build and strengthen agency integrity and corruption resistance' (Chapter 1, p. 5, ICAC "Codes of Conduct – The next stage http://www.icac.nsw.gov.au/files/pdf/pub2_55cp1.pdf). An agency's Code of Conduct should be reviewed regularly, with the active participation of both management and employees, and Code of Conduct training should be part of the induction programme for new employees. Regular refresher training should be provided to employees to reinforce the ethics, principles and regulations upheld by the agency and the importance of complying with those regulations at all times. The management should demonstrate their full support for the Code of Conduct and set an example by their compliance with the policies and procedures included in the Code. Detailed guidelines on how to develop an effective Code of Conduct can be found on the websites of the Hong Kong,China ICAC, the NSW ICAC, the Crime and Misconduct Commission (CMC) of Queensland, and other anti-corruption bodies.

The Recruitment Process

99. Recruitment should be an open, transparent process where consistent practices and selection criteria are applied to all applicants in order to select the best person for a job based on their merits. Apart from a well-developed policy on recruitment guarding against nepotism, favouritism or other unethical practices, FIUs should generally apply stringent security vetting for all potential new employees (see the section on Asset Registers below).

100. A security vetting package should be developed to encompass the information that potential employees will need to disclose regarding their personal and financial circumstances to allow the agency to conduct enquiries and assess their background and character. This package is sent to potential employees for completion and should include questions regarding their identity, marital status, financial information, criminal record and association with criminals, and disclosure of interests and associations with other people and organisations as well as information about close family members. Based on the information provided the agency can perform a probity assessment of the potential employee and make a decision as to their suitability for employment at the agency.

101. The security vetting package should also contain the agency's Code of Conduct, which the potential employee will be required to read and sign a written declaration confirming that they accept to uphold and comply with the policies and regulations at all times. The security vetting package and the information required to be disclosed to the agency to allow an effective probity assessment process should also be tailored to the specific work of an FIU. All job candidates should be made aware that, should they be recommended for employment, an offer will be subject to a successful security vetting clearance. An example of a security vetting package can be seen on the website of the NSW ICAC.

Conflicts of Interest

102. Properly managing conflicts of interest, pecuniary and non-pecuniary, is critical to maintaining an image of integrity and high ethical standards in public agencies like FIUs. The public's perception that a government official, and hence the official's agency, has acted in a biased and/or unfair way because of personal interest can be just as detrimental to the confidence in that agency's work as when an unlawful act actually occurs. The public expects that government officials put public interest above their private interests, and that government decision-making is a fair, open and impartial process. Therefore, agencies should have an effective conflicts of interest policy which should include clear guidelines for employees with regard to identifying and disclosing personal interests that may conflict, or may be perceived to conflict, with their duties as public officials.

103. The policy should provide clear definitions of the concept of conflicts of interest so that all employees understand in what situations they need to make a disclosure. All employees should know their obligations under the agency's conflicts of interest policy and should be able to identify and declare any potential and actual conflicts of interest that arise in the course of their work.

104. The policy should be included in the induction program of the agency. Regular reviews of the policy should be conducted, with the active participation of all staff, in order to ensure that identified areas of risk for conflict of interest as well as preventive measures are up to date, and potential new problematic areas are addressed to minimise the risk for actual conflicts of interest occurring.

105. Management should be responsible for reinforcing the policy, leading by example and providing guidance to employees when ethical dilemmas are brought to their attention for advice. For that purpose, it is particularly important that staff and managers are well-informed about the conflicts of interest policy and any changes resulting from reviews, and that they periodically attend appropriate training.

106. The Hong Kong,China ICAC has information on the key concepts related to this policy available on its website. The NSW ICAC and the CMC of Queensland have published a joint report and a toolkit on managing conflicts of interest in the public sector. These publications contain detailed guidelines on how to develop and implement an effective conflicts of interest policy as well as how to manage conflicts of interest.

Gifts and Benefits

107. Anti-corruption bodies are in agreement that managing effectively the corruption risks associated with gifts and benefits that public officials may be offered in the course of their work is critical for maintaining the integrity of an organisation. It is essential that public agencies have in place a gifts and benefits policy to govern the ethical decisions of their employees related to whether or not to accept a gift or benefit. The policy should explain the key concepts and provide guidelines to employees to help them assess in what circumstances they could accept gifts or benefits and when they should refuse them as the gifts could compromise, or be perceived to compromise, the employee and hence the agency.

108. This policy should be clearly communicated to an FIU's employees, and to any external stakeholders. Employees should have a thorough understanding of the ethical issues and potential corruption risks associated with gifts and benefits. If the policy does not provide guidelines for particular situations and employees are not sure how to respond to an offer of a gift or benefit, they should be encouraged to consult relevant anti-corruption provisions and seek advice from the management. Maintaining good records in such circumstances is essential, and the gifts and benefits policy should provide for such cases.

109. The policy should distinguish between gifts and benefits that have to be declared based on their nominal value, and those that can be accepted, and usually kept, without disclosure. All gifts and benefits that have to be declared should be recorded in a gift register to maintain transparency and accountability, and the management should decide how these agency assets are to be used. Periodic audits of the gift register should be conducted to ensure that misappropriation has not occurred, and that all relevant policy procedures have been complied with.

110. The policy should clearly state that public officers must never accept money as a gift. An FIU may also find that adopting a 'no gifts' policy could be best, but this will depend on local circumstances.

111. Special provisions should be included in the gifts and benefits policy related to bribery and all employees should understand clearly what a bribe is and that should they be offered a bribe they must report it immediately and follow all procedures outlined in the agency's gifts and benefits policy.

112. The NSW ICAC has produced a toolkit titled Managing Gifts and Benefits in the Public Sector that provides comprehensive information about the process of developing and implementing a gifts and benefits policy, and managing gifts and benefits.

Security and handling of confidential information

113. Public sector agencies should develop procedures for handling sensitive and confidential information. This requirement is particularly relevant for FIUs given their role in collecting, analysing and disseminating STRs. Agencies should include this issue in the risk assessment process and should identify areas of risk specific to the organisation based on its size and structure. This problem is important because it is related to corruption and fraud. The unauthorised release of confidential information to external entities may have serious consequences. For example, tipping off by a corrupt official may sabotage on-going investigations.

114. The policy on security of information should be made part of the agency's induction program for new employees, and new employees should be required to confirm in writing that they have read and understood the policy and that they agree to comply with it at all times. The policy should incorporate provisions for the classification of sensitive information, and the 'need to know' principle should be applied internally to regulate the access of employees to restricted information.

115. Good monitoring and control systems should be developed and implemented to manage employees' access to electronic databases and record-keeping systems. Procedures should be put in place to prevent cases of misuse of confidential information such as leakages or using someone else's username and password to access electronic systems. Hard copies of confidential documents should be securely stored and access to them should be monitored. Procedures should be also implemented for the appropriate way such documents are disposed of so that the information they contain can remain protected.

116. Regular reviews of the policy should be conducted so that the provisions, procedures and control mechanisms outlined in the policy are kept up to date with the development of technology. Malpractices and misuse of confidential information should be reported and the policy should provide for disciplinary measures to be taken against employees when such misconduct occurs.

Asset Registries

117. The sections above have outlined the relevant international best practice for corruption prevention in public institutions. These general guidelines have particular relevance for FIUs. Asset

registries also comprise an important measure for safeguarding the integrity of FIUs, but in addition their application is also potentially much wider. Indeed, interview sources relate that an asset registry is perhaps the most effective general anti-corruption measure. Depending on national circumstances, such a registry may include politicians and senior public officials, judges, police, members of the FIU and anti-corruption body and others. Asset registries are not a new idea. They are common in many governments, legislatures and anti-corruption bodies around the world. The 1996 Inter-American Convention against Corruption Article III 4 calls for a registry of the income, assets and liabilities of public officials; Article 9 calls for passing illicit enrichment laws covering public officials. The UNCAC also calls for a similar registry in Article 8 (5) under the rubric of dealing with conflicts of interest among public officials.

118. However, the effectiveness of these registries, covering all assets, income and liabilities, is severely compromised unless underpinned with supporting measures. First there must be meaningful (preferably criminal) penalties for those making false, misleading or incomplete declarations. Second there must be an obligation for registries to be regularly updated, preferably on not less than an annual basis. Third these registries should be cross-checked for accuracy regularly using AML and tax information. Unless these conditions are fulfilled then registries are unlikely to be effective in deterring and detecting corrupt practice. Judging on the basis of limited evidence, it seems unlikely that most register meet these conditions (the World Bank study on using AML information for anti-corruption purposes may well provide more systematic evidence on this matter).

119. The Hong Kong,China ICAC has a strong asset declaration policy in relation to its staff, which may be a productive model to emulate. Assets must be declared when an individual enters the organisation, and then the declaration is reviewed on an annual basis.

Judiciary, Prosecutors and Law Enforcement

120. The UNCAC Article 11 calls for measures to strengthen judicial systems in the following terms:

> 'each State Party shall, in accordance with the fundamental principles of its legal system and without prejudice to judicial independence, take measures to strengthen integrity and to prevent opportunities for corruption among members of the judiciary'.

121. In 2006 the UN ECOSOC endorsed the Bangalore Principles for Judicial Conduct. Further detailed guidance is provided by the Commonwealth Limassol Recommendation on Combating Corruption within the Judiciary. Among the common vulnerabilities to corruption identified by the Commonwealth are:

- A lack of public guidelines on judicial ethics.
- A lack of judicial training and mentoring programs in ethics and anti-corruption.
- Threats to the principles of appointment and promotion on merit through a competitive and transparent process.
- Court hearings are not open to the public.
- Judges salaries are too low to provide a secure livelihood.

122. A commonly identified challenge in remedying vulnerability to corruption is the reluctance of judges to undergo training in anti-corruption principles, especially when the training is conducted by non-judges.

123. In 2007 Transparency International released its *Global Corruption Report* with the special theme of corruption in the judiciary. This contained many of the same recommendations on corruption prevention already covered. In general the corruption threats to the judiciary in relation to money laundering cases are no different from those judges face in other kinds of cases.

124. To the extent that there are vulnerabilities specific to the money laundering-corruption nexus, they reflect the complexity of these cases, and the tendency to require co-operation from two or more jurisdictions. If the judiciary in any one country involved is corrupt, this will tend to hinder legal remedies in the other jurisdictions also. For example, if a jurisdiction is perceived as having a corrupt judiciary it is unlikely that other countries will permit individuals to be extradited to that jurisdiction. This will also tend to endanger asset recovery cases.

125. According to the 2007 *Global Corruption Report*, judicial corruption may produce a spiral of unaccountability: poorly-paid judges become susceptible to corruption; the corrupt judiciary undermines efforts to attack corruption and money laundering; this failure in turn prevents either successful deterrence of financial crime or asset recovery from abroad; the country becomes more impoverished (page 63).

126. Also included in this report are examples of judicial corruption and irregularities in relation to money laundering cases. In Mexico two armed individuals with connections to known drug traffickers were detained with USD 7 million in cash and a further USD 500 000 in valuables after attempting to evade the police. In contravention of the Criminal Code the judge ordered both individuals freed, even though the further investigations in progress against them meant they should have been held. The same judge freed the son of the local drug cartel boss after he was accused of money laundering and murder. Transparency International alleged that these decisions, both reversed on appeal, were a direct result of criminal influence over the judge (pages 77-78).

127. The same report also refers to a case in Nicaragua where $600,000 was seized after five individuals were convicted of money laundering. While the individuals were serving their sentences their representatives managed to withdraw this money with the authorisation of the Supreme Court (117-18). Once again, Transparency International alleges that this was a result of judicial corruption. The Supreme Court in Nicaragua has a monopoly on initiating investigations of judicial irregularities; it chose not to initiate an investigation in this case. A further example of alleged judicial corruption leading to the failure of money laundering is presented in Panama (page 253).

128. Complementing the general corruption prevention measures covered elsewhere in this chapter and the Commonwealth Limassol recommendations, Transparency International makes several other specific recommendations that this Report endorses. The appointment processes for judges should be transparent, and so too the process for hearing complaints and taking disciplinary action against judges. The reasoning behind judicial decisions should be published. Judges should declare conflicts of interest, and may be included in asset registries, again with the requirement that to be effective asset registers must be regularly updated and cross-checked against data collected by tax and AML authorities.

129. For the most serious and large-scale instances of corruption-based money laundering, there is a real danger that high-ranking political officials will be able to sabotage the proper functioning of the AML system. This might take the form of cabinet-level officials withholding permission to prosecute even once sufficient evidence for a prosecution has been gathered. This kind of failure may occur in developed or developing countries. This issue of PEPs is one of the most important concerns of this Report, and is dealt with separately at length in Chapter 3.

130. In particular it is important that the loophole of declining to prosecute cases on 'national security' ground be carefully investigated, as is currently being done by the OECD Working Group on Bribery. The problem has recently come to the fore in the case of the United Kingdom's decision to abandon a corruption investigation against British Aerospace Systems (BAE) involving arms sales to Saudi Arabia. The British government maintains that Saudi Arabia has threatened to cut off terrorism-related intelligence if the investigation is continued, and that the value of this intelligence outweighs the public interest in investigating accusations of corruption. Responding to this Al-Yamamah case, the OECD has noted: 'a number of questions remain unanswered and the Working Group maintains its serious concerns as to whether the decision was consistent with the OECD Anti-Bribery Convention' (*United Kingdom: Follow-Up Report on the Implementation of Phase 2 Recommendations*, 21 June 2007, page 7).

131. National security is such an elastic concept that it could conceivably used by highly-placed corrupt officials to sabotage almost any kind of investigation. Sani Abacha, along with many other corrupt governments, justified his massive looting of the Nigerian government treasury on national security grounds. Aside from carefully delineating the circumstances in which national security is or is not an acceptable reason to decline to prosecute, operational independence and once again asset registries may militate against this problem.

132. A problem relating to the prosecutorial function in some Commonwealth countries like the UK and Kenya (more than half of APG member jurisdictions are also members of the Commonwealth) concerns the dual position of the Attorney General as both member of the cabinet, and independent legal officer whose permission is required to prosecute senior public officials for corruption. As is increasingly recognised, such a dual role creates a potentially serious conflict of interest: the decision to bring charges against one government minister depends on the assent of a fellow minister.

133. The Review endorses the recommendation of the 2003 Report of the English *House of Lords /House of Commons Joint Committee on the Draft Corruption Bill* that ministerial involvement in the prosecutorial decision in corruption cases should be avoided (page 47). An appropriate solution is to separate these two roles, re-assigning the prerogative to bring charges to a genuinely independent legal official outside the government, such as the Director of Public Prosecutions.

134. In Australia the Commonwealth Director of Public Prosecutions has issued a direction to all prosecutors that when deciding whether or not to prosecute a person for bribing a foreign public official, prosecutors should not be influenced by considerations of Australia's or any other country's economic interest, the potential effect upon Australia's relations with another country, or the identity of the persons involved (individual and corporate entities).

135. Problems associated with political discretion over the decision to initiate, continue or terminate corruption prosecutions are, however, by no means exclusive to common law countries. During its implementation review reports, GRECO has highlighted potentially serious deficiencies in this area in a large number of its members. Similarly to the situation with judges, GRECO has also emphasised the need for a transparent, objective and merit-based system for the appointment, promotion and disciplining of prosecutors in order to avoid political interference.

136. Aside from this danger, Transparency International recommends that lawyer's trust accounts should be regularly audited. Their professional registration should depend upon these audits being conducted, and providing the practitioner in question with a clean bill of financial health (TI 2007: 96)

137. Although Interpol's detailed study of police corruption is not accessible to the public (and hence the authors), Interpol has passed resolutions laying down basic standards for members in this area. Specifically Interpol ANG71 Resolution: 'Global Standards to Combat Corruption in Police Forces/Services' including following clauses of interest:

- 4.11 Establishing and enforcing procedures for the declaration and registration of the income, assets and liabilities of those who perform policing functions and of appropriate members of their families.
- 4.22 Having legislation enacted to allow the proceeds of corruption and related crimes to be forfeited.

Financial Intelligence Unit Independence and Capacity

138. In addition to the generic corruption prevention policies presented above, a clear necessity for the insulation of FIUs from improper political influence is operational independence. This criterion is emphasised by the Egmont Group. FIUs that do not possess operational independence in law and fact represent a major point of vulnerability to corruption in the AML/CFT system.

139. At a minimum, independence requires the autonomous ability to hire and fire personnel, preserve basic pay and conditions, and decide which cases to investigate, prosecute and/or pass on to prosecutorial authorities (depending on the structure and prerogatives of the FIU in different national contexts). Beyond these basic prerequisites, however, there is some disagreement as to the trade-off between independence and capacity, particularly in the developing world where resource constraints are particularly tight.

140. Commonwealth and UNODC publications indicate that especially in small developing countries, having a stand-alone FIU may be too expensive. As a result, such an FIU may lack even the most basic facilities (*e.g.* electricity supply), and thus be functionally ineffective. An alternative solution is to house the FIU within the central bank. Again drawing on interviewees' responses, this provides the advantage of association with one of the best-functioning institutions in low capacity countries. Furthermore, the central bank can be expected to have a close working relationship with the private financial sector.

141. Two caveats, however, should be borne in mind. The first is question of the position of an FIU situated in the central bank if senior bank officials seek to exert improper influence over the conduct of the FIU's work. The second reservation is that central banks generally have little or no relationship with the law enforcement community. The ability of the FIU to liaise between private banks and the police may thus be compromised. To guard against this danger, it may be advisable for FIUs housed in central banks to ensure law enforcement personnel are seconded to them so as to ensure close links with this sector.

142. The prerequisites of operational independence and corruption prevention do not preclude an FIU being housed in the central bank. Creating a stand-alone FIU to ensure independence may be false economy if that FIU is untenable because of a lack of resources. Indeed, one of the reasons that there have been so few examples of corruption in FIUs in developing countries (apart from their relative novelty) may be that these bodies have not yet become effective enough to be worth corrupting. If under-staffed and under-resourced FIUs do not pose much of a deterrent to corrupt activities, those engaged in corrupt practice have little need to exert improper influence over them.

143. A further extension of nesting FIUs within other independent bodies would be to co-locate the FIU within the national anti-corruption agency. An example of such is the Nigerian Economic and Financial Crimes Commission, but Mauritius has also adopted a similar solution. Clearly this would be one logical solution to the common problem of a lack of communication (or even acquaintance) between anti-corruption and anti-money laundering bodies that this Report identifies as one of the most serious problems affecting efforts in these inter-linked areas (see below). Conceivably, this solution might also be more economical than having two stand-alone bodies. Another potential

positive is that the FIU would be subject to the same integrity safeguards as applied to the anti-corruption agency.

144. However there is a fundamental lack of knowledge concerning the extent to which these potential benefits have actually eventuated for countries adopting this solution, or would eventuate for countries that might emulate Nigeria and Mauritius in this fashion. Interviewees in general saw greater communication and joint training between anti-corruption and AML agencies as being preferable to a full merger of the two.

145. Finally, in terms of risk management, to the extent they have not already, FIUs should where ever possible adopt the dual control 'four-eyes' principle of risk management. This principle refers to such safeguards as dual control of assets, requiring two signatures on key documents, and a general presumption of cross-checking, review and segregation of functions. Such arrangements minimise the chances of malfeasance (as well as innocent error). It must be recognised, however, that this may be particularly challenging for small, developing countries where staff shortages are already pronounced.

146. **Private Sector Corruption and CSPs**

147. A major problem in complex money laundering schemes is the use of corporate vehicles as part of the layering process and to camouflage the trail of evidence. The use of corporate vehicles in hiding various kinds of financial crimes has been a long-standing concern for a variety of international organisations. This concern is evidenced by the coverage in the 1998 UNODC report *Financial Havens, Banking Secrecy and Money Laundering*; the 2001 OECD study *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*; and most recently the 2006 FATF study *The Misuse of Corporate Vehicles, Including Trust and Corporate Service Providers*.

148. The last-mentioned notes at page 1 that:

> 'Organised crime groups or individual criminals tend to seek out the services of professionals to benefit from their expertise in setting up schemes that the criminals then use for illicit purposes. Criminals may seek advice from trust and company service providers... as to the best corporate vehicles or jurisdictions to use to support their schemes, with TCSPs having varying degrees of awareness of or involvement in the illicit purposes underlying their clients' activities.'

149. For the majority of cases involving the use of corporate vehicles to assist in money laundering, including laundering the proceeds of corruption, Corporate Service Providers (CSPs) were wittingly or unwittingly involved in obscuring the illegal nature of the funds. Commonly this is done through the provision of shell companies, particularly International Business Companies (IBCs). However, other corporate vehicles, such as trusts, foundations and partnerships may also be used in this manner to launder the proceeds of corruption.

150. The examples provided by Hong Kong,China and Malaysia in the 2005 APG Scoping paper are particularly pertinent here. Through setting up such companies, Corporate Service Providers may then assist in opening overseas corporate bank accounts through which to channel funds. Or such companies may be used in generating false invoices, fictitious consultancy fees, or bogus loans. To the extent CSPs who are covered by the suspicious transaction reporting regime fail to lodge an STR in the expectation of personal gain, or are bribed to actively assist in laundering money, this kind of private sector corruption represents a key vulnerability in the existing AML system.

151. In addition to multilateral organisations raising the matter of regulating CSPs as a law enforcement and money laundering priority, various US government studies on the subject have come to a similar conclusion. Thus a Government Accounting Office study from 2000 indicated that CSPs were active in providing hundreds of Delaware shell corporations to groups of organised criminals from Russia. These Delaware corporations were then used to open US bank accounts and through them launder the proceeds of corruption. Further studies by the Treasury in 2005, the Government Accounting Office in 2006, and the Financial Crimes Enforcement Network in 2007 again drew attention to the threat posed by US shell corporations.

152. Exacerbating this danger is the fact that it is impossible to establish the beneficial ownership of such entities under the laws of 47 of 50 US states (GAO 2006). The combination of unlicenced CSPs and corporate vehicles for which it is difficult or impossible to establish the beneficial owner represents a particularly serious danger to the ability of a jurisdiction to meet the 40 + 9 Recommendations (particularly Recommendation 33) and Egmont Best Practice (see Legal point 7), not to mention the danger it represents to the integrity of the financial sector as a whole. In such cases beneficial ownership may be obscured especially where bearer securities are allowed (unless they have been immobilised), where companies can be formed on-line without the need for supporting documentation (*e.g.* notarised copies of a passport), or where there is no obligation to disclose the beneficiary or settlor of a trust.

153. This Report strongly endorses the conclusion of the FATF study of the misuse of corporate vehicles that CSPs should be subject to a licensing requirement, including a test of fit and proper persons, and explicitly brought under the STR regime, including where the grounds of suspicion relate to corruption. The FATF misuse of corporate vehicles report was accepted at the February 2007 FATF Strasbourg Plenary, but no specific action to encourage members to licence CSPs in this manner was taken. As long as no action is taken, this crucial vulnerability will persist.

154. Some have raised doubts that such a licensing regime would be impractical, overly expensive, or threaten the commercial viability of CSPs. Yet the experience of imposing requirements in small jurisdictions like the Bahamas, Jersey, the Isle of Man and the British Virgin Islands indicates that such worries are overstated. If such small jurisdictions can successfully implement a robust system of CSP licencing, there is no reason why all FATF members cannot do likewise. Indeed, even very small developing jurisdictions like Vanuatu (which has had registered trust formation agents since the 1970s) has recently introduced a licensing system for CSPs modelled on that in place on the Isle of Man.

155. It is possible to discern the state of play with regards to licensing CSPs with the data presented in the 2006 FATF report on Misuse of Corporate Vehicles. The data indicates that of the jurisdictions surveyed, 22 allow intermediaries to form corporate vehicles but do not include them within the AML regime (FATF 2006: 14). A majority of the 17 jurisdictions in the sample that allow trusts do not regulate them (for example in terms of identifying beneficiaries). Sixteen jurisdictions allow bearer shares, many in combination with corporate and nominee directors. In nearly all cases, information on ownership in company registries covers only legal, not beneficial, ownership. In 14 jurisdictions it is not mandatory to keep the information with company registries regularly updated (including the United States and Germany). Only nine jurisdictions regulate TSCPs with a licence system; these intermediaries are regulated in the Bahamas, Jersey, Guernsey, the Isle of Man and Gibraltar, but unregulated in the United States and the United Kingdom (FATF 2006: 13-14).

156. Even granted that CSPs are licensed, fall within the suspicious transaction reporting regime, and are honest, it is still necessary to inculcate knowledge about corruption-related money laundering. To the extent that relevant typologies are unavailable, that AML training does not include inculcating an awareness of corruption issues, and that CSPs making reports in this area do not receive follow-up information from FIUs, it is unlikely that much progress will be made in remedying this weakness in the AML system.

157. An example of best practice in CSP regulation can be taken from the Isle of Man's Corporate Service Providers Act of 2000 and Fiduciaries Act of 2005 (including trust providers, a model that the US Government Accounting Office has proposed should be emulated among American states (GAO 2006). The Isle of Mann Acts cover those who are professionally involved in the formation of companies or trusts; the sale, transfer or disposal of companies; providing a registered office for a non-resident company; acting as a director, agent or registered secretary of a company or trustee of a trust; acting or arranging for others to act as a nominee member of shareholder; or offer administrative services for non-resident companies or trusts.

158. It is also a requirement of the Isle of Mann legislation that CSPs meet a 'fit and proper' person criteria, specified as integrity, competence and solvency. Prospective CSPs must provide a business plan, references and a police check which are then considered by a Board of Commissioners. If approved, CSPs then have to follow a regulatory code. The code includes prudential requirements (*e.g.* professional indemnity insurance), consumer protection clauses (*e.g.* holding clients' money separately in trust from the CSP's own funds), but also requires that CSPs practice Know Your Customer and are bound by the STR requirements. The Manx Financial Services Commission provides an online handbook to further explain these requirements (see http://www.gov.im/fsc/handbooks/guides/csps/welcome.xml).

159. More generally, a fundamental prerequisite for enhancing the integrity of the AML/CFT system in the private sector is effective implementation. Interviewees emphasised to the authors that as a general rule implementation difficulties tend to be a greater threat to the proper functioning of the AML/CFT regime than obsolescent or incomplete legislation. Nor are implementation problems confined to developing countries. For example, the repeated failure of Riggs Bank to observe the stipulations of the Bank Secrecy and USA Patriot Acts, and the active collusion of bank officials in assisting Augusto Pinochet to open accounts under false names and hide assets from foreign law enforcement officials using linked trusts and shell companies, shows that implementation failures can be important even in highly regulated sectors of developed country financial systems.

160. Finally, and as mentioned elsewhere in the Report, the lack of corruption typologies available to private sector reporting entities constitutes a point of vulnerability that may facilitate the laundering of the proceeds of corruption. Aside from deliberate collusion, firms may not be sensitised to report transactions that are suspicious from a corruption-related point of view. Indeed, given the lack of relevant typologies in this area (with exceptions like Belgium and the United States), and the artificial and unhelpful isolation that often exists between anti-corruption and anti-money laundering agencies discussed below, this lack of awareness is not surprising.

Compartmentalisation and Combating Money Laundering and Corruption

161. Before concluding this Chapter on corruption and the effectiveness of the various institutions that comprise the AML/CFT system, it would be remiss to overlook the problem of compartmentalisation: the left hand not knowing what the right is doing. Despite the many calls from a variety of multilateral organisations to response to money laundering and corruption as inter-linked problems (see Chapter 1), interview sources strongly suggested that these calls are not being followed or implemented. These same sources indicate that the problem of compartmentalisation is currently a greater threat to the effectiveness of efforts to counter these kinds of financial crime than the corruption of the systems designed to counter such activities.

162. Anti-money laundering agencies tend to see fighting corruption as someone else's responsibility. For their part, anti-corruption agencies often regard money laundering as outside their remit. As a result, the system for countering these related financial crimes tends to be much less than the sum of its parts. Respondents from various bodies informed the authors that personnel from AML/CFT and anti-corruption agencies had generally never met, much less ever co-operated in

operational matters. The lessons of corruption prevention are at best partially applied to FIUs, and the powerful intelligence and asset confiscation tools provided by AML/CFT laws are rarely used to deter, investigate or recover the proceeds of corruption. Of course there are positive exceptions (like Indonesia, see Chapter 6), but they are relatively scarce.

163. Because FIUs and anti-corruption bodies tend to be isolated from each other, training private firms in their STR requirements generally does not cover corruption cases. Although available evidence precludes drawing any strong conclusions, this lack of training in corruption-related money laundering may well explain the lack of corruption-related STRs noted in the OECD Phase 2 Mid-Term Review (see Chapter 1), and in turn the lack of convictions resulting from this kind of intelligence.

164. This dysfunctional compartmentalisation may extend even further, in that law enforcement and prosecutors are often more interested in corruption as a predicate crime than the money laundering that flows from it because of a lack of knowledge about AML/CFT practice. This tendency was identified as a common problem in the APG Scoping Paper.

Conclusion

165. This Chapter has analysed vulnerabilities to corruption in the AML/CFT system broadly conceived and suggested possible solutions. Once again it must be emphasised that deficiencies of political will and resources, as well as the problem of compartmentalisation, probably do more to inhibit efforts to counter money laundering and the financing of terrorism than corruption *per se*. With this in mind, standard-setting bodies should carefully consider the resource implications of imposing new corruption prevention requirements, especially in relation to low capacity developing countries.

166. The APG's typologies exercise on corruption-related money laundering from 2003 and the resulting Scoping Paper in 2005 comprise a very valuable initial source of information on the dimensions of the problem in the Asia-Pacific region. It provides a preliminary typology of the means by which the proceeds of corruption are laundered, and identifies some common points of vulnerability to corruption in the AML/CFT system.

167. The Chapter then went on to summarise best international practices in corruption prevention. These include policies relating to Codes of Conduct, recruitment, conflicts of interest, gifts and benefits, and security of confidential information. To the extent that these practices are not already being applied in FIUs and other public bodies in the AML system this may represent a point of vulnerability to corruption.

168. Asset registries comprise an especially valuable tool for ensuring the integrity and proper functioning of FIUs, but also the police, prosecutors, the judiciary and PEPs. For maximum benefit assets registers should be regularly updated, they should be cross-checked with data from AML and tax authorities to ensure accuracy, and there should be criminal penalties for false, misleading or incomplete declarations.

169. Judicial corruption presents a serious threat to the proper functioning of the AML/CFT system and the justice system generally. Where judges are poorly paid, appointment and promotion procedures are opaque or arbitrary, hearings are held in secret, and there is a lack of ethics and anti-corruption training, judges will be vulnerable to improper influence. In complex corruption-related money laundering cases spanning two or more jurisdictions even one corrupt judge may jeopardise the whole effort. The situation in which the decision to prosecute senior public officials for corruption lies with a government minister (attorney general) creates a serious conflict of interest. Prosecutorial authority in this context should be vested in an independent legal authority outside the government.

170. FIUs must fulfil the Egmont Group's requirement of operational independence. For small and developing countries, however, this does not preclude the FIU being housed within the central bank. Otherwise, a stand-alone FIU may be ineffective due to basic resource constraints. FIUs should also adopt the dual control 'four eyes' approach to risk management.

171. The often unlicenced and unregulated status of CSPs presents a major point of vulnerability in the existing AML/CFT system. This vulnerability is exacerbated in jurisdictions where there is no legal provision for private sector corruption, and where CSPs may form corporate vehicles for non-residents where the beneficial owner remains hidden. In response it was suggested that jurisdictions that have not already done so move to licence CSPs and bring them within the AML system, perhaps along the lines of the Isle of Man.

172. The point on the need for greater integration also relates to the Report's more general conclusion that there is a need for much more regular communication and information exchange between FIUs, anti-corruption agencies, law enforcement, prosecutors and reporting entities when it comes to the money laundering-corruption nexus. The compartmentalisation of different actors with common and overlapping responsibilities in fighting money laundering and corruption is one of the most prominent obstacles to the effectively fighting money laundering and corruption.

CHAPTER 3: POLITICALLY EXPOSED PERSONS, CORRUPTION AND MONEY LAUNDERING

Introduction and Summary

173. The FATF first became concerned with Politically Exposed Persons (PEPs) in 2001 in connection with private banking. Since 2003 FATF Recommendation 6 specifically addresses this issue. PEPs are seen to pose a high risk of money laundering, especially in connection with corruption. In turn, both the Basel Committee on Banking Supervision and the Wolfsberg Group have noted PEPs-related financial crime can pose a major reputational risk to any banks and other financial firms involved.

174. This chapter explores why PEPs should be managed as part of AML/CFT obligations. It deals with the question of whether domestic PEPs have inhibited the adoption and/or effective implementation of adequate AML/CFT measures. It also outlines the vulnerabilities of AML/CFT institutions to PEPs.

175. There is no single agreed-upon definition of PEPs, or even a consensus that this is the best term. Questions of terminology to one side, however, perhaps the best-developed definition of PEPs is that contained in the European Union Third Directive on Money Laundering. This definition is more precise than FATF Recommendation 6, in particular with regards to legal persons connected to PEPs by joint or individual beneficial ownership or control.

176. Gaps in the existing coverage of PEPs rules are the omission of sub-national leaders (*e.g.* regional governors in federal systems), senior figures in political parties, military and security police leaders, those directing public enterprises, and politically connected religious leaders and managers of charities. We recommend that all these categories are included within the PEPs rules. Furthermore, the problem of extended families or clans in some cultural contexts, and extra-marital affairs, are further complications to be considered.

177. A more serious omission, however, is the restriction of PEPs regulations in a large majority of countries to cover only foreign officials, and not domestic (exceptions including Brazil, Mexico and Belgium). But the UNCAC Article 52(1) does not distinguish between foreign and domestic public officials. As such, all those countries ratifying the UNCAC must now broaden their PEPs coverage to include domestic officials. This will most likely be controversial, as earlier some governments refused to pass anti-money laundering laws while these laws contained domestic PEPs provisions. In fulfilling this new legal requirement, governments should study best available practice from countries like Mexico in applying enhanced scrutiny to domestic PEPs in preparation for legislation in this area.

178. Evidence from the private sector further suggests that the coverage of PEPs in Recommendation 6 is no longer the state of the art, and thus is no longer the best guide for national law. Prominent private sector firms regard the different PEPs definitions in play as a secondary issue compared with the lack of implementation of Know Your Customer provisions. Complementing the provisions of the UNCAC with regards to domestic PEPs, many firms already apply a similar risk-based approach to foreign and domestic PEPs. Multilateral standard-setters and national regulators need to catch up with superior private sector practice.

179. At present just how PEPs are to be identified is under-specified and largely delegated to the private firms, who will often not have sufficient expertise and resources to perform this task adequately. This gap is even more pronounced given the likelihood of the PEPs category being expanded. At the very least, governments must be prepared to give much more and more specific guidance to private firms on identifying PEPs, if not become directly involved in drawing up PEPs lists.

Background

180. In 2006 the FATF/APG Project Group outlined the basis for studying PEPs as part of the research project into the links between corruption and money laundering (FATF/Plenary (2006) 42). It is useful to set out the Project Group's statement concerning PEPs:

Further Study of Politically Exposed Persons

181. The APG Typologies Working Group Scoping Paper on Corruption identified PEPs as being an issue where jurisdictions need clarification and guidance. Financial institutions have continued to express their difficulties in implementing Recommendation 6. Some of the issues identified were: the general difficulty in identifying PEPs, difficulty in identifying who their family members might be, and the length of time after leaving office that someone might be still be considered a 'PEP'. The February 2006 FATF Plenary also requested the Project Group to look into the PEPs issue further and report back in June. Project Group members meeting in May took stock of the on-going and recent developments in the area, while also incorporating the issue of PEPs into the research paper as an area for further study.

- These issues were also raised at the FATF/Private Sector dialogue in Brussels in December 2005, where a majority of private sector representatives agreed that there is a need for a risk-based approach in this area, and questioned how to identify higher risk PEPs (since they stated that not every PEP is high risk). While the private sector sought specific information on PEPs and other targeted individuals, some participants proposed a pragmatic approach: noting that it is unlikely that public authorities will publish a PEPs list and in the absence of a uniform definition, it suggested that financial institutions focus on the monitoring of transactions and activities of customers to come to their own perception of risk, to identify the PEPs and then decide how to deal with the appropriate risk for that customer. Regulators should then be responsible for assessing the appropriateness and reasonableness of the measures taken by financial institutions to address the issue of PEPs.

- In addition to the work by the private sector, the European Commission has also done more work in this area. In a process that began in 2005, in the EC launched a consultation in the 25 Member States regarding implementing measures for the Third Directive on the prevention of money laundering and terrorist financing. In September 2005 the EC published a working document with regard to implementing measures for the directive. The paper asked specific questions for input regarding, *inter alia*, the PEP definition such as what is meant by 'prominent public functions', 'immediate family members', and 'persons known to be close associates of PEPs'.

- After considering initial input, in February 2006 the EC issued a working document for public consultation on draft possible implementing measures, which included a more detailed definition of PEPs. After this second consultation period, proposed technical measures were formally presented to the European Parliament and to the

Committee for the Prevention of Money Laundering and Terrorist Financing (a regulatory committee composed of Member States and chaired by the European Commission) in April 2006. This Committee agreed on 10 May 2006 to the Commission's formal draft. In accordance with the Directive's procedures, the Parliament will have one month following the committee's vote to verify that the limits set in the 'level 1' measures have been respected, before the measures are adopted by the Commission, probably during summer 2006. Article 2 of the document includes a more specific definition of PEPs and is included as Annex 4.

- The Project Group recognises the work already done by the private sector and the EC, including the recent publication of a more comprehensive definition of PEPs. The project group also recognises that there might be more work to consider in this area, and therefore proposes that the PEPs area warrants further study and should be incorporated into the terms of reference for the research paper (attached as Annex 3). In particular, areas to be studied may include:

a. The definition of PEPs (including domestic and foreign) and the issues concerned with identifying PEPs to determine if more work beyond the EC definition should be pursued.

b. The role and treatment of friends, relatives, and associates (both natural and legal persons) of PEPs.

c. The vulnerability of AML/CFT institutions to influence by PEPs.

d. The implementation by the private sector of FATF Recommendation 6.

e. Considering the extent to which domestic PEPs could inhibit the adoption and/or effective implementation of adequate AML/CFT laws.'

Why Manage PEPs as part of AML/CFT obligations?

181. The FATF first examined the risks imposed by PEPs to the financial sector when in 2001 it analysed the money laundering vulnerabilities of private banking. In 2003 the FATF identified PEPS as requiring additional scrutiny due to the higher risks of money laundering or terrorist financing. The FATF issued its Revised Recommendations in 2003 which expressly dealt with PEPs in Recommendation 6. This measure was enacted as a result of increased international awareness of the vulnerability of AML/CFT measures to PEPS. It was designed so that financial institutions would have the necessary information and AML/CFT systems to deal with the increased risks arising from PEPs.

182. The FATF further explained its position in its 2003/2004 Typologies Report, which briefly examined the money laundering risks associated with PEPs. The FATF Report noted at paragraph 77 that:

'the sources for the funds that a PEP may try to launder are not only bribes, illegal kickbacks and other directly corruption-related proceeds but also may be embezzlement or outright theft of State assets or funds from political parties and unions, as well as tax fraud. Indeed in certain cases, a PEP may be directly implicated in other types of illegal activities such as organised crime or narcotics trafficking. PEPs that come from countries or regions where corruption is endemic, organised and systemic seem to present the greatest potential risk; however, it should be noted that corrupt or dishonest PEPs can be found in almost any country.'

183. The FATF Typologies Report contained four case studies demonstrating the linkage between corruption and money laundering. These studies (which are reproduced at Annex 2) show that the

'techniques employed by PEPs to launder illegal proceeds (are) very similar to those of other criminal money launderers. PEPs may use distinctive banking arrangements to assist them in creating a complex or sophisticated network of transactions to protect illicit assets they may have generated.'

184. As the FATF Typologies Report observed, financial institutions should perform enhanced due diligence on PEPs not only because of their susceptibility to corruption but also because they may use laundering techniques which if detected should give rise to suspect transaction reports. The policy implication is that corrupt activities by PEPs may be detected by 'applying enhanced due diligence methods employed similar to those used in countering money laundering.'

185. In October 2001the Basel Committee on Banking Supervision emphasized the high reputational and legal risk of corrupt PEPs and the damage that can be caused to a financial centre (*Basel Committee on Banking Supervision, Working Group on Cross-border Banking, Customer due diligence for banks, BIS Basel, October 2001*).The Basel Committee made the following observation at par 2.25:

> 'Accepting and managing funds from corrupt PEPs will severely damage the bank's own reputation and can undermine public confidence in the ethical standards of an entire financial centre, since such cases usually receive extensive media attention and strong political reaction, even if the illegal origin of the assets is often difficult to prove. In addition, the bank may be subject to costly information requests and seizure orders from law enforcement or judicial authorities (including international mutual assistance procedures in criminal matters) and could be liable to actions for damages by the state concerned or the victims of a regime. Under certain circumstances, the bank and/or its officers and employees themselves can be exposed to charges of money laundering, if they know or should have known that the funds stemmed from corruption or other serious crimes.'

186. Similarly, in 2002 Transparency International focused on the high reputational risk of PEPs:

> 'Money laundering cases involving PEPs can cause significant reputational damage to implicated financial institutions, lead to political instability in the PEP's home country, and demoralise public confidence in the global financial system in general. Thus, TI fully supports specifically identifying PEPs as high-risk customers.'

187. In 2006 the Wolfsberg Group expressed its view on corruption as imposing a series of risks on financial institutions. These risks include service risks (arising from private banking, project finance/export credits, retail banking), country risks (arising from high levels of institutionalised corruption), customer risk (arising from PEPS, intermediaries/agents, correspondent banking relationships, industry risks). From the Wolfsberg Group perspective, PEPs are one of the most important corruption-type risks. The Wolfsberg Group on Corruption Statement explained the nature of the PEP risk as follows:

> 'PEPs potentially represent higher risk because they are either are in a position to exert undue influence on decisions regarding the conduct of business by private sector parties, or have access to state accounts and funds.'

Do domestic PEPs inhibit the adoption and/or effective implementation of adequate AML/CFT laws?

188. PEPs enjoy a special status in their country of origin because of their executive, legislative, judicial, military, and/or bureaucratic power. They are in a unique position of influence in their nation state and perhaps also diplomatically when they are acting abroad. The enactment and implementation of AML/CFT laws and systems are potentially vulnerable to PEPS because they may threaten their

economic and political interests.

189. The authors have found no empirical study of whether and the extent to which domestic PEPs have inhibited the adoption and/or effective implementation of adequate AML/CFT laws. However, some of our interviewees suggested that certain governments initially opposed the enactment of AML/CFT laws because of their concern of the impact of such laws on their political and economic power. For example, there was resistance in some states to the implementation of the new AML/CFT standards because of concerns that this might be the 'thin edge of the wedge.' National politicians were concerned that new AML measures might lead to the application of PEPs requirements to domestic or national PEPs. This provides an additional argument why international standards on PEPs should apply to both foreign and national PEPs. This issue is discussed in detail below.

Vulnerabilities of AML/CFT institutions to PEPS

190. The special status of PEPs may prevent the detection of illegal financial activities in which they or their supporters are involved. In nearly all recent cases of grand corruption, the detection and investigation of the criminal activity of heads of government occurred only after there was a change of government.While the PEPs were in power, there was no real opportunity for domestic law enforcement agencies to investigate the financial crimes of government leaders. The successor regime had an obvious interest in exposing and investigating illicit activities of their political enemies. The reliability of accusations made by new governments concerning former PEPs must be scrutinised because this may represent a 'political settling of scores' rather than a genuine effort to obtain criminal justice.

191. PEPs are in a unique position to undermine the effective implementation of FATF international standards governing AML/CFT laws in their national jurisdictions. In some countries PEPs have considerable financial power and may own or control significant sectors of the economy, including major financial institutions. Where this occurs there is a significant potential obstacle to the application of FATF standards to those PEPs. Although we are not aware of any specific case of PEPs interfering in the reporting of suspect transactions involving their own illicit financial activities, the fact that such reports are rare would suggest the potentiality of obstruction of financial detection and investigation.

192. There is also the problem of lack of political will to assist in an investigation of a foreign PEP who is perceived as a friend of or is linked to senior officials or politicians of the government where investigatory assistance is required. Investigations of the foreign PEP may not be handled in a timely fashion or may be subject to such formalistic and inflexible requirements, that the investigation may be halted or rendered ineffective in supply any timely information.

193. An additional problem raised in the FATF Typologies Report 2003/2004 at paragraph 76 is that:

> 'Because of the special status of PEPs … there is often a certain amount of discretion afforded by financial institutions to the financial activities carried out by these persons or on their behalf. If a PEP becomes involved in some sort of criminal activity, this traditional discretion given to them for their financial activities often becomes an obstacle to detecting or investigating crimes in which they may be involved.'

194. Although the introduction of risk management systems in Customer Due Diligence standards (CDD) will not completely solve this real problem of detecting financial crime in which PEPs may be involved, it will impose increased legal responsibility on the private sector to detect PEP money laundering.

FATF Recommendation 6 and PEPS

195. The FATF considers that an important measure that financial institutions, non-financial businesses and professions can take to prevent money laundering and terrorist financing is the provision of customer due diligence and record-keeping. In the 2003 Revised FATF Recommendations, the new Recommendation 6 explicitly adopted a higher standard for dealing with PEPs. Recommendation 6 provides:

> 'Financial institutions should, in relation to politically exposed persons, in addition to performing normal due diligence measures:
>
> a. Have appropriate risk management systems to determine whether the customer is a politically exposed person.
>
> b. Obtain senior management approval for establishing business relationships with such customers.
>
> c. Take reasonable measures to establish the source of wealth and source of funds.
>
> d. Conduct enhanced ongoing monitoring of the business relationship.'

Identifying PEPS

196. The identification of PEPs is a complex problem for financial institutions. The greatest challenge is in the definition of a PEP which is considered in detail below. There are several possibilities in identifying a PEP. The customer may be required to disclose his/her PEP status, and this may be verified from publicly available information. Alternatively, or as an additional measure, all new customers are checked through PEP databases and other information sources which are available to the financial institution. Recent FATF assessments indicate that acceptable PEPs customer due diligence measures range from relying on customer statements on application forms to checking internal and external databases.

197. The first observation is that financial institutions will not generally have the information within their own databases to recognise PEPs, particularly foreign PEPs. The problem is even more acute for non-financial institutions, professionals and others who are required to take measures to prevent money laundering. The identification of who a person is will not necessarily result in identification of a person as a PEP. Potential clients are not likely to volunteer information about their political status, connections or relationships unless these are already well known. Indeed, it is likely that some PEPs will go to extraordinary lengths to avoid disclosure of their political relationships if they believe that this will result in increased scrutiny and disadvantage them in their dealings with financial or non-financial businesses.

198. The authors endorse the suggestion of the IMF that in implementing compliance with Recommendation 6, 'it is important that the supervisory authorities draft texts implementing the Law which spell out in more detail the particular measures for identifying PEPs for all non-financial professions' (*February 2006 IMF Country Report No. 06/72Belgium: Report on the Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism).*

199. That national governments are in a position to create lists of national PEPs is illustrated by the experience of one FATF member jurisdiction, Mexico. In order to facilitate financial institutions and other bodies to comply with their AML/CFT obligations, the Ministry of Finance of Mexico prepared an 'initial list of national PEPs made up of the position held by public officials' covered in article 110 of the law. The Mexican Ministry of Finance regarded this list as 'illustrative, rather than exhaustive',

so that ultimate responsibility for risk management of PEPs is placed on the reporting entity.

200. Up to now governments have resisted creating a domestic or national PEP lists on the ground that it is too politically sensitive or too difficult a task. In effect, governments have taken the position that the private sector should shoulder the entire responsibility for PEP intelligence by relying on publicly available information or expensive private PEP data bases. If governments are serious about corruption and money laundering then more needs to be done by the public sector in developing PEP information. Governments are in the best position to identify their own PEPs and to provide this information to the private sectors.

201. The authors consider that governments should develop national PEP lists which will assist both local and foreign institutions in combating both corruption and money laundering. The experience of the Government of Mexico in developing PEP intelligence should be studied by APG and other FATF member jurisdictions.

Risk Management

202. From a FATF perspective, financial institutions when applying their risk assessments must not only consider whether a person fits within the PEP definition, but also whether they are employed in an institution or in a country where there is an endemic culture of corruption. What is important is that financial institutions apply risk assessments which take into account all relevant information.

203. Any risk assessment of the identification of PEPs is also linked to the requirement of disclosure of beneficial ownership of companies and other legal entities. It is important that the risk assessment be made at the time of opening the account so that there is strong material evidence as to the beneficial owner or controller of the account. In most grand corruption cases, the PEP bank account is owned by or controlled by an offshore entity, such as a company, a trustee of a trust, or a partner of a partnership.

Senior Management Approval

204. Since 1987 Swiss banks have been required to obtain senior management approval when opening bank accounts on behalf of foreign PEPs. In 2003 the FATF adopted this requirement in its Recommendation 6. Given the significant reputational and legal risks of PEPs, it is considered necessary for senior management of financial institutions to take responsibility for the decision to take on a PEP as a client and to agree to the form and extent of the business relationship between the PEP and the bank. The decision to support a PEP account requires an understanding of the risks involved and this will require consideration by senior management of whether it has the resources to adequately manage such risks.

205. The imposition of a requirement of senior management approval in accepting a PEP as a customer ensures that the management of PEP risk is not merely a back-office function or a responsibility of wealth management advisers. PEP risk is a matter of concern for senior management who must ensure that risk management systems are in place to identify, quantify, control, monitor and report this risk.

206. Best practice requires senior management to supervise a risk assessment for PEP accounts. This will entail an evaluation of the quantity of PEP accounts. The United States Bank Secrecy Act AML Examination Manual sets out a matrix of factors which financial institutions should take into account when evaluating the quantity of PEP risk, including the type of services and products sought, the geographic coverage, the source of funds and level of financial activity.

207. For those financial institutions that have PEP accounts, it is important that there is a central internal data base of PEPs, which may be reviewed by senior management or regulators. In a survey carried out by the British Financial Services Authority (FSA), it was found that many financial institutions could not produce on request a centrally managed PEP list.

Source of wealth and funds

208. Prior to establishing a business relationship with a PEP financial institution is expected to obtain information that identifies the source of funds which are deposited in or transmitted through a PEP account, as well as the source of wealth of the PEP.

209. It is also best practice for financial institutions at the time of opening a PEP account to gather other information, such as the transaction authority of family members and close associates over the PEP account, and the purpose, as well as expected volume and nature of PEP account activity. A financial institution should reach agreement with the PEP as to the expected level of deposits in the account and should have sufficient knowledge of the sources of income and capital of the PEP to justify this level of banking activity.

Ongoing monitoring of PEPs

210. A financial institutions PEP obligations does not cease at account opening. FATF requirements include 'enhanced ongoing monitoring of the business relationship'. The United States Bank Secrecy Act Manual emphasises the important for all high risk customers, including PEPs, to implement systems which monitor bank account activity against anticipated transactions, so as to highlight discrepancies which may result in a suspect transaction report. Compliance managers should review PEP and PEP transactions on a regular basis throughout the term of the relationship. Senior manager also have a role in ongoing monitoring of PEPs, and annual reviews may be necessary.

211. One problem is that a PEP may not be identified at the account opening stage, and/or the existing status of a customer may change over time so that a PEP status is acquired. It is estimated that there are over 100 elections each year throughout the world, resulting in new PEPs being created. It is important that financial institutions regularly review their customer data base against PEP lists or other privately held or publicly available information, so that they uncover new PEPs.

212. Particular care must be taken to ensure that there is monitoring of important changes in the client circumstances and the business relationships of the clients. This was emphasised by the Jersey Financial Services Commission (FSC) in its 2003 review of the Island's financial institution's involvement with the former President of Nigeria, General Sani Abacha and other Nigerian residents in positions of power. The Jersey FSC gave as examples of changed circumstances : "where an individual client becomes a Cabinet Minister with responsibility for government contracts, and where trading structures commence sensitive activities. Structures created to hold wealth that are subsequently used to conduct trade without warning are also a potential risk."

The Definition of PEPs

213. There is no comprehensive or single definition of a politically exposed person. There are a number of international standards which provide some guidance as to the definition of a PEP. The most widely accepted definition of a PEP is the FATF definition, which was adopted in 2003 as part of the Revised Recommendations. The FATF defines PEPs as:

> 'Individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.'

214. The FATF definition is significant because the FATF is accepted as the international standard setter for AML/ CFT measures. Most nation states which have implemented the FATF's 40 Recommendations and 9 Special Recommendations have adopted the FATF definition, although some national laws have provided a wider definition.

215. The FATF definition covers individuals who occupy 'prominent public functions' in a foreign country. This definition emphasizes the reputational risks of accepting clients who may have been involved in corrupt activities. Although there are legal and compliance costs such as fines for failure to carry out adequate PEP due diligence, the underlying reason for implementing a PEP programme is to avoid reputational damage. This view is also reflected in the Wolfsberg definition of PEPs: 'The term should be understood to include persons whose current or former position can attract publicity beyond the borders of the country concerned and whose financial circumstances may be the subject to additional public interest.'

216. The FATF definition is not 'intended to cover middle ranking or more junior individuals'. This limitation on the definition of PEPs suggests that the major concern of the AML/CFT systems is to combat the most serious forms of international corruption, such as grand corruption by senior political leaders. There is a clear linkage between corruption by senior PEPs and reputational risk, while petty corruption or corruption by more junior officials is not viewed as so important from the reputational risk lens.

217. The exclusion of middle ranking or more junior public servants from the FATF definition is a matter of practical sense. If such individuals were included in a PEP definition, then hundreds of millions of individuals would be subject to PEP due diligence. Although these individuals are outside the enhanced PEP diligence requirements, financial institutions are required to apply increased diligence to all public or civil servant in certain circumstances. For example, a financial institution would be obliged to issue a suspect transaction report if a middle ranking public servant deposits substantial and unexplained funds into a bank account.

218. The FATF PEP definition further states that 'business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves'. Although family members are not expressly part of the FATF definition of PEPs, they are required to be subject to increased scrutiny to the extent that they entail increased risks

219. The UN Corruption Convention also deals with PEPs. For the purpose of the Convention, article 2 states:

> '(a) "Public official" shall mean: (i) any person holding a legislative, executive, administrative or judicial office of a State Party, whether appointed or elected, whether permanent or temporary, whether paid or unpaid, irrespective of that person's seniority; (ii) any other person who performs a public function, including for a public agency or public enterprise, or provides a public service, as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party; (iii) any other person defined as a "public official" in the domestic law of a State Party. However, for the purpose of some specific measures contained in chapter II of this Convention, "public official" may mean any person who performs a public function or provides a public service as defined in the domestic law of the State Party and as applied in the pertinent area of law of that State Party.'

220. The definition of 'public official' in the UN Corruption Convention is consistent with a key aim of the Convention to 'promote integrity, accountability and proper management of public officers and public property'. It is more comprehensive than the FATF definition of politically exposed person. It makes no distinction between domestic and foreign PEPs.

221. The UN Corruption Convention defines 'foreign public official' which is similar to and modelled on the OECD Bribery Convention definition. The UN Corruption Convention also defines 'officials of a public international organisations', which is important in that it recognises the potential for international civil servants to be engaged in corrupt behaviour.

222. The state of the art or more accurately the most recent international definition of PEPs is found in the 2005 European Union Third Directive on the Prevention of Money Laundering and Terrorist Financing ('EU Third AML Directive') and in the Draft Implementing Third Directive. Article 3(8) of the EU Third AML Directive defines PEPs as:

> 'natural persons who are or have been entrusted with prominent political functions and immediate family members or persons known to be close associates of such persons'.

223. The PEP definition in the EU Third AML Directive definition is wider than the original PEP definition proposed by the European Commission, which provided that PEPs means 'natural persons who are or have been entrusted with prominent public functions and whose substantial or complex financial or business transactions may represent an enhanced money laundering risk and close family members or close associates of such persons'.

224. The original EU Commission definition was criticised as being less precise than the FATF definition and so was altered (*Opinion of the Committee on the Internal Market and Consumer Protection on the proposal for a directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing, 2004/0137(COD), European Parliament, 18.3.2005).*

225. In contrast, industry bodies, such as the European Banking Industry Committee (EBIC), favoured the original European Commission definition because it targeted not PEPs per se but only those PEPs whose transactions involved an 'enhanced money laundering risk'. The EBIC argued in 2005 that the EU Third AML Directive definition was inconsistent with the risk-based approach of the Directive.

226. The broad EU Third AML Directive is complemented by Article 2 of the Draft Implementing Third Directive which provides for various categories of PEPs, as follows:

> '(a) natural persons who are or have been entrusted with prominent public functions who include:
>
> - Heads of state, heads of government, ministers and deputy or assistant ministers.
> - Members of parliaments.
> - Members of supreme courts, of constitutional courts and of other high-level judicial bodies, whose decisions are not generally subject to further appeal, except in exceptional circumstances.
> - Members of courts of auditors and the boards of central banks.
> - Ambassadors, charges d'affaires and high-ranking officers in the armed forces.
> - Members of the administrative, management or supervisory bodies of state-owned enterprises.

(b) immediate family members of the persons referred to above who include:

- The spouse.
- Any partner considered by national law as equivalent to a spouse.
- The children and their spouses or partners.
- The parents.

(c) persons known to be close associates of the persons referred to at (a) above including:

- Any natural person who is known to have joint beneficial ownership of legal entities and legal arrangements, or any other close business relationship, with a person referred to at (a) above.
- Any legal entity or legal arrangement whose beneficial owner is that natural person and which legal entity or legal arrangement is known to have been set up for the benefit of a person referred to at (a) above.'

Political Parties

227. The definition and categorisation of PEPs by the EU Third AML Directive is not intended to be exhaustive. One category that is missing from the EU list is senior officials of major political parties. Illegal and/or corrupt fund-raising activities of political parties are one of the most pernicious forms of corruption in that it undermines democratic systems of government. This problem applies both to developed and developing states. For example, in both France and Germany there has been major scandals involving political parties' funding, corruption and international money laundering. The failure of PEP AML policies to deal with senior officers of political parties is a major loophole which should be addressed.

Sub-National Political Figures

228. The EU Third AML Directive definition and categorisation of PEPs does not deal with the issue whether officials at the sub-national level should be included within the PEP list. The EBIC has suggested that the reference in the FATF and EU definitions to individuals with 'prominent public functions' in foreign countries, and the specific exclusion of 'middle ranking or more junior officials', imply that politicians at the sub-national level are not PEPs. This textual argument is highly debatable.

229. The FATF Recommendations and EU PEP definition are not intended to exhaustively deal with the risk of the laundering of the proceeds of corruption. From the FATF perspective, corruption is also important when performed by public officials below senior levels (FATF Typologies Report, 2003/2004, par 85). Middle level public servants who have significant responsibilities may also be prone to corruption, especially when their salaries are low and the bribes are high.

230. It was never intended that the FATF or EU definition of PEPs would automatically exclude sub-national political figures. Corruption by heads of regional governments, regional government ministers, and large city mayors are no less pernicious than corruption by prominent national figures. Sub-national political figures in some countries have access to more funds than national leaders in other states. They will often have significant opportunities for corrupt behaviour. There has been several PEP cases involving city mayors who have laundered their illicit funds in offshore jurisdictions. This would suggest that the rules governing PEPs should apply to sub national figures

who are exercising 'prominent public functions'.

Military and Security Personnel

231. The EU categorisation of PEPs does not specifically include senior law enforcement, military and government security personnel, albeit that this is partially covered by the FATF definition. It would be useful if there was a specific categorisation of military and security personnel as examples of PEPs. The case of the former head of the National Intelligence Service in Peru, Vladimiro Montesinos is illustrative of this type of PEP. In Peru Vladimiro Montesinos has been found guilty of embezzlement and bribery in connection with protecting drug traffickers and arms trafficking. The United States authorities have forfeited more than USD 20 million and the Swiss authorities have forfeited $77.5 million in illicit funds held or controlled by associates of Montesinos. These funds have been returned to Peru.

232. The opportunities for massive corruption in arms deals, the role of senior military and security personnel in protecting drug traffickers through corruption, and the laundering of those proceeds through the international financial system suggest that a more extended categorisation of PEPs is warranted. It is recommended that the PEP categories should expressly include senior members of the armed forces, senior members of the police forces and senior members of the secret services.

Religious Leaders and Managers of Charities

233. The EU categorisation of PEPs is also deficient in that it does not address the question whether senior religious leaders and/or heads of charity organisations connected to political figures should be included in the definition of PEPs. In a number of countries religious leaders control or manage substantial public funds, thereby presenting opportunities for corruption. The misuse of charities or religious foundations for money laundering or terrorist financing is not a new problem. Former heads of government in Iran and Indonesia have been accused of using charities as a vehicle for illicit enrichment. The heightened awareness of terrorist financing would suggest that organisers or managers of charities should be subject to additional scrutiny where they are associated with political power, and that one mechanism to do this would be to include them within the definition and/or categorisation of PEPs.

Should domestic PEPs be included in the PEP definition?

International Legal Obligations

234. The FATF definition of PEPs is limited to foreign PEPs. It refers specifically to individuals with 'prominent public functions in a foreign country'. Although there is no obligation under the FATF standards to provide for enhanced due diligence to domestic PEPs, the FATF does encourage the application of its PEP standards to domestic PEPs. The FATF in its Interpretative Note to Recommendation 6 states:

> 'Countries are encouraged to extend the requirements of Recommendation 6 to individuals who hold prominent public functions in their own country.'

235. Unfortunately, despite the exhortatory suggestion of the FATF, few FATF member jurisdictions have taken up this suggestion. Indeed, the tendency has been for states to apply the minimum international FATF standard only to foreign PEPs. In several jurisdictions, the absence of mandatory FATF standards in regard to domestic PEPs has resulted in successful lobbying by

financial institutions of national governments and/or legislatures to resist the extension of PEP rules to domestic PEPs.

236. In the case of the EU Third AML Directive, the definition of PEPs makes no distinction between domestic and foreign PEPs. However, paragraph 25 of the recital and article 13(4) of the Directive expressly recognise that there is to be differential treatment between domestic PEPS (which are subject to normal customer due diligence measures) and PEPS residing in another European Member State or in a third country (which are subject to enhanced customer due diligence). The justification for applying additional CDD to PEPs in third countries is that they are high risk persons coming 'from countries where corruption is widespread'. The same justification does not apply to PEPs from EU Member States, which are already subject to CDD systems.

237. The extension of PEP obligations to EU PEPs has been criticised by the EBIC on the ground that it is 'practically inappropriate', inconsistent with the risk-based model of the Directive, and a significant expansion of the targeted group to include PEPs from 27 member states. On the other hand, the extension of the enhanced obligations to EU PEPs may be considered as a half-way measure to a system which covers all PEPs. The policy justification for this extension is considered below.

238. The UN Corruption Convention does not distinguish between domestic and foreign PEPs in its definition of 'public officials'. This has an important consequence on the scope of the international obligations of State Parties to enact AML laws applying to domestic PEPs.

239. Article 52(1) of the UN Corruption Convention provides:

> 'Without prejudice to article 14 of the Convention, each State Party shall take such measures as may be necessary in accordance with its domestic law, to require financial institutions within its jurisdiction to verify the identity of customers, to take reasonable steps to determine the identity of beneficial owners of funds deposited into high-value accounts and to *conduct enhanced scrutiny of accounts sought or maintained by or on behalf of individuals who are, or have been entrusted with prominent public functions* and their family members and close associates. Such enhanced scrutiny shall be reasonably designed to detect suspicious transactions for the purpose of reporting to competent authorities and should not be so construed as to discourage or prohibit financial institutions from doing business with any legitimate customer.'

240. Article 52(1) imposes an international legal obligation on State Parties to enact measures to "conduct enhanced scrutiny of accounts… of individuals who are, or have been entrusted with prominent public functions and their family members and close associates", irrespective of whether those individuals are domestic or foreign.

241. Our researches indicate that no State Party which has ratified the UN Corruption Convention has made any declarations or reservations to Article 52 of the Convention. Under international law, those countries which have ratified the UN Corruption Convention without making a reservation in respect of Article 52 are obliged to enact AML measures requiring financial institutions to 'conduct enhanced scrutiny of accounts' of both foreign and domestic PEPs.

242. We have found that few of the State Parties to the UN Corruption Convention have implemented Article 52 so as to impose enhanced due diligence obligations on domestic PEPs. This includes FATF member jurisdictions and APG member jurisdictions. There is thus a major compliance gap in implementing article 52 of the Convention which should be addressed. One way of achieving this is to change the definition of PEP in national laws to include domestic PEPS.

National laws on PEPS

243. The vast majority of national laws treat foreign PEPs as more risky and potentially 'bad' PEPs, as compared to national PEPs. The idea that foreign PEPs are high risk compared to national PEPs is linked to two ideas. Firstly, in the case of developed countries, national PEPs are perceived to be less likely corrupt than foreign PEPs, so that there should not be any enhanced due diligence scrutiny of national PEPs. Secondly, PEPs are more likely to conceal their illicit funds by using banking services in foreign jurisdictions because they are not as well known and have a 'greater chance of concealing their identity and ill-gotten gains'.

244. The United States Patriot Act is based on the premise that foreign PEPs are more risky than domestic PEPs. In the United States the term 'Senior Foreign Political Figure' is used in national legislation instead of PEP. Section 312 of the USA Patriot Act defines a 'Senior Foreign Political Figure' as:

> 'A senior official in the executive, legislative, administrative, military or judicial branches of a foreign government (whether elected or not).
>
> A senior official of a major foreign political party. Or
>
> A senior executive of a foreign government owned commercial entity, being a corporation, business or other entity that has been formed by, or for the benefit of, a senior political figure.
>
> The immediate family member of a senior foreign political figure, including the figure's parents, siblings, spouse, children and in-laws.
>
> A 'close associate' of a senior foreign political figure, who is widely and publicly known to maintain an unusually close relationship with the senior foreign political figure, and includes a person who is in a position to conduct substantial domestic and international financial transactions on behalf of the senior foreign political figure.'

245. Section 312 of the Patriot Act and the regulations made thereunder impose an obligation on financial institutions to develop 'risk-based' procedures to identify all of their customers and assess their 'relevant risk factors' to determine who deserves 'enhanced scrutiny'. The rule explicitly compels financial institutions to apply that same "enhanced scrutiny" to the accounts of current and former senior foreign political figures, their family members and close associates to detect if any funds 'involve the proceeds of foreign corruption, including the misappropriation, theft, embezzlement of public funds, bribery, extortion or the conversion of government property'.

246. US law also targets the misuse of private bank accounts by non-US persons for laundering of the proceeds of foreign corruption, a problem highlighted in US Congressional hearings in 1999 (*US Senate Minority Staff Report for the Permanent Subcommittee on Investigations Hearings on Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities, November 9, 1999*). Section 312 of the Patriot Act and regulations made thereunder require financial institutions to conduct specified due diligence for private banking accounts maintained by or on behalf of a non-US person (which includes preventing the acceptance of the proceeds of foreign corruption). Financial institutions are also required to take reasonable measures to identify the nominal and beneficial owners of, and the source of funds, deposited in such private accounts.

247. There are few FATF member jurisdictions which impose a mandatory obligation of enhanced due diligence on domestic PEPs. Belgium is one of the few developed countries which have also applied its AML law to domestic PEPs, albeit that Belgium is not a Party to the UN Corruption Convention because it has only signed the Convention. European Union states which are subject to the EU Third AML Directive will be required by December 2007 to treat PEPs from other EU states

in a similar fashion to foreign PEPs.

248. APG member jurisdictions and observers were surveyed in 2007 as to their legal position on PEPS. In the countries surveyed, most of the 17 member jurisdictions which responded to the survey, had laws, regulations or guidelines which imposed an explicit obligation of financial institutions to carry out enhanced AML/CFT due diligence on foreign PEPs. Several member jurisdictions, including Afghanistan, Sri Lanka, Solomon Islands and Timor-Leste had express laws, regulations or guidelines that imposed enhanced due diligence requirements on financial institutions which had domestic PEPs.

249. A number of APG member jurisdictions appeared to be of the view that applying a risk assessment system to both domestic and foreign PEPs was sufficient to comply with international best practice. Applying this view, domestic PEPs would be subject to normal customer due diligence procedures as set out in regulator requirements, but would not automatically be considered to present a higher risk, requiring enhanced due diligence. For example, one observer organisation considered that best practice would be facilitated by regulatory guidance that applied to all PEPs, but with 'emphasis on (i) links to jurisdictions that are vulnerable to corruption; and (ii) customers involved with businesses that appeared to be most vulnerable to corruption'. Although this view has the advantage of flexibility, it ignores the new international obligations under article 52(1) of the UN Corruption Convention. Imposing an appropriate risk management system to deal with domestic PEPs is only one of four requirements for enhanced due diligence under FATF Recommendation 6, and would not be sufficient to comply with the article 52(1) obligation.

250. Our survey showed that no APG member jurisdiction has plans to change their AML laws to comply with the international obligations under article 52(1) of the UN Corruption Convention. Indeed, in one case a member jurisdiction which recognised in 2006 that international obligations under article 52 of the UN Corruption Convention required the introduction of enhanced due diligence requirements for domestic PEPs, has stated in 2007 that no policy decision has been taken as to whether to extend the proposed law to domestic PEPs.

251. Countries which have ratified the UN Corruption Convention and have applied their laws to both domestic and foreign PEPs include FATF members Mexico and Brazil. For example, in 2004 Mexico enacted an AML/CFT law which defined PEPs as 'any individual who performs or has performed important public functions in a foreign country or within the nation's territory, including among others, chiefs of state or government, political leaders, high-ranking government, judicial or military officials, senior executives of state-owned companies or officers or important members of political parties' (*See OECD Directorate for Financial and Enterprise Affairs, Mexico: Phase 2: Follow up report on the Implementation of the Phase 2 Recommendations, Application of the Convention on Combating Bribery of Foreign Public Officials in International Transactions and the 1997 Revised Recommendation Combating Bribery in International Business Transactions, OECD, Paris, 4 April, 2007, p 37).*

252. Under the Mexican law obligated entities must 'develop mechanisms for determining the degree of risk of operations carried out with PEPs, and for this purpose will determine whether the transactional behavior corresponds reasonably to their functions, level and responsibility'. In addition, they establish the obligation to establish a system of alerts in order to detect changes in their transactional behavior and report the operation as unusual, if that is the case (*See OECD, April 2007, p 23*).

253. A similar definition of PEPs is found in Circular 3.339 issued by the Central Bank of Brazil on 22 December 2006:

> 'those public agents that perform or have performed in the last five years in Brazil or in foreign countries, territories and dependencies any relevant public position, employment or function, as

well as their representatives, families and other closely related person'.

254. The Brazilian Central Bank provides detailed guidance on PEPs, including a descriptive list of occupations of Brazilian PEPs. This list of occupations is very helpful to the private sector because it is authoritative and explains which public service positions may constitute national/domestic PEPs.

Extending the PEP obligation to national PEPs

255. This raises the question whether there should be any differentiation between domestic or national PEPs and foreign PEPs. The strongest argument in favour of extending the PEP definition to domestic PEPs is that it is now an international legal obligation for State Parties to the UN Corruption Convention. For other countries, there are strong policy arguments supporting an extension. Domestic PEPs can be as corrupt as foreign PEPs, and may launder illicit proceeds in the local economy, for example, through real estate and/or financial transactions. By imposing enhanced AML obligations on financial institutions which deal with domestic PEPs, countries with major corruption problems would be assisted in their fight against corruption and money laundering.

256. It is sometimes suggested that there is a lack of political will to expand PEP due diligence to national PEPs. Industry lobby groups do not favour an expanded PEP definition because this may impose undue costs in circumstances where governments are not prepared to assist in the formulation of PEP intelligence. It is also the case that it is in the interests of corrupt PEPs to resist the extension of AML laws to domestic PEPs.

257. There is some evidence that the international standards of the FATF concerning PEPs are falling behind the actual practice of major financial institutions. For example, it has been reported that several multinational financial institutions in the United States are applying the same standard of enhanced scrutiny to senior US politicians as they do to foreign PEPs. One of the leading private PEP database service providers has stated that its clients should not distinguish between domestic and foreign PEPs.

258. The history of money scandals, illicit political funding, and outright bribery and corruption cases involving domestic politicians is extensive and continuing. This is found in both developed and developing countries. The legal and reputational risks involving national politicians who abuse taxpayers' funds or personally enrich themselves through corrupt behaviour may in some cases be more significant than those pertaining to foreign PEPs. Empirical evidence and logic suggest that there is no real justification for distinguishing between national and foreign PEPs.

259. In our opinion the international standards on PEPs as expressed in the FATF Recommendation are not sufficiently rigorous. Limiting special AML measures to foreign PEPs establishes an unfortunate precedent, especially for developing countries. If developed countries do not require enhanced scrutiny of their national politicians, why should developing countries not follow their example and apply the same minimum due diligence standards to their domestic politicians. This undermines efforts to prevent corruption in poorer countries. If corruption is to be effectively prevented, then measures of accountability through the process of CDD should apply equally to both national and foreign PEPs.

Family Members and Relatives

260. Although the FATF definition of PEPs does not clearly include "family members or close associates", it does point out that there are similar reputational risks between customers who are PEPs and customers who have a family or other association with PEPs. The UN Corruption Convention is more specific and precise in requiring enhanced due diligence of families and associates of PEPs.

261. The EU Draft Implementing Directive sets out specific categories of family members who are PEPs. These include: "immediate family members" of PEPs, "the spouse, any partner considered by national law as equivalent to a spouse; the children and their spouses or partners; and the parents." In an earlier version of the Draft, there was a specific reference to "in-laws", but this was excluded from the final version.

262. The EU categorisation of family members is confined to "immediate family members." It does not take into account that in some states, especially in developing countries in Asia, the Pacific, Africa and the Middle East, there are extended family and kinship obligations which may facilitate nepotism and corruption. Although the EC categorisation may be justified on the basis that it reduces the potential target group for PEP risk assessment, it is oversimplistic in its understanding of the complexity of family relationships throughout the world.

263. The restriction of the EU category to a 'partner considered by national law as equivalent to a spouse' is formalistic and legalistic. Why should the legal status of de facto partners influence the definition of family members for the purpose of PEP reviews? From a risk perspective, a nation state's family laws and attitude to divorce and non married partners should not influence a bank's risk assessment policies in respect of PEPs. For example, a former head of government in an APG member jurisdiction, where there are no divorce laws, has been accused of laundering corrupt funds through properties which were acquired for the use and benefit of his mistresses and their children. In one FATF member jurisdiction it is estimated that 95 per cent of convicted corrupt officials had mistresses, who invariably benefited from the corruption and participated in the laundering of the illicit funds.

264. The important issue is whether a person's connections to a PEP are likely to be exploited by a PEP for money laundering purposes. The prevention of corruption requires a definition of PEPs that is consistent with the actual and functional relationship of a family and relatives in any given country. In this respect international standards would seem to be falling behind the best practices of industry. One leading international financial institution has informed the authors that it incorporate a broader range of family members who may be subject to PEP review. For example, the multinational institution has compiled a detailed list of categories of relatives who may be included in a PEP assessment. That list includes grandparents, grandchildren, aunts, uncles, nephews, nieces, in-laws and step parents. The institution states that the list of relatives is neither exhaustive nor compulsory. Senior managers of the institution in each country are required to adopt the list to local circumstances. The decision whether a person is a relative of a PEP will depend on local knowledge, rather than any global, imposed rule.

Business Associates – Natural and Legal Persons

265. The FATF PEP definition refers to 'business relationships with family members or close associates'. A more precise formulation is found in article 2 of the EU Draft Implementing Third Directive. Under this provision, enhanced PEP diligence is applied to persons known to be close associates with a PEP. The EU PEP categories encompasses two types of business associates:

> 'any natural person who is known to have joint beneficial ownership of legal entities and legal arrangements, or any other close business relationship' with a PEP.

> 'any legal entity or legal arrangement whose beneficial owner is that natural person and which legal entity or legal arrangement is known to have been set up for the benefit' of a PEP.

266. This definition distinguishes business associates of PEPs on the basis of whether they are natural persons or legal entities. This distinction is based on legal categorisation. In practice, business associates have played two roles in facilitating corruption. Firstly, business associates of PEPs have used their political connections to obtain favourable commercial opportunities, such as licences or monopolies. The business associates have enjoyed the corrupt benefits of 'crony capitalism' and as such are legitimate targets for corruption/AML investigations. An illustration of this phenomenon is the Philippines under the Marcos regime and Indonesia under the Soeharto administration.

267. Secondly, business associates may act as fronts for PEPs in concealing and laundering the proceeds of corruption. As the FATF Typologies report of 2003/ 2004 noted at paragraph 78:

> 'PEPs, given the often high visibility of their office both inside and outside their country, very frequently use middlemen or other intermediaries to conduct financial business on their behalf. It is not unusual therefore for close associates, friends and family of a PEP to conduct individual transactions or else hold or move assets in their own name on behalf the PEP. This use of middlemen is not necessarily an indicator by itself of illegal activity, as frequently such intermediaries are also used when the business or proceeds of the PEP are entirely legitimate. In any case, however, the use of middlemen to shelter or insulate the PEP from unwanted attention can also serve as an obstacle to customer due diligence that should be performed for every customer. A further obstacle may be involved when the person acting on behalf of the PEP or the PEP him or herself has some sort of special status such as, for example, diplomatic immunity.'

268. An even greater problem is the use of shell companies, foreign legal entities, opaque legal arrangements, and offshore banks, located outside the country of the origin of the PEP, to disguise the identity of the beneficial owner/controller of the illicit funds (FATF, Typologies Report 2003/2004, paragraph 79). The role of Corporate Service Providers in supplying these financial arrangements was discussed in Chapter 2. In such cases, financial institutions may be incapable or unaware that the bank account is owned or controlled by a PEP and that it is obliged to conduct enhanced customer due diligence.

Inconsistent Definitions

269. One important issue is whether there are any adverse practical consequences of inconsistent definitions of PEPs. Does the lack of a global, uniform definition of PEPs undermine AML/CFT systems? For example, if different financial institutions have different operation definitions of PEPs does this create arbitrage opportunities for those PEPs who wish to launder their corrupt monies?

270. In national debates about money laundering, financial institutions have often complained about a lack of a single definition of PEPs. This argument has usually been made together with the suggestion that governments should provide a database of PEPs since they are in the best position to judge whether an individual is a PEP. While ideally it would be preferable to have a single definition, the lack of such a definition does not appear to have caused practical problems for international financial institutions which operate in several jurisdictions.

271. One interviewee who has had considerable experience in both the private and public sectors in AML, informed the authors that it was unlikely that 'bad persons' could exploit differing definitions of PEPs by a process of arbitrage. The problem of arbitrage is more likely to arise when there is a perceived lack of enforcement of Know Your Customer policies in different jurisdictions or among different financial institutions. The expert interviewee confided that: 'the real issue caused by a lack of a uniform definition of PEPs is uneven supervision and enforcement by governments and regulators. Especially for global institutions, having varying definitions of PEPs makes it extremely difficult to put in place an effective global program, without taking the most comprehensive and inclusive definition and applying it globally.'

US Initiatives and Enforcement Actions Against corrupt PEPS

272. The United States is one of the few countries that has promulgated significant initiatives against corrupt foreign PEPs and taken enforcement action against PEPs who have laundered their proceeds of crime through the US financial system. The US experience provides lessons for FATF and APG member jurisdictions. Examples of US initiatives against corrupt PEPs include the following:

- The establishment in 2003 of the first Foreign Corruption Task Force Task Force in Miami to specifically target the proceeds of public corruption emanating from foreign nations that are being laundered in the United States. The 'PEP Task Force' has conducted numerous financial investigations on behalf of Central and South American and Caribbean Governments using section 315 of the USA Patriot Act which allows for the inclusion of foreign corruption crimes as predicate offences to money laundering crimes.
- Presidential Proclamation 7750 of January 2004, where the United States President gave specific legal authority to the Secretary of State to identify persons who should be denied entry into the United States because they are involved in public corruption that has serious adverse effects on the national interests of the United States.
- US comprehensive 2006 Strategy to Internationalize Efforts Against Kleptocracy, Combating High-Level Public Corruption, Denying Safe Haven, and Recovering Assets.
- Presidential Executive Order 13405 of June 2006 'Blocking the Property of Certain Persons Undermining Democratic Processes or Institutions in Belarus'. This executive order explicitly incorporated kleptocratic behaviour as a basis for designation.

273. Prominent US enforcement actions in relation to PEPs include:

- The investigation, forfeiture, and repatriation to Peru in 2004 of more than USD 20 million connected to the illicit conduct of former President Albert Fujimori and his associates, together with assistance in the capture of former Peruvian intelligence chief, Vladimiro Montesinos, and the return of illicitly acquired assets from other jurisdictions.
- The investigation, forfeiture and transfer by US Treasury to Nicaragua in 2004 of USD 2.7 million (out of more than USD 3.3 million seized) of funds embezzled by former Nicaraguan President Arnoldo Alema and Byron Jerez, Nicaragua's former Tax Commissioner. The illicit funds had been laundered through bank accounts in Panama and used to purchase eight Certificates of Deposit and a luxury condominium in Florida. In a press release issued 9 December, ICE explained that the repatriated funds

'stem from the seizure and forfeiture of eight certificates of deposit and a luxury condominium in Key Biscayne, Florida, that were purchased with funds embezzled by former Nicaraguan President Arnoldo Aleman and Byron Jerez, Nicaragua's former tax commissioner'.

- The US Treasury enforcement of a United Kingdom restraint order to freeze more than USD 400 000 in assets connected to a former Nigerian Governor charged with corruption offenses there and money laundering in the UK. This 2006 enforcement action was the first of its kind under the Patriot Act.
- More intensive enforcement action under the Foreign Corrupt Practices Act (FCPA), such as the 2006 conviction of a US company for violating the FCPA in connection with USD 3.5 million in illicit payments made to an advisor of the President of Benin. The company paid over USD 28 million in criminal and civil fines to resolve the Department's criminal action and a related SEC enforcement action.
- The successful prosecution in 2006 of Pavel Lazarenko, the former Prime Minister of the Ukraine for laundering money through correspondent bank accounts at three US-based banks and three US-based brokerage houses, in relation to USD 44 million of the USD 114 indictment counts.
- The successful prosecution of Riggs Bank NA for systematically failing to report suspicious transactions associated with bank accounts owned and controlled by various PEPs, including Augusto Pinochet, the leader or President of Chile from 1973 to 1990.
- The 2004 US Federal Reserve fine of USD 100 million imposed on UBS, the Swiss financial conglomerate, after it admitted that it had illegally transferred billions of dollars to Cuba, Iran, Libya and Yugoslavia in violation of US sanctions and its extended custodial inventory program for distribution of currency on behalf of the US Federal Reserve.

CHAPTER 4: BEST PRACTICES FOR INTERNATIONAL CO-OPERATION

Introduction and Summary

274. The APG study of corruption and international co-operation focuses on specific terms of reference which are as follows:

> 'Acknowledging that anti-corruption and AML/CFT strategies have a shared objective to promote international cooperation in targeting criminals and their proceeds of crime through:
>
> - Benchmarking effective systems for mutual legal assistance, extradition, confiscation and seizure of assets and the denial of safe havens for criminals and assets arising from criminal activities.
> - Identifying vulnerabilities for corruption in AML/CFT institutions in relation to the provision of effective MLA and making recommendations for dealing with such vulnerabilities.'

275. There are a wide variety of regional and global treaties and conventions aimed at facilitating international co-operation in fighting money laundering and corruption. An area of pronounced interest among APG members and more broadly has been the recovery of the proceeds of crime. Of particular relevance for this study are the UNCAC, the ADB/OECD Action Plan and associated work, and the OECD Anti-Bribery Convention. We recommend that all APG members that have not yet done so sign and ratify the UNCAC and endorse the ADB/OECD Action Plan, while other members may also wish to consider joining the OECD Anti-Bribery Convention.

276. The dual criminality criterion is a vital issue in mutual legal assistance in combatting cross-border corruption and money laundering. It is recommended that parties ensure that passive and active corruption are criminalised, as well as the bribery of foreign officials, bribery through intermediaries and subsidiaries, and private sector corruption. Beyond this, the appropriate test for dual criminality in extradition matters is the 'conduct test' as defined in Article 43(2) of the UNCAC, rather than more narrow technical approaches.

277. For non-coercive measures, countries should strongly consider extending mutual legal assistance even when the criterion of dual criminality is not fulfilled, given that such co-operation impinges to a much lesser degree on the rights of an individual. The Commonwealth Harare Scheme provides further guidance on mutual legal assistance in this manner.

278. A variety of international initiatives have successfully targeted banking secrecy as an obstacle to international legal co-operation. These include the OECD 'Increasing Access to Bank Information for Tax Collection Purposes' and 'Harmful Tax Practices' initiatives, the FATF NCCT exercise, and Article 40 of the UNCAC. Despite these welcome advances, de facto banking secrecy remains intact in many countries through quirks of national jurisprudence, or the failure to establish beneficial ownership of corporate vehicles that have entered the banking system (see Chapter 2).

279. In many countries those in prominent political positions, especially heads of state and government, enjoy immunity from prosecution, and in some cases this protection extends to former officer-holders also. In line with the Commonwealth Working Group on the Recovery of Assets we recommend that such immunities be abolished, or at least substantially reduced.

280. Asset recovery is one of the most important goals in mutual legal assistance, and in the last few years proceeds of corruption to the value of hundreds of millions of dollars have been repatriated to the Philippines and Nigeria. In particular, courts in Switzerland and the United States have been

common venues for complex grand corruption and asset recovery cases. In practice, the main obstacle to asset recovery has been the lack of admissible evidence, coupled with the delays and expense associated with this kind of international legal action.

281. We welcome the shift represented by UNCAC Article 51 that enshrines the principle of stolen assets being returned to the 'victim' country, rather than being kept by the country whose co-operation is requested in effecting this return. This principle does not, however, preclude requested countries being compensated for extraordinary expenses in tracing, freezing, confiscating and returning assets. Complementary or alternative measures for 'victim' states might be taking civil action in the foreign jurisdiction, or assisting the foreign jurisdiction to bring money laundering charges against local persons and/or institutions (see ADB/OECD publications for further details).

Need for International Co-operation in Corruption/Money Laundering Cases

282. In the APG Scoping Paper 2005 contributors emphasized that corruption-related money laundering is transnational in character, so that it is not uncommon for the proceeds of corruption, the evidence, and/or the briber/bribee/and money launderers are located in different jurisdictions. Investigations in transnational corruption cases may be complex, resource intensive and require co-operation from multiple jurisdictions, often through successive mutual legal assistance requests. There is an obvious need for enhanced international co-operation in recovering the proceeds of corruption and pursuing those involved in criminal activities (p 10).

283. The ADB/OECD Anti Corruption Initiative for Asia and the Pacific has produced two valuable papers to assist countries in improving international co-operation in this field*: Denying Safe Havens to the Corrupt and the Proceeds of Corruption* (2006) and *Mutual Legal Assistance, Extradition and Recovery of Proceeds of Corruption in Asia and the Pacific* (2007).

284. The ADB/OECD 2006 document is a major study of the mechanisms, obstacles and practices of international co-operation in relation to corruption/money laundering, focusing not only on the Asia/Pacific experience, but also major traffic mutual assistance countries, such as Switzerland.

285. The ADB/OECD 2007 document provide a thematic review of the framework and practices for mutual legal assistance (MLA), extradition and the recovery of the proceeds of corruption among 27 Asian and Pacific jurisdictions: Australia; Bangladesh; Cambodia; PR China; Cook Islands; Fiji Islands; Hong Kong,China; India; Indonesia; Japan; Republic of Kazakhstan; Republic of Korea; Kyrgyz Republic; Malaysia; Macao, China; Mongolia; Nepal; Pakistan; Palau; Papua New Guinea; Philippines; Samoa; Singapore; Sri Lanka; Thailand; Vanuatu; and Vietnam.

286. The ADB/OECD 2006 and 2007 papers detail the following obstacles to international co-operation:

- Misunderstandings of the differences in legal systems resulting in inadequately drawn requests for assistance or even 'self censorship', where a requesting state decides not to make a MLAT request.
- Requirement of dual criminality, which requires that the conduct alleged by the requesting country amount to a crime in the requested state: this causes problems because of the wide variety of offences of corruption throughout different jurisdictions.
- Differences in evidentiary procedures between the requested and the requesting state, which may result in evidence supplied by the requested state not being admissible in the requesting state.

- Wide range of grounds for refusing assistance listed in treaties and legislation, such as the concept of 'national security' or 'essential interests of the state'.
- Inordinate delays in obtaining evidence from the requested state (often caused by multiple appeal procedures in the requested state) which may stymie a prosecution for corruption/money laundering, and in some cases result in prosecutors abandoning a criminal case.
- The costs of investigating, tracing, freezing, confiscating and returning the proceeds of corruption.

287. International extradition, which is considered to be a more intrusive form of co-operation, provides additional obstacles, such as:

- The difficulty of entering into bilateral arrangements with States whose legal systems are based on different ideological and political perspectives, resulting in an absence of trust, which is the very cement of any effective extradition relationship.
- The principle of non-extradition of national, which is applicable in most non common law jurisdictions.
- The prima facie or probable cause evidentiary requirement, which is a very old extradition requirement, applicable in some common law jurisdictions.
- Wide ground for refusing extradition, such as severe penalties (*e.g.* death penalty) or humanitarian principle which certain states adhere to.

288. The corruption/money laundering paradigm of international co-operation is similar to the problem of investigating transnational financial crimes in general. What makes this topic different is the multiple layers of obstacles and complexities arising from the international tracing, freezing and recovery of the proceeds of corruption. Given the significant sums of corrupt proceeds that have been laundered in the past 20 years, there is an extra dimension to providing effective international co-operation in this field. Those political leaders who are engaged in grand corruption have access to significant technical, accounting, banking and legal resources to conceal their crimes and to prevent recovery of the bulk of their looted assets.

International Treaties and Instruments

289. There are a number of international instruments that are relevant to international co-operation in combating of corruption and money laundering. Prominent regional examples are: Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 1990; Organisation of American States Inter-American Convention against Corruption 1996; Council of Europe Criminal Law Convention on Corruption 1999; Council of Europe Civil Law Convention on Corruption 1999; and the African Union Convention on Preventing and Combating Corruption and Related Offences 2003. The industrialised developed world has sought to limit the demand-side of corruption through the landmark OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1998. The key universal multilateral instruments are those which have been sponsored by the United Nations: United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988 (Vienna Convention); United Nations Convention Against Transnational Organized Crime (Palermo Convention) and its supplementing protocols 2000; International Convention for the Suppression of the Financing of Terrorism 2002; and the United Nations Convention against Corruption 2003.

290. Each of these multilateral instruments provides mechanisms for international co-operation between the parties. They provide a gateway for co-operation between states which may have no

bilateral extradition or mutual assistance arrangements. The failure of states to sign, ratify and effectively implement these instruments may result in the creation of corruption and/or money laundering havens.

291. The authors consider that it is highly desirable that as many states as possible accede to and ratify these multilateral instruments so that the international network of co-operation is maximised. This was the view expressed in the APG Scoping Paper which pointed out that 'the development of consistent MLAs across the Asia-Pacific region would promote greater international co-operation through the ability of jurisdictions to pursue both the proceeds of corruption and criminals as well, coupled with the capacity to asset share' (p 10). It also accords with FATF Recommendation 35 which requires countries to take "immediate steps to become party to and implement" the Vienna Convention, Palermo Convention and the United Nations International Convention for the Suppression of the Financing of Terrorism.

292. In terms of fighting international corruption, including the laundering of the proceeds of corruption, the three most important instruments for APG members are: UNCAC, the ADB/OECD Action Plan, and the OECD Anti-Bribery Convention. The following table provides information as to the status of these multilateral instruments among APG member jurisdictions. It is based on publicly available information.

THE ASIA PACIFIC GROUP ON MONEY LAUNDERING – LEGAL STATUS OF INTERNATIONAL INSTRUMENTS ON CORRUPTION

Jurisdictions	UNCAC	ADB/OECD Action Plan	OECD Anti Bribery Convention
Afghanistan	Signed		
Australia	Ratified	Endorsed	Ratified
Bangladesh	Ratified	Endorsed	
Brunei Darussalam	Signed		
Cambodia		Endorsed	
Canada	Signed		Ratified
Chinese Taipei		Endorsed	
Cook Islands		Endorsed	
Fiji Islands		Endorsed	
Hong Kong,China	China ratify	Endorsed	
India	Signed	Endorsed	
Indonesia	Ratified	Endorsed	
Japan	Signed	Endorsed	Ratified
Republic of Korea (South Korea)	Signed	Endorsed	Ratified
Macao, China	China ratify	Endorsed	
Malaysia	Signed	Endorsed	
Marshall Islands			
Mongolia	Ratified	Endorsed	
Myanmar	Signed		
Nepal	Signed	Endorsed	
New Zealand	Signed		Ratified
Niue			
Pakistan	Signed	Endorsed	
Palau		Endorsed	
Philippines	Ratified	Endorsed	
Samoa		Endorsed	
Singapore	Signed	Endorsed	
Solomon Islands			
Sri Lanka	Ratified	Endorsed	
Thailand	Signed	Endorsed	
Tonga			
United States of America	Ratified		Ratified
Vanuatu		Endorsed	
Vietnam	Signed	Endorsed	

293. The most significant innovation is the UN Corruption Convention which was adopted by the General Assembly on 31 October 2003, was open for signature on 9-11 December 2003, and entered into force on 14 December 2005. As at 4 September 2007, there are 150 signatories, and 98 ratification/accessions to the UN Corruption Convention.

294. The author's researches show that 14 of the 34 APG member jurisdictions have signed UNCAC. These include jurisdictions, such as Bangladesh, Indonesia, Philippines, Macao (China) and Hong Kong,China, where anti-corruption is a key development goal. In contrast, with the exception of one country, all the 34 FATF members are signatories to UNCAC.

295. The record on ratification/accession to UNCAC is not so impressive. Only 98 member States and organisations have ratified/acceded to UNCAC, including 21 of the 34 FATF member jurisdictions, and 9 of the 34 APG member jurisdictions.

296. The authors strongly urged that all APG jurisdictions who have not signed UNCAC should do so as matter of priority. It is also highly desirable that all APG and FATF member jurisdictions accede to the UNCAC as soon as practicable. The importance of the UNCAC is discussed below.

297. Few APG member jurisdictions are parties to the OECD Bribery Convention. This is understandable given the origin of the OECD Anti-Bribery Convention. Presently, the only APG members who are parties to the OECD Anti-Bribery Convention are the six members of the OECD, namely, Australia, Canada, Japan, Korea, New Zealand and the United States of America.

298. Several non-OECD APG member jurisdictions have laws which would enable prosecution of foreign bribery in limited circumstances. For example, two APG states criminalize the bribery of foreign public officials provided the offer, solicitation, or acceptance of the bribe occurs in the local jurisdiction. There is no extraterritorial application of the anti-bribery law.

299. Interestingly, one non-OECD APG member jurisdiction has criminalized the bribery of local public officials and foreign public officials, irrespective of where the criminal conduct occurs. The anti-bribery law applies to officials, regardless of whether there is a law punishing such offences in the place where the crime was committed.

300. One of the limitations of the OECD Anti-Bribery Convention is that it has a narrow focus on the active briber, and not the bribee or recipient of the bribe. Despite this limitation, the authors recommend that APG members, especially those which have multinational corporations which may engage in bribery of foreign public officials, should seriously consider whether they should become parties to the OECD Anti-Bribery Convention. Alternatively, APG members may follow the example of one of its member jurisdictions which has criminalized foreign bribery, even though it is not a party to the OECD Bribery Convention.

301. Most APG member jurisdictions have endorsed the ADB/OECD Anti-Corruption Action Plan for Asia and the Pacific. Of the 27 countries of the region that have formally endorsed the Action Plan and committed to its goals, 24 are APG member jurisdictions. It is suggested that the 10 APG member jurisdictions which have not approved the Action Plan, which presently consist of several developed countries and small Pacific states, should give serious consideration to adopting the Plan.

International Best Practice under the FATF Recommendations

302. FATF Recommendations 35 to 40 and Special Recommendations I and VI provide a series of standards of international best practice in relation to international co-operation in regard to money laundering and terrorist financing. The FATF standards deal with mutual legal assistance, extradition and other forms of co-operation. Recommendation 36 provides that "countries should rapidly,

constructively and effectively provide the widest possible range of mutual legal assistance." In particular, countries are required to ensure that the powers of competent authorities to obtain documents and information for investigative, prosecutorial and related actions under Recommendation 28 are also available for use in response to requests for mutual legal assistance. International assistance should not be subject to unreasonable, disproportionate or unduly restrictive conditions.

303. Extradition is often a time consuming, expensive and an inefficient mechanism for international co-operation. FATF Recommendation 39 encourages countries to simplify extradition by allowing extradition based only on warrants of arrest or judgements. Best international practice in extradition requires countries, if permitted by their legal system, to eliminate the prima facie evidentiary rule of extradition, which was for over 150 years a legal requirement of extradition from the Anglo/American common law countries.

304. Recommendation 40 provides for more informal forms of co-operation between law enforcements agencies. International best practice encourages the exchanges of information in a prompt and constructive manner, directly between counterparts, either spontaneously or upon request in relation to both money laundering and the underlying predicate offences, which may include corruption.

305. The ADB/OECD 2006 and 2007 studies referred to above provide numerous examples of international best practice. Another useful source is the 2001 Report of the Informal Expert Working Group on Mutual Legal Assistance Casework Best Practice, sponsored by the United Nations Office on Drugs and Crime. The authors endorse the best practice recommendations found in the 2001 UN report which are designed to facilitate mutual legal assistance. Recommendations that are relevant to our study include:

- Strengthening the effectiveness of central authorities for mutual legal assistance: likewise FIUs need to be made more effective.
- Ensuring awareness of national legal requirements and best practice for domestic and foreign officials involved in the mutual legal assistance process.
- Expediting mutual assistance through use of alternatives to formal mutual legal assistance requests, for example, the use of joint investigative teams.
- Maximising personal direct contact between officers in different countries, together with eliminating or reducing technical impediments to execution of requests in the requested state.
- Increased use of modern technology to expedite requests and assistance, coupled with using the most modern mechanisms in a resource effective manner.

United Nations Convention Against Corruption (UNCAC)

306. The UNCAC has been presented as a landmark in international co-operation in the fight against corruption and the laundering of corrupt funds. It has been described as the 'first genuinely global, legally binding instrument on corruption and related matters, that is the first to be developed with an extensive international participation and with a broad consensus of signatory States and international private sector and civil society organisations' (*Antonio Argandoña*, *"The United Nations Convention Against Corruption and its Impact on International Companies:" (October, 2006). IESE Business School Working Paper No. 656, p 4)*. That gainsaid, the UNCAC represented a compromise between developing states which sought the rapid and unencumbered return of assets looted by political leaders, and developed states which sought to subject the recovery of such assets to the procedural

and substantive safeguards imposed by their legal systems.

307. The UNCAC requires all state parties to give the widest measure of international co-operation in combating, investigating and recovering the proceeds of corruption. It recognises that international co-operation between states depends on enhancing national criminal laws and national law enforcement agencies. The UNCAC provides for a wide range of national measures, such as

- Improving anti-corruption prevention (chapter 2), including measures to prevent money laundering (article 14).
- The criminalization of a variety of corruption offences (chapter 2, articles 15-28), including the criminalization of laundering of proceeds of crime (article 23) and the liability of legal persons (article 26).
- The implementation of a wide range of law enforcement strategies (chapter 2), including the freezing, seizure and confiscation of the proceeds of crime (article 31), the protection of witnesses, experts, victims and reporting persons (articles 32 and 32), and the creating of specialized authorities to combat corruption (article 36).
- The enhancement of co-operation with national law enforcement authorities (article 37), between national authorities (article 38), and between national authorities and the private sector (article 39).

308. International co-operation depends on the effectiveness of national institutions, such as anti-corruption agencies (article 6) and anti-money laundering bodies (article 14). For example, state parties are required to under article 14 paragraph 1(a) to institute a 'comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions…in order to deter and detect all forms of money laundering'. Article 14 paragraph 4 provides that in establishing a domestic regulatory and supervisory regime, state parties are called upon to use as a 'guideline the relevant initiatives of regional, interregional and multilateral organizations against money laundering'. Accordingly, state parties to UNCAC should apply the international standards recommended by the FATF and regional-style FATF bodies, such as the APG.

309. One measure to improve the deterrent effects of criminal laws dealing with bribery is the expansion of the jurisdictional net. For example, 'if bribery of a foreign official is criminalized in both the countries where the bribe give and the bribe recipient are located and under the law of the nationality of the participants in the briber, there will be an improvement in detection and punishment' (*David Chaikin, 'Extraterritoriality and the Criminalization of Foreign Bribes' in Corruption: The Enemy Within, BAK Rider (Ed), pp 285-301 (Kluwer, 1997).* A number of states have national laws with wide jurisdictional reach in implementing the OECD Foreign Bribery Convention.

310. Article 42 of UNCAC is less ambitious in that it permits but does not require state parties to adopt comprehensive bases of jurisdiction over Convention offences. State parties are obliged to establish jurisdiction based on the territorial principle, and may also assert jurisdiction based on the nationality principle and the passive personality principle (*Chaikin, 1997 pp 292-96*). State Parties are obliged to take measures to establish its jurisdiction over Convention offences when the alleged offender is present in its territory and it does not extradite the person on the ground that he/she is one of its nationals.

Extradition and Dual Criminality

311. Dual criminality is a long standing requirement in extradition law and practice of nearly all countries. It is usually a mandatory exception to extradition, so that if the requirement of dual criminality is not satisfied extradition is not permissible.

312. Under the dual criminality principle an act is not extraditable unless it constitutes a crime under the laws of both the state requesting extradition and the state from which extradition is sought. The justification for the principle is that it ensures that a person's liberty is not restricted when his/her conduct is not recognised as criminal in the state receiving an extradition request.

313. There is a wide variety of practice among states in applying the dual criminality principle in extradition cases. Some states apply a very technical approach to dual criminality so that there must be some correspondence or conceptual similarity between the offence in the requesting and requested states. For example, if a requested state does not recognise the offence of possession of proceeds of crime as distinct from money laundering, it may refuse extradition because the offence is unknown to its law.

314. Most countries do not require that the corresponding offence in the requested state be described by the same name as the alleged offence in the requesting country. Nor is it also necessary that the crime concerned be conceptually similar in both countries. In practice, there has been some relaxation of the dual criminality requirement by virtue of the adoption of the 'conduct test' by national legislatures and courts. For example, Justice Deane of the High Court of Australia in *Commonwealth v Riley* (1985) 159 CLR 1 at pages 17-18, summarised the dual criminality requirement under the Australian extradition legislation as follows:

> 'The preferable view--and that which commands general acceptance--rejects the need for precise correspondence between labels or between the constituent elements of identified legal offences under criminal law of the requesting and requested States and defines the principle of double criminality in terms of substance rather than technical form. On this view, the requirement of double criminality is satisfied if the acts in respect of which extradition is sought are criminal under both systems even if the relevant offences have different names and elements... This view places primary emphasis upon the acts constituting the offence alleged against the accused in the warrant rather than upon the general theoretical correspondence between the legal elements of the offence which he is alleged to have committed against the law of the requesting State and some offence recognised by the law of the requested State.'

315. The UNCAC Convention adopts a flexible conduct-based approach to dual criminality. Article 44 paragraph 1 of UNCAC provides that the Convention applies to corruption offences where the offence for which extradition is sought is punishable under the domestic law of both the requesting state party and the requested state party. Article 44 is subject to Article 43 which applies to both extradition and mutual legal assistance, and is as follows:

> 'In matters of international co-operation in criminal matters, whenever dual criminality is considered a requirement, it shall be deemed fulfilled irrespective of whether the laws of the requested State Party shall place the offence within the same category of offence or denominate the offence by the same terminology as the requesting State Party, if the conduct underlying the offence for which assistance is sought is a criminal offence under the laws of both State Parties.'

316. Article 43 provides the same international standard for dual criminality as is found in a number of international treaties, as well as in FATF Recommendation 37. Although article 43 adopts the 'conduct-based' test of dual criminality, this does not obviate the difficulties surrounding the requirement. The 'application of the double criminality principle may require a translation or

substitution of certain factors, such as locality, institutions, officials and procedures' (*Chaikin, "International Extradition", Bond Law Review, Vol 5, No2, December 1993 p 143*). This entails difficult legal questions, particularly where the alleged conduct is committed in relation to an institution which is of a purely parochial character, and which is unrecognisable by the requested state.

317. It is not surprising that the dual criminality principle has been criticised as 'cumbersome', 'time wasting' and as 'an obstacle to an efficient and effective extradition system' (*UN Office on Drugs and Crime, Submission to the Australian Federal Attorney-General's Department, A New Extradition System: A Review of Australia's Extradition Law and Practice, 2006*). There is no doubt that the dual criminality principle has provided defendants with a legal basis for challenging their extradition and in some cases have considerably delayed the extradition process. Although it is rare for an extradition case to fail on the ground of dual criminality, the time delays in processing extradition have resulted in some cases of countries withdrawing their extradition requests and abandoning prosecutions.

318. There are several initiatives to change international practice on dual criminality. Paragraph 2 of Article 44 of UNCAC recognises that states may, if their domestic law permits, extradite a person for a convention corruption offence without dual criminality. The Australian Government's Attorney-General's Department, which is reviewing Australia's extradition law and practice, has questioned whether dual criminality should continue to be a mandatory ground for refusing extradition. The suggestion is that national courts should no longer be empowered to deny extradition on the basis of lack of dual criminality. Instead, the relevant Government Minister should have a discretion to refuse extradition 'on the basis of dual criminality on a case by case basis were there are concerns about the nature of the offence for which the country seek extradition' (*Attorney-General's Department 2006, page 24*).

Dual Criminality in Legal Mutual Assistance Cases

319. There is a much weaker case for retaining dual criminality as a requirement in legal mutual assistance than extradition because mutual assistance is less intrusive on the rights of an individual. In terms of international co-operation in tacking money laundering, FATF Recommendation 37 provides that countries should, to the greatest extent possible, provide mutual legal assistance, notwithstanding the absence of dual criminality.

320. Multilateral legal mutual assistance treaties or arrangements, such as the Scheme relating to Mutual Assistance in the Commonwealth (the Harare Scheme), do not usually require dual criminality as a mandatory ground for refusing mutual legal assistance. Instead, under the Harare Scheme members of the Commonwealth have a discretion to refuse mutual legal assistance on the ground of dual criminality.

321. Similarly, the UNCAC provides that state parties may decline to render legal mutual assistance for Convention corruption offences on the grounds of dual criminality. However, Article 9 represents an advance of past multilateral instruments in that it also provides that a "requested State Party shall, where consistent with the basic concepts of its legal system, render assistance that does not involve coercive action." Article 9 is modelled on the position under Swiss law, where dual criminality is a mandatory ground for refusing assistance in the case of coercive measures, but a discretionary ground in other cases.

322. For example, the effect of Article 9 is that non-coercive measures, such as interviewing witnesses or taking evidence from voluntary witnesses, providing publicly available or government sourced documents, or identifying assets without using compulsory measures, should be available even if the principle of dual criminality is not satisfied. On the other hand, mutual legal assistance measures such as the execution of search and seizures, the obtaining of bank documents under court orders, and the freezing, seizure and confiscation of assets, are coercive measures which some states (for example, Switzerland) will not grant unless the principle of dual criminality is satisfied.

323. The application of the principle of dual criminality may cause problems is illustrated by certain Convention offences. Article 20 of UNCAC provides:

> 'Subject to its constitutional and the fundamental principles of its legal system, each State Party shall consider adopting such legislative measures as may be necessary to establish a criminal offence, when committed intentionally, illicit enrichment, that is a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her unlawful income.'

324. The criminal offence of illicit enrichment exists in several APG member jurisdictions, including Hong Kong,China, India, Malaysia, Pakistan, Singapore and India. This offence was introduced into these jurisdictions when the United Kingdom was the colonial power, albeit that Britain never enacted a similar criminal offence in its domestic jurisdiction. There are several other APG member jurisdictions which have the offence of illicit enrichment, such as Indonesia and Philippines, but none of the APG member jurisdictions which belong to the OECD group have such offences. Many developed countries do not have an offence similar to illicit enrichment, in one APG member jurisdiction because the offence of illicit enrichment is considered to violate the presumption of innocence guaranteed under the constitution.

325. The offence of illicit enrichment imposes on a public official the burden of proving his or her source of income and/or assets. The use of anti-money laundering measures to trace the assets or resources of a public official is a vital first step in establishing the offence of illicit enrichment. If legal mutual assistance is refused because of the principle of dual criminality, then the evidence to establish this crime will not be available.

326. There are several ways of reducing the impact of the dual criminality principle on international co-operation. Practical experience shows that where the underlying offence in the requesting state is illicit enrichment, the request for legal assistance to the requested country should not be confined to the evidence relevant to the offence of unjust enrichment. Where the requested state applies the conduct-based theory of dual criminality principle, then the requesting state should draft its request to reflect the totality of conduct, not merely what is criminal under the law of the requesting state.

327. The authors recommend that when making mutual legal assistance requests (or in cases of extradition) concerning unjust enrichment allegations, all the facts of the case which point to criminality should be transmitted to the requested state. This is what happened in the Marcos case where the Philippine Government in its mutual assistance request of Switzerland alleged that Ferdinand Marcos, the President of the Philippines, had a declared net worth of only USD 7 000 in 1965, and that during his presidency had a reportable income of USD 2.4 million, whereas President Marcos and his wife Imelda Marcos' Swiss bank accounts had USD 357 million in 1986. Ferdinand Marcos as a public servant failed the net worth test in that he did not give any credible explanation as to the sources of his Swiss based accounts. The Philippine government's mutual assistance request of Switzerland was not limited to factual allegations about his income and assets, but also contained detailed allegations of bribes, kickbacks from government contracts and embezzlement of public funds (see *David Chaikin, "Controlling Corruption by Heads of Government and Political Elites" in Corruption and Anti-corruption, P Larmour and N Wolanin (Eds) pp 97-108 (Asia Pacific Press 2001).*

OECD Convention, International Co-operation and Dual Criminality

328. The OECD Bribery Convention provides an international framework for countries to criminalize the payment of foreign bribes and to assist party states carry out effective international investigations into those offences. All 37 countries which have ratified the OECD Bribery Convention have criminalised foreign bribery. This is a requirement arising from Article 1 of the OECD Bribery Convention which provides:

> 'Each Party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person 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 retain business or other improper advantage in the conduct of international business.'

329. Of the 21 states which have been examined under Phase 2 of the OECD review process, there is evidence that nearly all covers acts of bribery through intermediaries, which is the common modus operandi of this offence (OECD, 2006, pp 13-14). The OECD Phase 2 Review found that almost all examined parties have provided prompt legal assistance to other parties as required by Article 9 of the Convention.

330. Legal mutual assistance is not only available for the purpose of criminal investigations and proceedings, but also for non-criminal proceedings, within the scope of the Convention brought by a party against a legal person. The obligation of signatory parties to establish the liability of legal persons (eg corporations) for the offence of foreign bribery is critical to the effective operation of the Convention.

331. In many of the successful foreign bribery prosecutions, important evidence of bribery was obtained from another party to the Convention (p 105). There is a problem of gaining timely co-operation from non-EU countries and certain major financial centres, and the extreme difficulty of obtaining any effective legal assistance from non-parties to the Convention. The unavailability of evidence from a foreign jurisdiction in which a foreign bribe transaction takes place was cited by some party states as the key reason for the non-prosecution of foreign bribery offences.

332. Lack of mutual legal assistance may arise because there is no treaty relationship between the requested and requesting state. The United States has entered into case-specific 'Lockheed-style Agreements' to overcome this difficulty. There is also the dual criminality principle, which continues to cause practical problems despite the terms of article 9(2) of the Convention.

333. The variety of definitions of foreign public official in the countries which have laws prohibiting bribery of foreign public officials may raise dual criminality issues. The problems identified by the OECD Phase 2 Review at pp 14-18 include:

- Countries which have a non-autonomous definition that is not as broad as the definition of "foreign public official" in Article 1 of the OECD Convention.
- Countries where it is not clear that the offence of bribery covered bribery of foreign officials of a sub-division of government.
- Countries where the offence of bribery does not cover bribery of foreign officials of a country which was not recognised as a state, for example, North Korea.
- Countries where it is not clear whether the definition of a foreign public official covers a person exercising a public function for a "public enterprise" (public enterprise is

defined to include indirect and de facto control of the enterprise by a foreign government consistent under Commentary 14 of the OECD Convention.

334. Dual criminality is a larger problem for the vast majority of developing countries which do not have any offence of bribing a foreign public official. Where the dual criminality principle is not satisfied, then international co-operating may not be forthcoming. If this is the case then it is imperative that nation states consider passing laws criminalizing foreign bribery of public officials.

Mutual Legal Assistance and Bank Secrecy

335. It is well recognised that bank secrecy has provided a difficult, and in some cases, insuperable obstacle, to the obtaining of financial information in international corruption cases. Since the 1970s financial havens and bank secrecy jurisdictions have spread to all parts of the globe, including the Caribbean, Europe, Asia and the Pacific, the Middle East and Africa.

336. Several measures have reduced bank secrecy as an obstacle to money laundering investigations, including the FATF issuance of reports designating countries as 'Non-Cooperative Countries or Territories' from June 2000 to date, the 1998 OECD report on 'Harmful Tax Competition' which targeted 41 jurisdictions as tax havens, and the United States Treasury Department's use of Financial Advisories and Tax Information Exchange Agreements. These measures have reduced the attractiveness of bank secrecy jurisdictions for concealing the proceeds of corruption.

337. Multilateral treaties have also undermined bank secrecy, such as the United Nations Convention Against Transnational Organized Crime 2000. Article 18.6 of the Organized Crime Convention provides that partes shall not decline to provide mutual assistance on the grounds of bank secrecy. A similar provision is found in the FATF Recommendation 40 par b.

338. There are several important provisions in the UNCAC which are designed to counter bank secrecy. Article 31 paragraph 7 requires state parties to empower their courts to 'order that bank, financial or commercial records be made available or seized', in cases of international co-operation. Article 40 requires state parties to ensure that in domestic criminal investigations of Convention offences, there are appropriate mechanisms to 'overcome obstacles that may arise out of the application of bank secrecy laws'. Article 46 paragraph 8 of UNCAC provides that 'State parties shall not decline to render mutual legal assistance on the grounds of bank secrecy.'

339. The UNCAC provision may require state parties to change their domestic laws so there are mechanisms to overcome bank secrecy. The effect of these provisions is that financial institutions in a corruption investigation may not rely on bank secrecy as a legitimate reason for failing to comply with a court order to search, seize or confiscate the proceeds of crime (*see* UNODC*, Legislative Guide for the Implementation of the United Nations Convention against Corruption,* 2006, p 125*).*

340. Although UNCAC eliminates bank secrecy as a ground for refusing assistance, this may not be sufficient to overcome the incidental consequences of bank secrecy. One unclear issue is the effect of the bank secrecy provisions of the UN Corruption Convention on Switzerland. Under Swiss law bank secrecy per se has never been a ground for refusing mutual legal assistance. Disclosure of information which involves a Swiss bank secret is permitted in Switzerland where a competent Swiss court orders disclosure pursuant to a mutual legal assistance request. However, Swiss jurisprudence has applied its principles of mutual assistance, such as the principles of dual criminality, speciality and proportionality, as 'firewalls in protecting fiscal secrets', with collateral damage to co-operation in international corruption cases *(David Chaikin,, "Impact of Swiss Principles of Mutual Assistance on Financial and Fiscal Crimes", Revenue Law Journal, Vol.16, pages. 192-214).* It is recommended that further study be carried out on whether de facto bank secrecy continues to be an obstacle to effective international co-operation despite the formal provisions in the UNCAC.

International Asset Recovery and Asset Sharing

341. FATF Recommendation 38 provides that domestic authorities should take expeditious measures in response to foreign requests to 'identify, freeze, seize and confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value'. Recommendation 38 also encourages countries to enter into arrangements for the co-ordinating seizure and confiscation proceedings, including asset sharing. This is an important Recommendation which should facilitate the tracing and recovery of illicit assets, including corrupt payments and the proceeds of corruption.

342. The potential for international asset recovery was highlighted in the case of Ferdinand Marcos, the president of the Philippines from 1965-1986. In March 1986, the Swiss Federal Council ordered the freezing of the assets of Ferdinand Marcos, his wife Imelda, his children and various business associates. Two Swiss banks, Credit Suisse and the Swiss Banking Corporation, froze USD 357 million in five bank accounts held under the names of four Liechtenstein Foundations and a Panama corporation. Twelve years later in 1998 the Swiss banks transferred the sum of USD 567 million to the Philippine National Bank to be held in escrow until a final judgment of the Philippine courts. In July 2003 the Supreme Court of the Philippines ordered the forfeiture of the illicit assets (which now totalled USD 650 million) to the Philippine government. The actual transfer of the funds from the Swiss National Treasury to the Philippine Treasury took place in February 2004 (Chaikin, 2005, page 44).

343. The Marcos case illustrated the policy and legal obstacles in recovering dictators' plunder. It was one of several cases where the 'Swiss courts were at the centre of a legal battle to recover the plundered wealth of developing countries. The Swiss legal system has dealt with claims against former Heads of State or Heads of Government from Argentina, Ethiopia, Gabon, Haiti, Iraq, Ivory Coast, Kazakhstan, Liberia, Mali, Nigeria, Pakistan, Philippines, Peru, Ukraine and Zaire. The list of countries is even larger if one includes Swiss freezing measures against former Ministers, senior politicians, and public servants of foreign countries who have used Swiss banks to conceal illicit monies' (Chaikin, 2005, page 28).

344. The legal and political experience of the grand corruption cases in Switzerland, coupled with the Abacha scandal in the United Kingdom, and Saddam Hussein's plundering of the Iraqi economy, have been very influential in the development of international standards for asset recovery and asset sharing.

345. A key aim of the UNCAC as stated in Article 1(b) is 'to promote, facilitate and support international co-operation and technical assistance in the prevention of and fight against corruption, including in asset recovery'. Chapter 4 (Articles 43 to 50) contains provision on extradition, mutual legal assistance, law enforcement co-operation, joint investigations, and special investigative techniques, such as controlled delivery. These provisions assist in the detection, investigation, extradition and prosecution of persons who are suspected of committing Convention corruption offences. Although Chapter 4 of UNCAC is modelled on several international criminal law treaties, it has several innovative provisions which seek to reduce the obstacles to more timely and effective international co-operation.

346. The UNCAC differs from previous multilateral treaties, such as the Organized Crime Convention, and bilateral mutual legal assistance treaties, under which the ownership of confiscated property belonged to the requested State where the property was located. Recommendation 38 of FATF represented an improvement in that it encouraged states to establish asset forfeiture funds and share confiscated property with the requesting state, particularly when confiscation was a result of co-ordinated law enforcement. In contrast, UNCAC imposes mandatory obligations on requested states to return the illicit assets to the requested state in so far as this is consistent with the principles of the Convention. There is an underlying preference under UNCAC to return the assets to the state asserting that it is a victim of the corruption offence.

347. Article 51 of Chapter V states that the return of assets is a 'fundamental principle' of the Convention, and that State Parties are encouraged to give the 'widest measure of co-operation and assistance in this regard.' As the United Nations has optimistically argued:

> 'the lesson that so-called "grand corruption" can only be fought through international and concerted efforts based on genuine commitment on the part of Government has been learned' and this lesson is expressed in UNCAC (United Nations 2006, page232).

348. Chapter 5 details the processes and conditions for asset recovery, including provisions dealing with direct recovery of property by way of civil and administrative actions (Article 53), mechanisms for the recovery of property through international co-operation by recognising and taking action based on foreign confiscation orders (Articles 54 and 55) and measures for the return and disposal of illicit assets to the requesting state party (Article 57).

349. Article 57 imposes mandatory obligations on States in returning illicit assets to the rightful legal owner. Paragraph 3 of Article 57 envisages three scenarios for asset recovery, depending on the nature of the corruption offence, the strength of the evidence and claims of ownership of property, the rights of prior legitimate owners of property, as well as the entitlement of other victims of corruption offences, other than states (United Nations, 2006 page 264).

350. The first situation is where public funds are embezzled or laundered, so that the funds clearly belong to the requesting state (Article 57 paragraph 3(a)). In such a case the requested State is obliged to return the confiscated property to the requesting state. This may be achieved by means of a confiscation order in the requested state based on a final judgment in the requesting state.

351. Secondly, in the case of proceeds of any other corruption offence which were not embezzled, the requesting state may or may not be the owner of those funds (Article 57, paragraph 3(b)). The requested state's obligation in such as case is to return the confiscated property to the requesting state when then requesting state 'reasonably establishes its prior ownership' of such confiscated property, or when the requested state recognises damages to the requesting state as a basis for returning the property. This does not mean that the requested state may not take into account 'the rights of bona fide third parties' (see Article 57, paragraph 2), but that the Convention imposes a preference for the return of the assets to the requested state, in accordance with the fundamental principles of the Convention.

352. Thirdly, in all other cases, the requesting state is obliged to give priority to returning confiscated property to the requested state, or to its prior legitimate owners, or compensating the victims of the crime (Article 57, paragraph 3(c)).

Delays and costs as obstacles

353. One of the biggest problems is the time delay in recovering illicit assets. There are many causes of delay in mutual legal assistance cases. There is the availability in requested states of well developed procedural and substantive rights of persons the subject of foreign mutual assistance requests. For example, there were considerable delays in Switzerland in the Marcos, Abacha and Duvalier cases because of the Swiss mutual assistance process. As a result of the delays in the Marcos case, Switzerland amended its domestic legislation so as to reduce the range of legal remedies and limit the number of parties which had appeal rights. It is recommended that states streamline their mutual assistance processes so that co-operation is both timely and effective. The Australian Attorney-General's Department Review on Mutual Assistance contains some valuable suggestions in this regard.

354. Delays may also be the product of investigatory failures and the interminable delays in the judicial system in the requesting State. This is a particular problem for many developing countries which do not have the investigatory or judicial infrastructure to supply the requested State with sufficient material concerning the underlying predicate crime in money laundering cases. It is recommended that greater resources be given to developing countries for reform of their legal system so that they have an increased capacity to make and receive mutual assistance requests in a timely fashion.

355. Costs in asset recovery cases are also a major issue. UNCAC provides some guidance on this matter. Article 28 of the Convention provides that the requested state should bear the ordinary cost of executing a request, but where the expenses of a substantial or extraordinary nature will be required to execute a request, the state parties shall consult as to the terms, conditions and responsibility for the costs. Recognising that asset recovery may entail considerable expenses, Article 57(4) of the Convention allows the requested state to deduct reasonable expenses from the proceeds or other assets before they are returned to the requested state.

356. Since the requested state bears the ordinary cost of investigation in its territory it may not have sufficient incentive to carry out a comprehensive investigation on behalf of a requesting state. This may be a significant problem where the requested state, has draconian laws restricting foreign investigations in their territory. For example, under Swiss law, it is a criminal offence to carry out an unauthorised investigation or obtain information in Switzerland for the purpose of a foreign legal proceeding. In such a case the requesting state is prohibited from carry out any investigation in the territory of the requested state, a principle which is endorsed by Article 4(2) of the UN Corruption Convention, and is very dependent on the good will and competence of the foreign investigatory procedures.

357. Also many developing countries might not be in a position to meet even ordinary expenses, especially in complicated and lengthy requests. The UNCAC recommends that in such cases developed countries give consideration to paying for the mutual legal assistance in the requested State. The Harare Scheme on Mutual Assistance as amended in 1999 sets out specific guidelines on apportioning costs in executing mutual assistance requests, paying special attention to the needs of developing countries.

Civil Forfeiture of corrupt proceeds

358. Several APG member jurisdictions including the United States, Philippines and Australia have laws which permit civil forfeiture of illicit assets. The US federal statue on civil forfeiture (18 U.S.C. # 981) is one of the most effective mechanisms for the recovery of corrupt proceeds arising from foreign offences. Under the civil forfeiture provisions of # 981, any property involved in a money laundering offence, or a violations of the Bank Secrecy Act, such as involving currency reporting,

may be forfeited. The action is against the property itself, rather than against the defendant as a person. This provision does not require a concurrent criminal case in the United States against a specific defendant. It may be used in circumstances where the money launderer is dead, missing, a fugitive, or can not be located. The government is not required to prove its claim by relying on the criminal standard of proof: it is sufficient if the government can show that based upon probable cause the property is subject to forfeiture. The civil forfeiture provision permits forfeiture of property held in the name of a nominee who can be shown to have been involved in money laundering, in circumstances where there is insufficient evidence to obtain a criminal conviction of that nominee. It is a necessary requirement of all civil forfeiture cases that the property the subject of the forfeiture was involved in or is traceable to the offense. This requirement may not be satisfied in complex money laundering cases where the paper trail has been cleverly obscured (*see Chief Judge B Lynn Winmill, Anti-money Laundering Law & Cases in the United States, APEC/NCC Workshop, Bangkok, August 2007*).

Civil Proceedings in common law countries

359. Taking civil proceedings in the requested State offers an alternative to criminal law based legal mutual assistance. This possibility arises because of the civil liability of corrupt public officials to the state (see Chapter on private sector corruption). There are many advantages in pursuing civil remedies in asset recovery cases, rather than relying on criminal remedies. For example, in common law jurisdictions such as England, Australia or Hong Kong,China, judges may order banks which have been used for money laundering, to disclose details about bank accounts, thereby enabling assets to be identified and traced. In such proceedings, wrongdoers may also be compelled to give a full account of what has happened to the corrupt proceeds that they allegedly received. Furthermore, the doctrine of constructive trust may result in a reckless bank being held liable for the full amount of illicit money that has been transmitted through the bank.

360. The authors endorse the recommendations of the Commonwealth Working Group that countries explore the possibility of 'using mutual legal assistance to gather evidence for use in civil proceedings brought by a victim country for the recovery of assets in corruption cases'. Further study of this topic is needed so that countries have a greater understanding of the strategic and tactical advantages of using criminal and/or civil procedures. It would be useful to examine recent litigation in England, Guernsey, Jersey and/or the Isle of Man, where civil proceedings have been brought in relation to Sani Abacha, the former President of Nigeria (Ajaokuta litigation), Frederick Jacobi Titual Chilubu, the former President of Zambia (Zamtrop and BK conspiracies), Benazhir Bhutto, the former Prime Minister of Pakistan, and her husband, Asif Ali Zardai, and Hutomo Manaul Putra (Tommy) Soeharto, the son of the former President of Indonesia (Banque National de Paris funds litigation).

Vulnerabilities for corruption in AML/CFT institutions

361. PEPs pose a series of corruption-type risks to AML/CFT institutions and systems in their own jurisdictions but also may undermine international co-operation in combating AML/CFT. Where PEPs enjoy statutory or de facto immunities from prosecution, this reduces the effectiveness of the justice system. Law enforcement investigations may be compromised because of the power of PEPs. Asset recovery may be hindered because of the concern that the requesting government may be as corrupt as the PEP whose illicit assets are the subject of international mutual assistance. The vulnerability of FIUs to corruption and prevention policies to deal with this problem has already been considered in chapter 2. This section considers FIUs' best practices in international co-operation.

Immunities from Prosecution

362. In corruption cases, politicians and public servants who are accused of corruption will frequently object to civil and criminal jurisdictional claims on the basis that they are protected by various privileges or immunities. A number of international legal instruments provide guidance on the question of immunity. For example, Article 40(2) of the United Nations Convention against Corruption provides:

'Each State Party shall take such measures as may be necessary to establish or maintain, in accordance with its legal system and constitutional principles, an appropriate balance between any immunities or jurisdictional privileges accorded to its public officials for the performance of their functions and the possibility, when necessary, of effectively investigating, prosecuting and adjudicating offences established in accordance with this Convention.'

363. Article 40(2) gives a nation state a wide measure of discretion as to how it regulates the immunities of its public officials. The provision does not require states to change their domestic laws. This is unfortunate became many countries provide what may be considered excessive immunities to their Heads of State, senior government officials, members of Parliament and state governors.

364. Some countries have passed constitutional laws giving former heads of state immunity from legal prosecution even after they have left office. For example, in 2000 the Parliament of Gambia passed a constitutional amendment which provided that 'the President of the Republic, who has ceased to exercise his functions may not be challenged, pursued, sought, arrested, detained or judged for any facts arising from basic law provided for in Article 81 of the Constitution'.

365. The endemic problem of corruption in Nigeria has also been confronted with the issue of legal immunities. Under section 308 of the Constitution of the Federal Republic of Nigeria, the governors of the 36 states enjoy immunity for prosecution. This immunity applies within the territorial jurisdiction of Nigeria, but it has no extraterritorial application. Many of the Nigerian governors have been accused of corruption but have avoided prosecution because of their constitutional immunity. Here are some case examples:

- In 2004 Nigerian Governor Joshua Davies from the central state of Plateau was arrested and questioned by the London Metropolitan police for money laundering. He was released on bail, returned to Nigeria, where he has refused to answer any further questions from the London police, relying on his immunity.
- In 2005 Governor Diepreye Alamieyeseigha of the oil-producing southern state of Bayelsa was arrested in Britain and charged with laundering GBP 1.8 million. While on bail, he escaped to Nigeria where he can not be prosecuted or extradited to Britain while he is in office.
- In 2007 a Nigerian federal high court struck out the name of Dr Emmanuel Ewetan Uduaghan (the Governor of the oil rich state of Delta) from a suit instituted by some indigenes of the state requesting the Economic and Financial Crimes Commission (EFCC), to investigate an allegation that Uduaghan conspired with Chief James Ibori to divert over N120 billion of public funds.

366. The Nigerian cases illustrate the problem of immunities from prosecution in corruption/money laundering cases. Since the immunity is found in the Nigerian constitution, it can not be waived by the legislature. In practice corrupt governors can only be removed from office by a complex and difficult process of impeachment.

367. Sometimes national courts are prepared to lift immunities. For example, General Augusto Pinochet who ruled Chile for many years was on his retirement bestowed with immunity by virtue of his appointment as 'Senator for life'. In 2005 the Santiago Court of Appeals removed his congressional immunity relating to fraud charges connected with the embezzlement of public funds, and in a separate decision also lifted his immunity on tax evasions charges relating to his foreign bank accounts. The Chilean courts had previously in 2000 removed Pinochet's immunity from prosecution for human rights crimes, including torture.

368. In addition to domestic laws, international law also provides immunities for heads of state. Under customary international law heads of state and their families enjoy absolute immunity from the criminal law process. This means that a head of state is immune from criminal investigation or criminal prosecution by another state. For example, in 1989 the Swiss Supreme Court ruled that Ferdinand Marcos, the former President of the Philippines, enjoyed head of state immunity from criminal jurisdiction for 'private acts' (which would include looting of assets). The Swiss Supreme Court also held that because the Philippine government had waived the immunity, Ferdinand Marcos could not assert this immunity. Similarly, the Supreme Court of Switzerland ruled that Jean-Claude Duvalier, the former "President for Life" of Haiti was not entitled to immunity from jurisdiction because of the waiver by the government of Haiti. In contrast, the French Cour de Cassation held that the claim for restitution of funds from Duvalier was not maintainable because this would involve the enforcement of claims of foreign states based on their public laws (*David Chaikin "Policy and Legal Obstacles in Recovering Dictator's Plunder", (2005)17.2 Bond L.R 27 pp 31-34*).

369. An important policy question is whether crimes of grand corruption committed by heads of state should continue to enjoy absolute immunity from the criminal process. Since 1997 the Institute of International Law has called for limits on the immunity of heads of state in cases of 'misappropriation of assets of the states which they represent'.

370. The authors endorse the recommendations of the Commonwealth Working Group on the Recovery of Repatriation of Illicit Assets which suggested that governments 'should strive for a position where there are no immunities' not only for heads of state and government, but for all public officials. The justification for eliminating immunities is that they violated the 'fundamental principle that all persons are equal before the law'. In the author's opinion legal immunities should be narrowly confined to those cases demanded by international law, eg diplomatic immunity.

371. It may be expected that the increasing international concern with public corruption, money laundering and terrorist financing may lead to the development of state practice which curtails the abuse of immunities by heads of state and senior politicians/public servants in criminal cases of grand corruption. Until this is the case, heads of state who deposit illicit monies in foreign bank accounts will be protected by the traditional immunity in criminal matters.

Political Interference

372. There is a general problem of carrying out an investigation into illicit assets where the target is an influential Politically Exposed Person or a powerful business figure with political connections. In the case of grand corruption it may be well nigh impossible to obtain the approval of the requested country for any legal mutual assistance where its PEPs are implicated. The problem is compounded because of the wide range of reasons for refusing assistance, such as 'sovereignty, security and essential national interests', 'immunities' of office, or even a claim that the foreign investigation is politically motivated.

373. The Commonwealth Working Group on Asset Repatriation has made a number of suggestions which may limit or reduce the vulnerability of AML and anti-corruption systems to political

interference. We endorse the following suggestions which have been adapted from the Commonwealth Group:

- Impose an obligation of enhanced scrutiny for both domestic and foreign PEPS.
- Create independent and effective mechanisms to investigate, prosecute and recover assets of current heads of state/government who are allegedly involved in corruption.
- Establish an international and/or regional ad hoc peer review mechanism for monitoring allegations of corruption by serving heads of state/government.

Misuse of Repatriated Corrupt Assets – Abacha Example

374. Developed countries have expressed concern that where illicit assets are returned to a developing country, it may be misused by the government. That is concerns about corruption in the requesting state may be an obstacle in the recovering of laundered corrupt assets.

375. In 2001 the Swiss government adopted a policy of delaying the return of illicit assets to a developing country when it perceived that there was a risk that the looted monies will be stolen or misused by the leaders of the new government. This policy was applied in the Sani Abacha case. Following the Swiss Federal Supreme Court decision in February 2005 that the Abacha assets could be returned to Nigeria, the Swiss Federal Council in May 2005 imposed two conditions before the illicit assets could be repatriated. Firstly, the transfer of the funds would be staggered over a period of time ostensibly because some of the assets were not liquid. The second condition was that the World Bank would monitor the Nigerian government's use of the funds for specific development projects in health, education and infrastructure, as soon as practicable. Although initially expressing opposition to these conditions, the Nigeria Government ultimately co-operated in their implementation.

376. In September-November 2005 USD 505.5 million was transferred from Switzerland to Nigeria in and USD 44.1million in the first quarter of 2006. The World Bank and the Nigerian Ministry of Finance agreed to carry out a joint monitoring exercise on the 'Utilization of the Repatriated Abacha loot'. The field monitoring survey in 2006 involved 20 field monitors, 6 Nigerian government departments and various Nigerian NGOs. The World Bank report concluded that the allocation of Abacha funds in the Nigerian budget which occurred prior to the actual transfer of monies had made it difficult to accurately track the use of the Abacha loot. There was no suggestion of fraud or impropriety, but that there was insufficient planning of the monitoring program. The report recommended that in future monitoring arrangements and special project selection should be agreed in advance (World Bank, 2006). The report noted that one of the consequences of the failure to clearly track the use of the Abacha funds was that in Nigeria there was no clear appreciation of how the Abacha loot had benefited specific development projects. This is unfortunate because it deprives a victim country of the political, educative and law enforcement benefits/achievements of international asset recovery. It is recommended that the Abacha case should be carefully studied in order to learn lessons for future repatriation of illicit funds from developed countries to victim states.

Financial Intelligence Units and International Co-operation

377. In 2001 the United Nations Security Council passed Resolution 1373, calling upon states to 'find ways of intensifying and accelerating the exchange of operational information, especially regarding actions or movements of terrorist persons or networks'. For anti-money laundering purposes, the key national agency to collect, analyse and transmit financial intelligence is the Financial Intelligence Unit (FIU), which has been established in jurisdictions under AML/CTF legislation. Article 41 paragraph 1(b) and Article 58 of the UNCAC Convention require State Parties

to consider establishing a Financial Intelligence Unit (FIU) to be 'responsible for receiving, analysing and disseminating to the competent authorities reports of suspicious transactions'.

378. The international government body which provides a vehicle for co-operation between FIUs is the Egmont Group, which is headquartered in Toronto. The common goal of the Egmont Group is 'to provide a forum to enhance mutual cooperation and to share information that has utility in detecting and combating money laundering and, more recently, terrorism financing' (see http://www.egmontgroup.org).

379. The Egmont Group has approved the following definition of a FIU:

> 'A central, national agency responsible for receiving, (and as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information
>
> (i) Concerning suspected proceeds of crime and potential financing of terrorism. Or
>
> (ii) Required by national legislation or regulation.
>
> In order to combat money laundering and terrorism financing.'

380. The key feature of an Egmont FIU is that it must maintain a central and national database of information on disclosure of suspicious financial transactions required by anti-money laundering and counter terrorist financing laws. FIUs are required to quickly and securely transmit sensitive and confidential financial information to domestic and international law enforcement agencies, in accordance with national laws. The financial intelligence is exchanged through the Egmont Secure Web (ESW) system.

381. There are about 100 jurisdictions which are members of the Egmont Group. The following 15 jurisdictions from the Asia-Pacific Group on Money Laundering are operational units meeting the Egmont definition of FIUs.

Jurisdictions	Name of Financial Intelligence Unit
Australia	Australian Transactions Reports Analysis Centre (AUSTRAC)
Canada	Financial Transactions and Reports Analysis Centre of Canada/Centre d'analyse des opérations et declarations financiers du Canada (FINTRAC/CANAFE)
Chinese Taipei	Money Laundering Prevention Centre (MLPC)
Cook Islands	Cook Islands Financial Intelligence Unit (CIFIU)
Hong Kong,China	Joint Financial Intelligence Unit (JFIU)
Indonesia	Pusat Pelaporan dan Analisis Transaksi Keuanagan/Indonesian Financial Transaction Reports and Analysis Centre (PPATK/INTRAC)
Republic of Korea	Korea Financial Intelligence Unit (KoFIU)
Malaysia	Unit Perisikan Kewangan, Bank Negara Malaysia (UPW)
Marshall Islands	Domestic Financial Intelligence Unit
New Zealand	NZ Police Financial Intelligence Unit
Philippines	Anti Money Laundering Council (AMLC)
Singapore	Suspicious Transaction Reporting Office (STRO)
Thailand	Anti-Money Laundering Office (AMLO)
USA	Financial Crimes Enforcement Network (FINCEN)
Vanuatu	Financial Intelligence Unit (FIU)

382. There are a number of jurisdictions within the Asia-Pacific Group on Money Laundering which have agencies that operate as FIUs, but they have not yet been recognised by the Egmont Group (*e.g.* National Accountability Bureau of Pakistan).

383. The Egmont Group has published two documents, namely, 'Principles of Information Exchange' and 'Best Practice for the Exchange of Information' which provide guidelines for efficient co-operation between FIUs. The jurisdictional competence of FIU's should not be limited to money laundering but should extend to all predicate offences for money laundering as well as terrorism financing, which would include corruption-type offences. Another key principle is that the 'exchange of information between FIUs should take place as informally and as rapidly as possible and with no excessive formal prerequisites, while guaranteeing protection of privacy and confidentiality of the shared data'.

384. It is common practice for some jurisdictions to require a formal agreement as a pre requisite for the exchange of financial intelligence between FIUs. For example, AUSTRAC has formalised its relationships with 47 jurisdictions by signing Memoranda of Understanding (MOUs) and Exchanges of Letters (ELs). AUSTRAC has agreements with FIUs from the following 14 jurisdictions in the Asia-Pacific Group on Money Laundering: Canada, Cook Islands, Hong Kong,China, Indonesia, Japan, Korea, Malaysia, Marshall Islands, New Zealand, Philippines, Singapore, Thailand, United States of America and Vanuatu.

385. Some jurisdictions do not require MOUs, while other jurisdictions require a treaty before they are willing to exchange information. Since the information that is to be exchanged may include information that was obtained by compulsion, it is considered necessary in some jurisdictions that the information must be subject to national data protection laws.

386. Whether a MOU will provide a vehicle for the sharing of financial information with anti-corruption agencies may depend on the national law. For example, the Australian Transactions Reports Analysis Centre (AUSTRAC) is given statutory authority to share financial data with numerous law enforcement agencies, including all state anti-corruption agencies in Australia. By extension and through a MOU, AUSTRAC may reply to a request from another FIU in relation to an investigation into a corruption offence. In accordance with Australian law, the MOU and the Egmont Group Best Practice, information which is supplied to a foreign law enforcement agency for a specific purpose can not be transmitted to another agency, without the consent of AUSTRAC.

387. The World Bank has compiled and transmitted a questionnaire on the governance of FIUs to 15 selected FIUs which are members of the Egmont Group. The questionnaire will gather information about 'how countries have sought to structure FIU governance, and which measures have proved effective and which have not'. An innovative part of this confidential survey is the gathering of facts about the role of FIUs in the fight against corruption.

CHAPTER 5: PRIVATE SECTOR CORRUPTION AND MONEY LAUNDERING

Introduction and Summary

388. The UNCAC encourages signatories to make private corruption a criminal offence (Articles 21 and 22), and from the results of the APG Scoping Paper at least 11 members have done so. From 1997 the International Chamber of Commerce has urged action on private sector corruption, arguing that in its effect private corruption distorts commercial activities in the same way as corruption among public officials. The same body has stated that divergent definitions of this offence (where it exists at all) and the likelihood of an international dimension make it extremely difficult to adequately counter private sector corruption.

389. Private sector corruption may pose a particular threat to the integrity of the AML/CFT system. Reporting entities may be bribed to actively collude in money laundering, for example by opening bank accounts in false names. Private sector corruption may also threaten the integrity of the AML/CFT system when reporting entities are bribed to refrain from lodging an STR, or to tip off individuals that an STR has been lodged.

390. Hong Kong,China's efforts to counter private sector corruption represent best international practice, both in terms of legislation (the Prevention of Bribery Ordinance section 9) and implementation (through Hong Kong,China ICAC). Hong Kong,China ICAC currently receives more reports of corruption in the private sector than in the public sector.

391. We recommend that those APG members who have not yet done so follow the suggestion of the UNCAC in criminalising private sector corruption. Turning to implementation, we recommend that other jurisdictions study the example of Hong Kong,China with an eye to adapting anti-corruption measures in line with their own national circumstances.

Background

392. Our terms of reference for the study of corruption and the private sector are as follows:

> 'Studying the application of anti-bribery standards (for example in relation to financial institutions and professionals) by jurisdictions, benchmarking the international standards and reviewing the treatment of bribery in an AML/CFT context.'

393. There are a range of issues which the topic corruption and the private sector raise from an AML/CFT perspective:

- What is the significance whether a country has criminal laws dealing with private sector corruption, and whether a country enforces such laws?
- How prevalent is private-to-private sector corruption in relation to financial crimes compared with public sector corruption?
- What is the relationship between private sector corruption and money laundering?
- Where private sector corruption proceeds are laundered, is private sector corruption easier to prove where there is suspicion of money laundering?
- Is it more important to focus on private sector corruption in developed countries? And

if so, why from an AML perspective?

- Would enforcement of AML/CFT laws be facilitated by the enactment of a criminal law dealing with private sector corruption and its rigorous enforcement?
- How would the application of anti-bribery standards to the private sector (*e.g.* financial institutions and professionals) assist in promoting AML/CFT systems?

394. This chapter does not attempt to deal with all of these issues, but to provide some guideposts for further study. The authors outline the relationship between private sector corruption and money laundering, examine the key international instruments dealing with private sector corruption and illustrate the variety of laws dealing with aspect of private sector corruption, both under the criminal and civil law.

Private Sector Corruption and AML systems

395. Several reasons have been given for States being concerned about private sector corruption:

- Growth of international business transactions and the growth of the private sector which is larger than the public sector in most countries.
- Blurring of the distinction between private and public sectors by reason of privatization of governmental functions, market liberalisation, outsourcing, public/private partnerships in infrastructure projects, and other developments.
- Bribery of corporate officials has transnational dimensions just like bribery of public officials, with potential cross-over effects into the public sectors of several countries.
- Private sector corruption undermines the efficiency and credibility of free, open and global competition, destroying trust in markets and imposing a major barrier to creating a level playing field in international trade.
- Tolerating private sector corruption undermines public and private confidence in the rule of law, with potentially serious economic and political consequences, including limiting sustainable development.
- Private sector corruption may have a malevolent influence on public sector policy, for example, the misuse of political lobbyists and other techniques to weaken the AML/CFT regulatory environment.
- Private corruption may destroy the reputation of a corporation, reduce shareholder value, and affect public investors' confidence in the market.

396. The strongest advocate of criminalizing of private sector corruption is the International Chamber of Commerce (ICC). Since 1997 the ICC has argued that there is no meaningful difference between public and private bribery, in that they both 'distort commercial dealings and that they deserve similar treatment in the law'. This position has been fortified by the increase in privatisation throughout the world, including in developing countries, and the 'increased complexity and interaction between the public and private sectors in international transactions and by an increase in the monetary value of these transactions'.

397. One of the key objectives of AML laws and systems is to reduce the level of financial crimes in a country. Since most financial crimes occur in the private sector, then AML policy must be concerned with private sector corruption. Several economic crime experts have pointed out that although corruption applies equally to the private sector as it does to the public sector, the private sector is less inclined to report and investigate it. Surveys by the ICC indicate that most business

enterprises preferred to handle private sector complaints by self-regulation or civil suits, rather than through criminal sanctions.

398. As the Hong Kong,China ICAC has stated:

> 'This may be due to reputational risks and the fear that exposing the corruption will suggest weak management and poor governance of the business entity. Consequently, when private sector players in the anti-money laundering system are compromised, it may not become publicly known unless it is the subject of a criminal prosecution. Therefore the problem in the private sector may appear to be less serious than it actually is.'

399. The APG Scoping Paper drew attention to the vital role of the private sector in money laundering:

> 'When viewing corruption as a facilitative activity to support money laundering, the involvement of private sector players cannot be ignored. Corruption can be a key step in money laundering by securing the corrupt cooperation of bankers, accountants, lawyers, remittance agents etc, for the purposes of concealing the laundering activities and ensuring access to funds and profits.'

400. There are a number of ways that the private sector may provide corrupt assistance to facilitate money laundering. Employees in financial and non-financial institutions, may be corrupted so as to:

- Facilitate the opening or operating of accounts in false names.
- Assist in the placement and layering of transactions or destroying records to avoid detection.
- Ignore reporting requirements to submit STRs. Or
- Tip off customers who may be the subject of STRs.

401. At a more sophisticated level corrupt senior managers of financial institutions may use their positions to avoid AML/CFT compliance systems. There are also members of professional bodies, such as lawyers, accountants or financial advisers, who may use their skill set to organise money laundering transactions.

402. Given the typology of private corruption and money laundering, it follows that effective AML/CFT systems require an adequate legal and institutional framework of laws, policies and enforcement mechanisms to ensure that financial institutions and designated non-financial businesses and professions fulfil their AML/CFT obligations.

Global Instruments dealing with Private Sector Corruption

403. It is now accepted that private-to-private corruption is a matter of international concern for both governmental and non-governmental organisations. Subsequently and especially since the 1990s several regional and international organisations have incorporated prohibitions on private-to-private corruption in their international instruments. Examples include:

- Council of Europe Criminal Law Convention on Corruption 1999, entered into force on July 1, 2002, with 36 ratifying States; article 7 (active bribery in the private sector), article 8 (passive bribery in the private sector).
- Council of Europe Civil Law Convention on Corruption 1999, entered into force on November 1, 2005, with 28 ratifying States; articles 1 and 2 (State parties are required to

provide remedies for victims of private corruption).

- United Nations Convention against Transnational Organised Crime, 2000, entered into force on September 29, 2003, with 134 ratifying Parties; article 8 (2) (State parties are required to consider establishing as criminal offences other forms of corruption, in addition to corruption by public officials).
- African Union Convention on Preventing and Combating Corruption, 2003, signed by 21 Parties; Article 5 (State parties are required to establish as offences conduct within article 4, *i.e.* active and passive corruption in relation with a private sector entity).
- Framework Decision of the Council of European Union on Combating Corruption in the Private Sector 2003; Article 2 (Member States are required to criminalize both active and passive corruption in the private sector, within profit and non-profit entities).
- UNCAC 2003, which entered into force on December 14, 2005, and has been ratified by 98 Parties (comprehensive provisions dealing with private sector corruption).

International Chamber of Commerce Rules of Conduct

404. In 1977 the ICC produced its first Report on Extortion and Bribery in International Transactions, and published its Rules of Conduct to Combat Extortion and Bribery. These Rules of Conduct set out the first major voluntary guidelines for private enterprises in this field. The ICC Rules of Conduct have been revised and updated in 1996, 1999 and 2005. Although the ICC Rules of Conduct have no direct legal effect, they represent best international commercial practice.

405. Article 1 of the ICC Rules of Conduct require 'enterprises' to prohibit bribery and extortion at all times, in whatever form, whether direct or indirect. This prohibition applies to payments made to public officials, political parties, and directors, officers, employees and agents of a private enterprise, for the purpose of obtaining or retaining business or other improper advantages. Article 2 provides that agents and intermediaries of enterprises are expected to comply with an enterprise's anti-corruption polices. There are also rules about joint venture partners and parties to outsourcing agreements (Article 3), as well as gifts and expenses (Article 5), and facilitation payments. The board of directors have ultimate responsibility for the enterprise's compliance with its Rules of Conduct (Article 9). Anti-corruption policies must be applied to all controlled subsidiaries, whether foreign or domestic (Article 7). Accurate financial recording and auditing (Article 8) and independent audit committees (Article 8) are also key rules which may prevent the misuse of corporations not only for corrupt conduct but also as vehicles for money laundering.

406. To promote the widest possible use of the ICC's Rules of Conduct, the ICC has established the ICC Commission on Anti-Corruption. A major initiative of the ICC Commission has been the sponsorship of a study of private commercial bribery laws (*see Gunter Heine and Thomas Rose, Private Commercial Bribery: A Comparison of National and Supranational Legal Structures, Max-Planck Institut for Foreign and International Criminal Law and ICC, Paris 2003).* This ICC study comprises a comparative analysis of the national criminal, civil and administrative laws of thirteen OECD countries which are designed to curb private sector corruption. One of the ICC's major recommendations is that the prohibition on private-to-private corruption should be incorporated into relevant OECD instruments. This view is supported by Transparency International.

The UNCAC and Private Sector Corruption

407. The UNCAC contains several provisions dealing with private sector corruption. Article 12 (1) provides that: 'Each state party shall take measures, in accordance with the fundamental principles of

its domestic law, to prevent corruption involving the private sector, enhance accounting and auditing standards in the private sector and, where appropriate, provide effective, proportionate and dissuasive civil, administrative or criminal penalties for failure to comply with such measures.'

408. Article 12 recognises the importance that the UNCAC places on the prevention and penalisation of corruption in the private sector. It details a range of measures to achieve this aim, including a number which will also facilitate AML objectives, for example: the promotion of transparency in the 'identity of legal and natural persons involved in the establishment of corporate entities' (Article 12(2)(d)); the imposition of internal auditing controls to detect acts of corruption (Article 12(2)(f)); and the prohibition of specified acts, such as the falsification or destruction of records (art 12(3)). Tax deductibility of private bribes is forbidden under article 12(3) of the UNCAC which parallels the situation with public bribes.

409. The most significant anti-private sector bribery provision is article 21 of the UNCAC which reads:

> 'Each State Party shall consider adopting such legislative and other measures as may be necessary to establish as criminal offences, when committed intentionally in the course of economic, financial or commercial activities:
>
> a. The promise, offering or giving, directly or indirectly, of an undue advantage to any person who directs or works, in any capacity, for a private sector entity, for the person himself or herself or for another person, in order that he or she, in breach of his or her duties, act or refrain from acting.
>
> b. The solicitation or acceptance, directly or indirectly, of an undue advantage by any person who directs or works, in any capacity, for a private sector entity, for the person himself or herself or for another person, in order that he or she, in breach of his or her duties, act or refrain from acting.'

410. Article 21 mirrors the illegitimate practices that the International Chamber has condemned. Article 21 of the Convention does not oblige state parties to criminalize private sector corruption, in contrast to the mandatory obligations under Article 16 (bribery of foreign public officials) and Article 17 (embezzlement of diversion of property by a public official). Although Article 21 does requires state parties to 'consider adopting' measures to criminalize private sector corruption, this is a watered down obligation. The non-mandatory language of Article 21 was arrived at as a compromise, because there was some initial opposition to including it in the Convention on the curious ground that it might have a negative impact on business in terms of retraining trade.

411. The language of Article 21 is broadly worded in that it covers cases of active and passive corruption in the private sector. A significant improvement is that private sector corruption is made a Convention crime in circumstances where it is not necessary to show that the company has been harmed by the corrupt employee or agent. Previously in many jurisdictions, the prosecution of private sector corruption-type offences, such as fraudulent management, required proof that the misconduct of an employee or agent caused harm to the employer or principal. Where a company consented to the payment of the bribe, it could be argued that this provided a defence to a prosecution in that the company's consent indicated that there was no harm caused to the company. No such defence is available under Article 21 of the UNCAC. This should facilitate prosecutions for private bribery in that it will not be necessary to counter a consent argument or to demonstrate that the briber directly damaged the bribee.

412. A separate criminal offence is found in Article 22 which provides:

> 'Each State Party shall consider adopting such legislative or other measures as may be necessary to establish as a criminal offence, when committed intentionally in the course of economic, financial or commercial activities, embezzlement by a person who directs or works, in any capacity, in a private sector entity of any property, private funds or securities or any other thing of value entrusted to him or her by virtue of his or her position.'

413. This provision is similar to Article 17 which criminalizes embezzlement of property in the public sector. It provides further evidence that public corruption and private corruption are to be treated as equally harmful under the Convention. It is widely worded in that it covers "unwarranted used for the benefit for oneself or others, of goods or services that is entrusted to an individual in a private company' *(see UNCAC, Legislative Guide for the Implementation of the United Nations Convention Against Corruption, 2006*).

Criminalization of Private Sector Corruption

414. While public corruption, especially pertaining to the judiciary and public officials, has attracted criminal sanctions for a considerable period of history, private sector corruption has only been criminalised in some countries and then only in the last 100 years. For example, at common law in the Anglo/American legal systems there was no criminal offence of private corruption. At common law the criminal offence of bribery was restricted to corrupt payments to persons who were performing public functions. In the late 19th century and early 20th century many states in the United States, as well as Commonwealth countries under the influence of Great Britain, passed statutes which criminalized the bribery of private persons. It was not until 1906 that private sector/commercial corruption became a statutory offence under English law. Other countries in the Commonwealth have followed suit, such as the various states in Australia, Canada, Hong Kong,China, India, Singapore and New Zealand.

415. A 2007 survey of 20 APG member jurisdictions indicate that nearly all have laws which criminalize some aspect of private sector corruption. A large number of member jurisdictions who are members of the Commonwealth have specific laws criminalizing secret commissions by agents and employees in the private sector. In one jurisdiction its Secrets Commissions Act has expanded the criminal jurisdictional net to cover gifts to agent without the consent of the principal, acceptance of gifts by agents, false receipt offences and receiving secret rewards for procuring a contract. Many jurisdictions have laws such as criminal breach of trust, embezzlement, theft, fraud and economic espionage, which may also be used to combat private sector corruption. Two jurisdictions criminalize private sector corruption in a partial fashion. For example, one jurisdiction extends the definition of concept of "public servant" to include managers of companies running a business monopoly, or staff of credit institutions. In another jurisdiction public sector corruption laws apply to a private body conducting economic activities where it obtains financial support from the State which results in financial loss to the State.

Max Planck Report on Commercial Bribery

416. The 2003 Max Planck Report into commercial bribery found that three of the thirteen OECD countries surveyed had no private commercial bribery statute. Similarly there are a number of APG member jurisdictions which do not criminalize business-to-business corruption. In several jurisdictions private sector corruption is widespread, although it is not illegal.

417. The Max Planck report noted that even where there was a statutory criminal prohibition, there were differing opinions as to the policy goals which private sector bribery laws should vindicate. The legal interests protected by the criminal law in relation to private sector bribery offences varied from country to country and included three broad models: protection of corporate assets, shareholder

interests and property interests; penalizing violations of loyalty and duty of employees to employers, or agents to principals; and curbing unfair or unfree competition. The various approaches taken by different national systems to defining private sector bribery has resulted in substantial differences in the range of applications of the laws (p 11).

418. The problem of enforcement of private sector bribery criminal laws in an international setting were summarised in the 2003 report at p4:

> 'There is no uniform, systematic definition of the crime of private-sector bribery today in the thirteen countries or in international legislation. Divergent criminal laws produce different burdens of proof and different defences. The existence of "international elements" in a criminal bribery case virtually assures the case will not be prosecuted. This may result from procedural or evidentiary hurdles, from a requirement of "double criminality", from the need for a request to prosecute from the victim or authorities of his country, from victim's reticence or because prosecution of such crimes is not a high priority of the state. Jurisdictional concepts have been too narrow to support vigorous prosecution of private-sector bribery. A "territorial" basis for jurisdiction--a reflection of the normal roots of bribery law--is not sufficiently extensive to reach the new international dimensions of transactions today, with their complex and exotic patterns.'

The Hong Kong,China Experience

419. Apart from Singapore, Hong Kong,China is unique in that in comparison with other APG member jurisdictions there have been a large number of prosecutions for private sector corruption. According to the Hong Kong,China ICAC, there are more reported cases of private corruption than public corruption. For example, in the period January to September 2006, there were 2 461 corruption reports, with 1,463 reports (59%) being private sector corruption reports. The different sectors of the economy affected by private corruption were as follows: building management (40%); finance and industry (9%); catering and entertainment (7%), construction (6%); and transport and related services (5%) (*see Hong Kong,China ICAC Post, 2006*). While the statistics for reported private sector corruption cases were lower in 2006 compared to 2005, the finance and insurance percentage share was up from the 2005 figure of 6.5 per cent.

420. The Hong Kong,China statistics are revealing. If private sector is numerically as important as the Hong experience suggests, then laws which criminalize private sector corruption may facilitate the reduction of financial crime, especially where such crimes are committed by rogue individuals in organizations. That 9 per cent of private sector corruption cases in Hong Kong,China involve the finance and insurance industries is important from an anti-money laundering perspective because it indicates the vulnerability of the financial sector to corruption.

421. In Hong Kong,China private sector corruption is given the same enforcement priority as public sector corruption. Both private sector and public sector corruption are criminalized under the Prevention of Bribery Ordinance (POBO). Under section 9 of POBO private sector corruption can only take place if an agent is offered a bribe, or solicits or accepts a bribe as a reward for acting in relation to his/her principal's affairs or business. An agent is defined in s 2(1) as including any person employed by or acting for another. This means that the private corruption offence applies to all employees within the private sector, including those who are subject to ensuring compliance with AML/CFT laws and regulations. The AML reporting obligations have been extended in the private sector to persons in the banking, insurance and investment industries, as well as professional accountants, lawyers, estate agents, bullion and precious metal dealers, and remittance agents. Any attempt to bribe these private sector persons to circumvent the AML/CFT requirements would clearly be an offence not only under AML laws but also under the corruption laws of Hong Kong,China law.

Civil Liability of Corrupt Agents

422. The 2003 Max Planck Report found that in most countries private bribery gives rise to civil liability so that the victim of bribery may make a claim of damages. In some jurisdictions a criminal conviction for bribery was a necessary prerequisite for the courts to award damages. The legal basis for a civil suit of damages may include breach of contract or breach of fiduciary duty. Tortious remedies may also be available, such as inducing a breach of contract, interference with a trade or business by unlawful means, anti-trust violations, unfair trade practices, or civil conspiracy. The various legal bases for civil suits reflect the wide variety of forms of private sector corruption.

423. In common law jurisdictions it is well established that an agent or servant is civilly liable to his/her principal for unlawful acts (see for example, Attorney General v Goddard [1929] KB 743; Reading v Attorney-General [1951] AC 507). In Attorney-General for Hong Kong,China v Charles Warwick Reid [1994] 1 AC 324 the Privy Council said:

> 'A bribe is a gift accepted by a fiduciary as inducement to him to betray his trust. A fiduciary is not always accountable for a secret benefit, but he is undoubtedly accountable for a secret benefit which consists of a bribe.'

424. In the Anglo/American common law systems, the civil enforcement mechanism has considerable advantages over its criminal counterpart in terms of detection, flexibility, remedies and resources. Corruption is more likely to be detected by its victims, such as a competitor which has lost a valuable contract or which has had its employees suborned. Private litigants enjoy all the advantage of flexibility in framing a suit, in contrast to the narrow confines of the indictment. Private remedies increase the likelihood of compliance with regulatory standards of behaviour by giving the victim an incentive to participate in the enforcement process. Private suits provide direct compensatory remedies as well as potential restitutionary remedies which may deprive the defendant of its unlawful gains. Moreover, the great advantage of the civil law is that there are some very speedy procedures to freeze the defendant's assets

425. The payment of secret commissions or bribes gives rise to civil liability. At common law the acceptance of a secret commission by an agent, employee or fiduciary involves a breach of duty. Where such payments are made, the recipient will be compelled to hand them over even if the beneficiary or principal suffers no loss from the corrupt deal. The beneficiary or principal may also sue the briber for damages or fraud. It is, however, a complete defence if it can be shown that there has been full and proper disclosure to the beneficiary or principal.

426. At one time in England and in most common law countries a significant limitation was imposed on the recovery of the proceeds of bribery. A 1890 decision of the English Court of Appeal (Lister v Stubbs (1890) 45 Ch D 1) had held that a secret commission does not belong to the beneficiary or principal so that he/she is only entitled to sue the recipient for the actual amount of the bribe itself, either in an action for money had and received or in a personal claim in equity. Accordingly, there was no right to recover from the fiduciary or agent the profits made by the use of the secret commission. Nor was there any preferential rights in bankruptcy since the beneficiary or principal was merely in a creditor relationship with the fiduciary or agent.

427. In 1993 the Privy Council in Attorney-General for Hong Kong,China v Reid (1993) 3 WLR 1 143 overturned over 100 years of precedent. The facts of the case are notorious in that the Head of the Commercial Crime Unit of the Hong Kong,China Attorney General's Department had accepted bribes as an inducement to exploit his official position by obstructing the prosecution of certain suspected criminals. After pleading guilty, Mr Reid was sentenced to 8 years imprisonment and ordered to pay the Crown HKD 12.4 million (*i.e.* NZD 2.4 million) being the value of assets then controlled by Reid which could only have been derived from bribes. The Hong Kong,China Government sought to recover three of Reid's properties in New Zealand whose value had increased

from NZ 540 000 to NZD 2.4 million. The Privy Council held that the Attorney-General of Hong Kong,China was entitled to lodge caveats on the properties because it had an equitable interest in the properties.

428. Lord Templeman delivering the judgment for the Privy Council said:

> 'A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust. A secret benefit, which may or may not constitute a bribe, is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary. A fiduciary is not always accountable for a secret benefit but he is undoubtedly accountable for a secret benefit which consists of a bribe. In addition, a person who provides the bribe and fiduciary who accepts the bribe may each be guilty of a criminal offence.'

429. The reasoning of the court bears close examination (at 1146):

> 'When a bribe if offered and accepted in money or in kind, the money or property constituting the bribe belongs in law to the recipient. Money paid to a false fiduciary belongs to him. The legal estate in freehold property conveyed to the false fiduciary by way of bribe vests in him. Equity, however, which acts in personam, insists that it is unconscionable for a fiduciary to obtain and retain a benefit in breach of duty. The provider of the bribe cannot recover it because he committed a criminal offence when he paid a bribe. The false fiduciary who received the bribe in breach of duty must pay and account for the bribe to the person to whom that duty was owed. ...[I]f the bribe consists of property which increases in value or if a cash bribe is invested advantageously, the false fiduciary will receive a benefit from his breach of duty unless he is accountable not only for the original amount or value of the bribe but also for the increased value of the property representing the bribe. As soon as the bribe was received it should have been paid or transferred instanter to the person who suffered from a breach of duty. Equity considers as done that which ought to have been done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on constructive trust for the person injured.'

430. This decision has wide ranging implications for the recovery of monies in corruption cases in countries applying English concepts of equity. The imposition of a constructive trust in respect of the proceeds of a bribe applies not only to public officials as in this case but to any private individual who may be considered to be a fiduciary. Trustees, servants, employees, agents and directors who accept bribes and betray the trust of their beneficiaries, masters, principals and corporations may be considered to be fiduciaries whose profits arising from bribes may be recovered under the doctrine of constructive trust. This civil remedy for private bribery provides a flexible and effective way of stripping the profits of corruption.

CHAPTER 6: RESOURCE AND TRAINING GAPS IN CORRUPTION/ MONEY LAUNDERING

431. The terms of reference of this chapter are:

> 'In consultation with dedicated anti-corruption agencies and bodies, identifying training and guidance gaps in current anti-corruption programmes specifically relating to the AML/CFT issues. Developing an outline for training modules and guidance to address the identified gaps.'

432. The aim of this final concluding Chapter is to summarise the major points made in the body of the Report and identify current training and resource gaps. In many cases the Chapter further makes some suggestions as to how these training and resource gaps might be addressed. Before enumerating specific training and resource gaps, some general lessons of the study are presented.

General Conclusions

433. AML/CFT systems can contribute at least as much to fighting corruption as anti-corruption systems can contribute to the effective operation of AML/CFT systems. Although detailed, definitive evidence is lacking, interview sources and other evidence are more likely to attribute failures in AML/CFT systems to factors other than corruption. Particularly in the developing world, factors including the relative novelty of AML/CFT systems, the lack of experience of law enforcement, prosecutors, and judges in dealing with money laundering cases, the magnitude of the cash and informal economy, and a lack of resources for the FIU are all adduced as being more important obstacles to an effective AML/CFT system than corruption. In other words, even with a perfect anti-corruption system in place, the benefit to combating money laundering and terrorist finance may only be modest.

434. Incremental benefits to the effectiveness of the AML/CFT systems can, however, be obtained from applying standard corruption prevention measures to FIUs and to other components of the system. But the incremental improvements in effectiveness should be carefully compared with the direct, indirect and opportunity costs of applying new standards in this area, particularly where there are many other demands on government resources. Applying anti-corruption measures to other components of the broader AML/CFT system (*e.g.* law enforcement, prosecutors and judges) may bring very substantial benefits to the criminal justice system in general (though this is outside the scope of the Report), but once again seems likely to produce only modest benefits in terms of the fight against money launderers and those financing terrorism.

435. All of the resource and training gaps detailed below, and indeed the Report's conclusions more generally, need to be interpreted in the light of local circumstances, all the more so with reference to developing countries. As noted by the FATF at its last two plenaries, low-capacity countries are already struggling to implement the 40+9 Recommendations. Imposing an additional set of anti-corruption standards on their already over-burdened and fragile AML/CFT systems would only make their tasks more difficult, and probably reduce rather than enhance the effectiveness of such systems overall. Taking into account the existing challenges faced by developing countries in establishing an effective AML/CFT system is particularly important for the APG, which has a more heterogenous membership in terms of size and development level than any other FATF-Style Regional Body.

436. At present the great missed opportunity revealed by this Report is the under-utilisation of AML/CFT systems for anti-corruption purposes. In this area significant gains can be had with little or no extra commitment of resources, especially in developing countries. Through legislation, the establishment of financial intelligence systems, and the creation of specialised anti-money laundering bodies, countries have also provided themselves with potent anti-corruption instruments. At present, however, these instruments generally go unused.

437. This missed opportunity is in large part the result of an excessively narrow conception of the proper function of the AML/CFT system, whereby FIUs generally have little interaction with anti-corruption bodies, and vice versa. The tendency for these two kinds of agencies to remain compartmentalised and operationally isolated from each other persists even in the face of the World Bank's conclusion that for many countries corruption offences are probably the main predicate offence for money laundering.

438. The significance of these unrealised benefits can be gauged by the magnitudes of the costs corruption imposes, in developed and developing countries. The Bretton Woods institutions identify corruption and problems of governance more broadly as the single greatest obstacle to successful development. Clearly, a problem as complex and multi-faceted as corruption cannot be extirpated with any single new approach, including the application of AML/CFT remedies. But given the scale of the losses caused by corruption, even a partial reduction of this damage translates as a major benefit. This calculation is all the more favourable given that countries are already bearing the cost of AML/CFT systems, but often under-employing these systems where they could achieve the most conspicuous successes.

439. Specifically, as examined in more detail below, the two most important benefits the AML/CFT system can provide in combating corruption are extra financial intelligence and more robust asset confiscation provisions.

440. The extra financial intelligence arises from the specific requirements of the 40+9 Recommendations, including Customer Due Diligence, establishing beneficial ownership and control of corporate vehicles, Suspicious Transaction Reporting, Money Laundering Reporting Officers in private firms, FIUs, and enhanced provision for the international exchange of financial intelligence through facilities such as the Egmont Group's secure website. This intelligence can assist both the investigation and deterrence of corruption. But such information can also boost the effectiveness of corruption prevention measures. For example, if parliamentarians or judges are required to declare their assets and financial interests, information received and collated in response to AML/CFT requirements can be used to cross-check the veracity and completeness of these declarations.

441. The asset freezing and seizure provisions of current AML/CFT practice can be put to good use in an anti-corruption role, both in respect to domestic and international cases. The ability to bring money laundering charges against corrupt officials and those abetting them can bring conviction-based asset confiscation procedures into play. Perhaps even more effective are the non-conviction based and civil mechanisms by which those involved in money laundering/corruption cases can be parted from their illicit gains with a reduced burden of proof. Being able to confiscate assets in this manner acts as deterrent and penalty, but may also provide more resources to bolster capacity through the confiscated assets.

Training and Resource Gaps

442. In identifying training and resources gaps, as in Chapter 1 the authors wish to stress that these conclusions remain provisional until the appearance of the five reports relevant to the corruption-money laundering link appear later in 2007 or early in 2008. These are the World Bank reports on the use of AML/CFT measures for anti-corruption purposes, the governance of FIUs, and grand

corruption and money laundering, and the regional reports by ESAAMLG and GIABA. At time of writing none of these is available to the authors, and thus some of the recommendations of this Chapter may be fulfilled by this work.

443. As a general rule, it would be preferable to deploy AML/CFT and anti-corruption expertise in tandem rather than separately. As such, in any subsequent work on this subject it may be advisable to include the joint and equal direction and participation of a dedicated anti-corruption organisation. For the APG the most logical partner in this respect may be the ABD/OECD Anti-Corruption Initiative for the Asia-Pacific. The ADB/OECD has indicated an in-principle willingness to co-operate on such an endeavour, both in its Strategic Action Plan and at the APG's 2007 plenary meeting. In addition, the broad participation of countries and other multilateral organisations would be essential to the successful conclusion of any future work to remedy the shortcomings and gaps identified in this Chapter, and the Report more generally.

444. Aside from training and resource gaps, this Report encourages APG members to join the various initiatives and ratify the relevant Conventions devoted to fighting both money laundering and corruption. One such positive move would be for APG members that have not yet done so to join the ABD/OECD Anti-Corruption Initiative for Asia and the Pacific. Similarly, more members may wish to join the OECD Anti-Bribery Convention. The Report strongly recommends that countries sign and ratify the UNCAC, as well as the other relevant UN Conventions on combating drug trafficking, transnational crime and the financing of terrorism.

445. Similarly, the logic of this Report argues for a legislative program to correct common deficiencies. Elements of such a program would ensure criminalising the bribery of foreign officials, ensuring the criminal liability of legal persons for corruption, criminalising private sector corruption in line with ICC standards, and making sure all kinds of corruption offences are predicate offences for money laundering. Furthermore, the authors echo the Commonwealth's call for immunities for public officials to be wound back with an eye to eventual elimination.

Connecting AML/CFT and Anti-Corruption Strategies

446. Among interview sources, probably the most common explanation of the so far disappointing impact AML/CFT laws and regulation have had on corrupt practices centred on the compartmentalisation and lack of communication between relevant parties. This disconnect between AML/CFT and anti-corruption efforts is especially important with regards to FIUs and anti-corruption bodies, but it also extends to judges, prosecutors, police and private sector reporting entities. The most urgent training and resource gap is to remedy this disconnect.

447. The first step to capitalising on potential synergies between AML/CFT and anti-corruption measures is to encourage joint training and enhanced links between FIUs and anti-corruption bodies. The UNODC and Commonwealth have already adopted this principle in many of their technical assistance programs, but further reinforcement along these lines is needed. In particular, anti-corruption bodies should be trained to know how to access STRs and follow-up financial intelligence gathered by FIUs. (Those countries that currently have legislation forbidding the exchange of information between such bodies may consider amending the legislation to remove this prohibition.).

448. Anti-corruption agencies should also know how they can ask the FIU to request financial intelligence on their behalf, particularly for from foreign counter-parts. In order to do so effectively, these agencies should be informed about what information can be exchanged with which countries according to extant Mutual Legal Assistance Treaties, Memoranda of Understanding, Exchanges of Letters and/or the Egmont Group secure website. Financial intelligence concerning PEPs may often be especially useful for anti-corruption purposes.

449. Anti-corruption agencies and FIUs may find it most effective to directly conclude Memoranda of Understanding, which ideally would include the ability of the former to remotely access data from the latter via a secure portal. A praiseworthy example of such a Memorandum of Understanding is the current arrangement between the Indonesian Financial Transaction Reports and Analysis Centre (PPATK) and the Corruption Eradication Commission (KPK). Anti-corruption agencies and FIUs should be regularly briefed on each other's priorities. Each type of body should have designed Liaison Officers for responsible for facilitating and co-ordinating information and feedback flows. An example is the designated officers in the Australian FIU (AUSTRAC) responsible for liaising with the various sub-national anti-corruption bodies.

450. A more specific measure for improving the information flow between FIUs and anti-corruption bodies suggested to the authors by one interviewee is to compile a list of corruption key words or phrases. STRs containing such key terms could automatically be forwarded to the anti-corruption agency, in the same way that in some countries STRs containing terrorism key terms are immediately forwarded on to anti-terrorist agencies.

451. Information gathered for AML/CFT may have considerable utility in bolstering corruption prevention measures. In particular financial intelligence held by or accessible to FIUs may be used to check the veracity of declarations for asset registries for a variety of public officials, potentially including ministers, members of the legislature, senior bureaucrats, judges, police and members of FIUs and anti-corruption agencies themselves. To be most effective, the information provided by FIUs should enable verification of individual and joint beneficial ownership or control of corporate vehicles.

452. Conversely, either by themselves or preferably in conjunction with anti-corruption agencies, most FIUs need to do much more in terms of sensitising private sector reporting entities as to the need to submit corruption-related STRs. Such an effort should not only include regular training sessions of Money Laundering Reporting Officers and general staff, but also regular feedback on those corruption-related STRs that have been submitted. Education along these lines may well also be profitably extended to Designated Non-Financial Businesses and Professions (DNFBPs). Through this kind of training the scarcity of corruption-related STRs identified as a key problem in the OECD Working Group on Bribery's Mid-Term Review should be ameliorated.

453. Training relating to common patterns of money laundering-corruption linkages may also be productively extended to law enforcement and prosecutors, who according to the APG Scoping Paper often tend to be exclusively interested in the predicate offence rather than the associated money laundering. Judges also need to understand the linkages between corruption and money laundering, as well as asset freezing and confiscation provisions.

The Need for a Money Laundering-Corruption Typology

454. The major resource gap in fostering an awareness of the money laundering-corruption nexus is the lack of a dedicated typology exercise detailing the links between corruption and money laundering. As long as a typology on these lines is not available progress in increasing general awareness of money laundering-corruption linkages will be difficult. Such a document could be used to increase reciprocal understanding between FIUs and anti-corruption bodies, but may also help foster awareness of these kinds of inter-related financial crimes among law enforcement, prosecutors and private sector reporting entities also.

455. The APG Scoping Paper has provided a valuable preliminary indication of what such an exercise would look like. The typology should include coverage of the legal environment among different countries, examples of crimes including money laundering and corruption (anonymised or otherwise), and examples of successful responses. The document would need to be based on country surveys and interviews, as well as open source material like media coverage and court records. Furthermore, such a typology would need to be drawn up with the active and equal participation of anti-corruption agencies as well as AML/CFT bodies at the national and multilateral level, not just AML/CFT bodies in isolation.

456. Rather than working from scratch, a corruption-money laundering typology could draw on the APG Scoping Paper, the valuable work conducted along these lines by the Belgian and US governments, and the examples drawn from a variety of earlier publications and replicated in the Annex of this Report.

Regulating CSPs and Establishing Beneficial Ownership

457. As identified in Chapter 2, the presence of unregulated, unlicenced Corporate Service Providers represents a major threat to the integrity of the AML/CFT system in general, as well as facilitating the laundering of the proceeds of corruption in particular. The FATF's 2006 paper on the misuse of corporate vehicles has identified a large number of countries that have not regulated their CSPs. This threat is all the more pressing in countries that do not have a private sector corruption offence and/or do not require disclosure of beneficial ownership and control of all corporate vehicles. Successful examples such as the Isle of Man demonstrate that it is possible to licence and regulate Corporate Services Providers without imposing excessive administrative burdens or negating commercial competitiveness. Countries should be made aware of such successful examples through models of best practice, a research paper or seminars in order to stimulate the spread of CSP regulation.

458. Perhaps the single greatest weakness in the existing AML/CFT regime is the failure of many FATF members to establish beneficial ownership and control of corporate vehicles, including Limited Liability Corporations, private companies, trusts and foundations. Currently, failure on this front seriously compromises the global AML/CFT regime. Publicising the efforts of jurisdictions like the British Virgin Islands in immobilising bearer shares and establishing beneficial ownership of a large number of non-resident companies (International Business Companies) may help to catalyse sufficient political will to remedy this very grave shortcoming.

Asset Recovery and Mutual Legal Assistance

459. Despite the very valuable work done by the ADB/OECD, Commonwealth and World Bank Stolen Asset Recovery (STAR) program among others, the successful international recovery of the proceeds of corruption and money laundering remains a serious problem. To complement existing efforts, this Report suggests that further consideration of the uses of AML/CFT laws in corruption-related asset recovery in the context of seminars and/or training workshops would make a useful contribution to improving existing practice in this area. The same goes for workshops on the relative merits of asset seizure and repatriation according to conviction, non-conviction and civil approaches.

460. A further training gap at present is the uncertainty concerning the different rules governing extradition and mutual legal assistance among APG member countries that has impeded cross-border co-operation in fighting financial and other crimes. Further training in this area would assist the investigation and prosecution of complex, large-scale corruption and money laundering cases.

461. In order to further knowledge of such cases positive and negative aspects of the recovery of

assets stolen by Sani Abacha and repatriated to Nigeria may produce considerable insight for future practice. The same can be said of other high-profile cases (both concluded and on-going) involving other PEPs such as Benazir Bhutto of Pakistan, Frederick Chilubu of Zambia, Tommy Suharto of Indonesia, and Pavel Lazarenko of the Ukraine (these cases may be covered in the forthcoming World Bank study of grand corruption and money laundering).

462. To foster improvements in mutual legal assistance, particular in terms of making such assistance more timely, technical assistance should be provided to developing countries to investigate the feasibility of amendments to their legal system to enable faster responses for foreign requests. Effective international co-operation also depends on cost. Requests for assistance made of developing countries in complex cases may well involve substantial commitments of time and resources. To alleviate these costs the Commonwealth's Harare principles on cost sharing in international legal co-operation should be studied to determine their appropriateness for further adoption.

Politically Exposed Persons

463. PEPs was identified in the Terms of Reference as one of the most important issues for the Report to consider. Chapter 3 identified a number of common shortcomings in the treatment of PEPs. Perhaps the most prominent of these is the widespread failure to appreciate the legal requirement to institute a domestic PEPs regime contained in the UNCAC. In turn the need to create such a regime has considerable training and resource implications. Aside from the provisions of the Convention, the logic of confining enhanced scrutiny to foreign PEPs only is inherently not convincing.

464. The large majority of those countries that have signed and ratified the UNCAC but not yet fulfilled the domestic PEPs requirement can learn from the example set by such countries as Brazil, Mexico and Belgium. There is an urgent need for technical assistance, especially with regards to developing countries, on how to establish a domestic PEPs regime. Aside from the UNODC itself, regional seminars sponsored by FSRBs, the Bretton Woods institutions, regional development banks, or other multilateral bodies like the Commonwealth and the OECD would greatly assist in formulating and diffusing best practice in this area.

465. More broadly, governments will have to take on a greater burden in drawing up PEPs lists and defining adequate risk-based practice, in contrast to the current approach which involves an excessive reliance on the private sector. Once again, to the extent this creates a new burden for developing states it is important that bilateral donors and/or multilateral agencies step in to help defray costs and provide technical assistance. Even for developed countries, seminars and workshops through which to share experience should greatly assist in rapidly responding to this gap while avoiding unnecessary expense and duplication of effort.

466. Existing regulations may well be overly restrictive in defining PEPs. Chapter 3 pointed out that in important instances sub-national leaders, senior figures in security forces, heads of charities and extended family members have had a prominent role in major corruption-related money laundering cases. Extending coverage of PEPs may depend on the benefits of a broader definition versus the costs of applying enhanced scrutiny to a substantially larger group of people. In order to strike the right balance further research is required.

467. Although not as pressing as the above-mentioned priorities, it seems that the FATF PEP definition is no longer an adequate guide to best practice. The lack of a domestic PEPs requirement, the narrow coverage of family and personal associates, and the exclusion of business associates who share ownership or control of legal persons signify the obsolescence of the FATF definition. This rendering not only lags the UNCAC and EU definition, but is also less rigorous than the standards applied by some prominent private financial services firms. Given these inadequacies, the FATF may like to give some consideration to updating Recommendation 6.

Private Sector Corruption

468. Turning to private sector corruption, countries should make use of the expertise of the International Chamber of Commerce and be sensitive to the criticisms of this institution. The ICCs claim that instances of private sector corruption taking place across borders are almost never successfully prosecuted gives grounds for serious concern, and repay further investigation and remedial action. Best practice in this area in relation to both legislation and implementation is provided by Hong Kong,China, other countries could profitably learn from this experience.

469. The text above has identified the most prominent training and resource gaps relating to inter-related practices of money laundering and corruption. There are a variety of institutional sources potentially available for providing these resources and conducting or facilitating training, seminars and technical assistance. Many of these are covered in Chapter 1 relating to those bodies active in investigating the money laundering-corruption relationship.

Corruption Prevention in FIUs and other Knowledge Gaps

470. Chapter 2 laid out international best practice on corruption prevention with particular emphasis on FIUs. The state of the art in this area calls for codes of conduct, rigorous recruitment guidelines, as well as rules on conflicts of interest, gifts and benefits, and the handling of confidential information. Given the significant costs that adopting all of these measures would impose on FIUs, and the uncertain benefits that they would deliver in terms of increased effectiveness, reforms in this area should take place only after a careful cost-benefit analysis. Interviewees and source material available to the authors did not indicate that corruption in FIUs is currently a serious problem, though this evidence is fragmentary rather than conclusive.

471. Corruption amongst judges, prosecutors and police, on the other hand, definitely does limit the effectiveness of the criminal justice system in many countries. More wide-ranging corruption on this scale can be expected to impede the fight against money laundering and terrorist finance also.

472. There is presently very little knowledge concerning how to deal with the proceeds of bribery, as opposed to the bribe itself. Interview sources could not indicate any examples of successful international asset recovery of the proceeds of bribery.

473. A similar knowledge gap concerns de facto banking secrecy. Notwithstanding the successes recorded by the OECD, FATF and other organisations in removing formal bank secrecy as an obstacle to international legal co-operation, de facto banking secrecy in some FATF members still seems to impede the international flow of financial intelligence. Further research on de facto secrecy would establish the scale of the problem, as well as prompting though on how to overcome this continuing problem.

474. Another resource gap identified both by interviewees and in published reports is the lack of consistent data gathered by national authorities (see especially the OECD Working Group on Bribery Phase 2 Mid-Term Review). Because of this shortage it is difficult to investigate (for example) why new AML/CFT requirements have seemingly had so little impact on the fight against corruption. The authors recommend that any future review mechanism for the UNCAC pay close attention to national reporting requirements, and to be sensitive to the link with AML/CFT practices. Valid and reliable cross-national data on anti-corruption strategies and the interaction with the AML/CFT system, like the number of corruption-related STRs, would comprise a very useful resource.

ANNEXES

Annex 1: Examples of the Money Laundering - Corruption Nexus

CASE 1 (Source: APG, Scoping Paper, 2005)

475. An executive of a Hong Kong,China representative office of a foreign bank accepted advantages of approximately HKD 3.51 million) as a reward for assisting two mainland companies in obtaining loans/credit facilities amounting to approximately HKD 390 million. The advantages to be paid to the banker were included in the consultancy fees paid by the borrower to a BVI company controlled and operated by an accountant.

476. The advantages to the banker were paid by the accountant to him partly in the form of cash (HKD, GBP and USD) and HKD cheques which were deposited in his own account. Advantages were also paid in the form of a GBP demand draft issued in favour of a third person. This demand draft was deposited in a United Kingdom bank account and proceeds remitted by wire transfer to Thailand where it was then withdrawn in cash.

CASE 2 (Source: APG, Scoping Paper, 2005)

477. A senior manager of a local bank, 3 shareholders and 2 employees of a money changer company have been charged with conspiring with persons believed to be money couriers from mainland to Hong Kong,China to deal with large sums of cash of HK$50 billion, knowing that the money in whole or part represented proceeds of an indictable offence. The money brought in by courier to Hong Kong,China was partly converted to other currencies and then deposited in various nominated accounts. The senior manager of the bank was also charged with accepting advantages of USD 20 000 in loans from a shareholder of the moneychanger company. The senior manager was alleged to have conspired with another bank officer to record cash deposits in the account of the moneychanger as transfer deposits, purportedly to circumvent suspicious transaction reports.

CASE 3 (Source: APG, Scoping Paper, 2005)

478. The Investigation Bureau of the Taipei Municipal Field Office investigated a corruption case in 1998. The indictment indicated that the main suspect Chuang, director of Land Administration Bureau, Taipei County Government, legal government official, was intentionally to make illegal profits for specific businessman Lin by means of fabricating of official document to help materialize illegal land buying in behalf of receiving kick back/illicit profits from them. Due to Chuang's violation of a government official's obligation, the purchaser gained a huge amount of illicit profits from the State Treasury. Based on the prior arrangement of the two parties, Chung gained three percentage of commission from the above illicit profits accordingly.

479. Money laundering avenue: In order to hide and gloss over the fact these funds were criminal proceeds, Chuang requested Lin to remit part of the commission to bank accounts maintained by Chuang's relatives. Simultaneously, Chuang asked Ho, his brother-in-law to act as an intermediary to receive kick backs from overseas on his behalf and afterwards wire transfer the proceeds to an off shore bank account in the name of his spouse. These systems were designed to ensure that evidently details would be hidden and prevent law enforcement from subsequent tracing the proceeds.

480. Chuang and Lin were both convicted on charges of violation of Article 4, 11, Anti-Corruption Statute and Article 9, Money Laundering Control Act Chuang was sentenced to 20 years and Lin 13 years imprisonment.

CASE 4 (Source: APG, Scoping Paper, 2005)

481. Hsih used the status of a lawmaker, in order to assist Ho to obtain a petroleum contractor and received a payment of US$760,000 in unjust enrichment, as a reward for of abusing a lawmaker's privilege by illegally lobbying at a specific committee of the parliament for Ho.

482. Due to Hsih's illegal lobbying, Ho was successfully awarded the contract of a specific petroleum transportation construction and paid USD 760 000 in bribes to Hsih. In order to prevent law enforcement from pursuing, Ho directed his employees Ting and Lai, to wire/transfer money to the bank account of a person named Wong. Wong nominally used the funds to buy shares in China Engineering Limited Corp. After three months of Wong off set all the aforesaid shares and wired the money to Hsih's bank account in order to intentionally shift the corruption proceeds derived from the illegal lobby of Hsih.

483. While investigating the flow of the corruption proceeds and prosecuting process, the prosecutor interviewed Hsih and Ho regarding the USD 760 000. Both of them denied corruption and alleged that the nature of the USD 760 000 was a loan to Hsih by Ho in order to invest in the shares of China Engineering Limited Corp.

484. The defendants submitted false witness to the court in order to prove their innocence. It is the most difficult problem in the field of money laundering identification

CASE 5 (Source: APG, Scoping Paper, 2005)

485. In 2003 a government official employed by Work and Income New Zealand received bribes for ensuring that a particular developer was chosen to do the work on government projects the official was responsible for. Following a two-week jury trial he was convicted and sentenced to three years in prison.

486. The official set up a number of companies to launder his bribes. He used friends to "front" the companies and conceal his involvement. He also used a friend's nominee company to launder money

CASE 6 (Source: APG, Scoping Paper, 2005)

487. The case relates to the local government officer (herein after referred to as Mr HBI) in charge in the enforcement unit of a government agency. He demanded a sum of monthly corrupt payment from owners of premises in return for not taking action against them under Local Government Act or Sub-local Government Act.

488. As a Unit Head, his duty is to conduct an inspection on these premises to ensure compliance with the Act requirements such as the business license, business hours schedule, etc.

489. Mr HBI will issue summons to any premise owner who does not comply with the Act requirements.

490. In return for restraining actions or for not taking actions for the non-compliance, corrupt payments were transacted as a favour between the non-compliers and Mr HBI via a 'Middleman' whom the later set in place.

491. After receiving such corrupt payments, Mr HBI instructed the Middleman to place Fixed Deposits (FD) with the bank(s) under the Middleman family members using that corrupt money. Besides, the money was also used to purchase stocks.

CASE 7: (Source: APG, Scoping Paper, 2005)

492. Mr DBI is a Director of Procurement Department in a company in which the Government holds 60% of the equity. Parallel with the definition of a 'Public Body' as interpreted under section 2 of the Anti-Corruption Act 1997, which states that any company is a Public Body provided that the Government has a controlling power in that company, Mr DBI is thus an officer of a public body.

493. Mr DBI has an authority to purchase equipment below RM200, 000 without having to submit a proposal to the Tender Board Committee for prior approval.

494. Two nominees had been appointed by Mr DBI to set up several companies: X Sdn Bhd and Y Sdn Bhd, whereby each one maintains its own separate accounts.

495. Mr DBI offered contracts to these companies, which in turn invested their money/ fund into businesses with a BVI offshore company.

496. The BVI company then invested the money into the company XX Sdn Bhd that engaged in a consultation line, delivering consultation services to foreign investors wanting to invest in Malaysia. This XX Sdn Bhd is actually owned by the wife to Mr DBI. Therefore via this set up, Mr DBI would manage to recoup the money which he indirectly 'invested' in the said offshore company.

CASE 8 (Source: Egmont Group, *FIUs in Action: 100 Cases from the Egmont Group*, 1999)

497. Tom was a member of the Chamber of Deputies in his home country. He was able to support his family on his modest government salary until he began to develop a severe gambling habit. Increasingly in debt, and increasingly desperate for money, he formulated a plan to make him rich enough to carry on gambling indefinitely. As a project planner within the Ministry of Finance, he had the power to propose and approve schemes in a specific sector of the annual public works budget. It occurred to Tom that offering to approve schemes in return for a small monetary gift was an ideal solution to his money problems. Unsurprisingly, a number of businessmen were willing to pay him well for the guarantee of government business, and Tom became rich very quickly through his corrupt activities.

498. Tom's friend Gina, who owned an exchange and tourism company, was willing to help him launder the bribes that he was receiving. She used her employees as 'straw men' to create a number of different bank accounts through which funds could be laundered–more than USD 4 000 000 was laundered in total through such accounts. However, the cash payments and subsequent transfer offshore risked attracting attention, and so Tom developed a more sophisticated laundering method–a fruit delivery company. This company, which was owned by Gina's husband, laundered USD 2 700 000 in three months, disguising the transactions by creating false invoices which were settled by the businessmen on Tom's instructions. In this way, there was no direct link between Tom and the corrupt payments, and the businessmen had invoices to justify the payments should any questions be asked. The fruit company could then transfer the funds offshore as 'settlement' for fruit importations, attracting few suspicions.

499. However, the earlier transactions had not remained unnoticed by the financial institutions involved. In view of the unusually large amounts of cash deposits and the rapid offshore transfers–especially in view of the declared low-income employment of the account holders–the institutions decided to disclose to the national FIU on a variety of accounts. Following analysis by the FIU, the police had obtained a clear understanding of Tom and his corrupt activities, and had instigated a full investigation. Inquiries showed that Tom had used assessors of the House of Representatives to assist in the approval of his schemes. One assessor, who did not have any involvement, had his signature counterfeited to obtain the necessary authorisation. Another assessor had helped Tom by visiting the exchange and tourism company and receiving cheques in his name. After receiving the cheques, the assessor deposited the money in one of Tom's accounts.

500. At time of writing, the police were trying to link the corruption inquiry into another case currently before the Supreme Court. The total amount of money Tom laundered was estimated to be in the region of USD 1 000 000 000. It is worth noting that the disclosures by the institutions took place because of the simple initial laundering scheme, whereas the later scheme involving an established company appeared to have little risk of disclosure.

CASE 9 (Source: Egmont Group, *FIUs in Action: 100 Cases from the Egmont Group*, 1999)

501. The police of an American country asked the national FIU for assistance in a criminal investigation on Giorgio and Benedetto. They were believed to be involved in concealing illicit proceeds resulting from corruption activity in a South European country. Although the FIU had not received any disclosures from financial institutions concerning the case, it initiated a financial investigation.

502. In 1981 Giorgio began to work for Benedetto as a financial advisor. Following Benedetto's orders, Giorgio opened a current account on his behalf in a central European country using the name of an American offshore corporation. From 1981 to 1987 the account was credited with corruption funds using the assistance of a banking official named Ugo. Some of the money was transferred onwards to a current account opened in a bank in a central European country, again using the same of the same corporation, because Ugo had moved jobs to this institution and wished to continue to provide services for Giorgio. In February 1993, following Benedetto's orders, Giorgio transferred the American corporation rights in favour of Gabriel, an American citizen.

503. From Feburary 1993, the American corporation's account located in the Central European country was used by Maurizio (a citizen of the same country as Giorgio, Benedetto and Ugo) and Gabriel. They transferred half the money of the American corporation to a bank in a central European country and half to bank in another American country. By March 1993, the account had been emptied of all funds. Gabriel, Maurizio and Adriana, all American citizens and Augusta, a European woman, all knew that the funds involved originated from a range of criminal activities. From July 1993 until May 1994 they transferred over USD 1 200 000 to account opened in a bank in another American country.

504. In March 1993, they created a corporation in the last mentioned American country to transfer the funds of the American offshore corporation. Gabriel and Maurizio transferred together 5 000 shares with a total value of USD 50 000.

505. Once the money was deposited in the bank accounts, between 1993 and 1994, several transfers were made between the accounts in order to further conceal the origins of the funds and increase the difficulties of any subsequent analysis by law enforcement investigators.

506. Despite this attempt to confuse the picture, the FIU analysed all of the fund movements and the proceeds that had been transferred to the offshore corporation were seized by the police in the country where Gabriel and Maurizio had their accounts. This success was possible due to a high level of co-

operation with the Government of the South European country. There was no co-operation with the FIU in that country, but there was close co-operation between the General Attorney's Offices of the two countries. The American country was also able to extradite two of the suspects responsible for the scheme to the European country.

CASE 10 (Source: FATF, *Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, 2006)

507. Mr. E a CEO of a local telecommunication company received corrupt money of RM 300 000 as an inducement to award supply and work worth RM 5.0 million to company P. Which belongs to Mr. F. Mr. F paid the corrupt money as a payment by company Pro company Q for services rendered. Company Q also belongs to Mr. F, but was merely a dormant shell company with RM 2.00 paid up in capital. The money was later withdrawn from company Q and placed in a stock-broking firm under the name of Mr. G, a nominee of Mr E, who opened an account with the same stock-broking company using his son's name. The money in G's account was later used to purchase shares in the open market and later sold to Mr. E's son using numerous married deal transactions whereby the shares were later sold to Mr. E's son in the open market at a higher price. Capital gains subsequently were used to open fixed deposits, sign up for an insurance policy (under the name of Mr. E) as well as purchase assets in the name of Mr. E's relatives.

Annex 2: PEP Money Laundering Case Studies

CASE 1 Pavel Lazarenko

(*Source*: APG, Scoping Paper, 2005)

508. On 23 July 2001, Pavel Ivanovich Lazarenko, the former Prime Minister of the Ukraine, was charged with violations of the federal money laundering statutes, wire fraud, receipt of stolen property, and criminal forfeiture of certain property. Lazarenko was the Prime Minister of the Ukraine from May 1996 to July 1997, and had occupied other official positions in the Ukraine since 1992. The grand jury indictment charged that Lazarenko conspired to launder money through US bank accounts, and that the money represented the proceeds of various crimes including extortion, fraud, and illegal transportation of property obtained by fraud. Lazarenko used various bank accounts in Switzerland and Antigua into which he deposited the money, and the indictment charged Lazarenko with laundering approximately USD 21 million of the criminal proceeds through bank accounts located in the United States. The US sought forfeiture of 21 million of funds that were laundered through correspondent accounts.

509. Although twenty-three counts were dismissed and one dropped as the result of a defense motion for acquittal after prosecutors finished presenting their case in early May, U.S. federal prosecutors won a money laundering conviction against the former Ukrainian Prime Minister on 3 June 2004, when a US District Court jury found him guilty of seven counts of money laundering and 22 other related charges including wire fraud and interstate transportation of stolen property.

510. The case was prosecuted by the US Attorney's Office for the Northern District of California (San Francisco), and was a unique demonstration of the extra-territorial reach of US money laundering laws. Lazarenko is the first foreign head of state to be convicted for laundering the proceeds of foreign crimes via US banks, and only the second head of state, along with Manuel Noriega, to be tried in the United States.

511. In addition to the money laundering conviction, Lazarenko was found guilty of one count of conspiracy to commit money laundering, 10 counts of wire fraud, and 11 counts of interstate transportation of stolen property. Among Lazarenko's assets that the US government has moved to forfeit, is a $6 million home in Marin, California.

512. Lazarenko had been under investigation by the FBI and Internal Revenue Service-Criminal Investigation Division since late 1997. The investigation took nearly four years to complete and to come to trial.

513. Lazarenko, who was arrested in 1999 just three years after he became prime minister of the Ukraine, left a complex trail of money transfers, deposits, and withdrawals over three continents that investigators were able to piece together. In 1997, he withdrew $96 million from SCS Alliance, a Swiss bank, and deposited the money into the bank's branch in the Bahamas. He then moved that money into a shell bank, European Federal Credit Bank, in Antigua, which had correspondent accounts at US banks.

514. In 2000, U.S. authorities charged Lazarenko with laundering money through these correspondent accounts, including accounts at the Commercial Bank of San Francisco, Pacific Bank, Bank of America, and West America Bank, as well as through brokerage firms Merrill Lynch, Hambrecht & Quist, and Fleet Boston Robertson & Stephens.

515. Before jurors could convict Lazarenko on the US charges, they had to find him guilty of crimes committed in the Ukraine: Extorting his former partner, Peter Kiritchenko; Defrauding Naukovy State Farm, a state-owned dairy farm; and depriving the Ukrainian people "of his honest services as a public official." The prosecution team made four trips to the Ukraine to gather documentary evidence and to interview witnesses. In addition to the trips to the Ukraine, witnesses were deposed in Israel, Cyprus, Istanbul, The Netherlands, London, Switzerland, and Canada. Forty witnesses testified for the government at the trial (including a Swiss banker), and eight witnesses testified for Lazarenko.

516. The crimes committed in the Ukraine laid the groundwork for the wire fraud and Interstate Transportation of Stolen Property counts, which served along with the extortion as the "specified unlawful activities" (SUAs) that triggered the money laundering charges.

517. The 29 charges were slightly more than half of the original 53 counts in the indictment. The counts on which Lazarenko was convicted encompassed USD 44 million of the USD 114 million the indictment charged him with laundering. Additionally, in June 2004, U.S. Department of Justice filed a civil forfeiture action against more than 214 million in funds located in Antigua and Guernsey that represent proceeds of corruption laundered by Lazarenko. That action is pending before federal court in Washington, DC.

CASE 2: <u>An associate of a PEP launders money gained from large scale corruption scandal</u>

(*Source*: FATF Money Laundering Typologies Report 2003/2004)

518. A video tape aired in Country A showed presidential adviser Mr. Z purportedly offering a bribe to an opposition politician. This publicity about Mr. Z, widely regarded as the power broker behind then-President in Country A, led the president to appoint a special prosecutor prompting numerous other investigations in Country A into the illicit activities of Mr. Z and his associates. An investigation initiated by authorities in Country B authorities froze approximately USD 48 million connected to Mr. Z (An additional USD 22 million was later discovered. Mr. Z fled the country and was eventually captured and extradited to Country A to face corruption, drug trafficking, illicit enrichment and other charges.

519. Prior to the capture of Mr Z, an associate of Mr Z, Mr Y was arrested on a provisional arrest warrant and request for extradition from Country A. Mr Z and his associates, including Mr Y, generated the criminal proceeds forfeited in this case through the abuse of Mr Z's official position as advisor to former the President of Country A. Some of the principal fraudulent schemes involved the purchase of military equipment and service contracts as well as the criminal investment of government pension funds.

520. Mr. Y was involved in a huge kickback scheme that removed money from both Country A's treasury and their military and police pension fund. Mr. Y and others used pension fund money and their own money to buy a majority interest in a Country C banking institution, Bank M which in June 1999 was bought by another bank in Country A. Mr. Y was in charge of seeking investments on behalf of Bank M and identified construction and real estate projects for the bank and pension fund to finance. He also controlled the construction companies which built those projects. Mr. Y established a pattern of inflating the actual cost of the pension fund investment projects by 25 percent and billed Bank M accordingly. Projects recommended by Mr. Y were automatically approved by the board members at the police pension fund, as several of them received kickbacks. A USD 25 million project was fraudulently inflated by USD 8 million. Similarly, Mr. Y covertly formed and controlled several front companies used to broker loans from Bank M in exchange for kickbacks from borrowers. When some loans defaulted, Mr. Y would purchase the bankrupt projects at extremely low prices for resale at a profit.

521. In addition, Mr Y and members of Bank M's board of directors were authorised by Country A's government to arrange the purchase of military aircraft for the nation. In just two aircraft deals the government of Country A paid an extra USD 150 million, because of a fraudulent 30% mark-up added on to the sale price. This illicit money allegedly was funnelled through Bank M. From there, it flowed into numerous accounts under a variety of names in banks in foreign jurisdictions to conceal the origin of the funds.

522. Mr. Y consistently used a group of banks abroad to launder his and others' share of criminal proceeds. Ms. D, a banker who is married to Mr. Y's cousin, formerly was a member of the board of directors of Bank N, helped Mr. Y conceal more than USD 20 million in one jurisdiction.

523. Mr. Y opened a bank account in Country C, and moved about USD 15 million through it until he was arrested. Initially, the account opening did not raise any suspicion because Country A nationals often opened bank accounts in the Country C to protect their assets from inflation. However, financial institutions holding bank and brokerage accounts owned or controlled by Mr. Y, Ms. D and others gradually noticed unusual activity in the accounts. According to bank officials, Mr. Y's financial transactions had no apparent business justifications and the origin of the funds was suspicious.

CASE 3: A senior government official launders embezzled public funds via members of his family.

(*Source*: FATF Money Laundering Typologies Report 2003/2004)

524. The family of a former Country A senior government official, who had held various political and administrative positions, set up a foundation in Country B, a fiscally attractive financial centre, with his son as the primary beneficiary. This foundation had an account in Country C from which a transfer of approximately USD 1.5 million was made to the spouse's joint account opened two months previously in a banking establishment in neighbouring Country D. This movement formed legitimate grounds for this banking establishment to report a suspicion to the national FIU.

525. The investigations conducted on the basis of the suspicious transaction report found a mention on this same account of two previous international transfers of substantial sums from the official's wife's bank accounts held in their country of origin (A), and the fact that the wife held accounts in other national banking establishments also provisioned by international transfers followed by withdrawals. The absence of any apparent economic justification for the banking transactions conducted and information obtained on the initiation of legal proceedings against the senior government official in his country for embezzlement of public funds led to the presumption, in this particular case, of a system being set up to launder the proceeds of this crime. The official concerned was subsequently stopped for questioning and placed in police custody just as he was preparing to close his bank account. An investigation has been initiated.

CASE 4: A senior employee of a state-owned company involved in high level corruption

(*Source*: FATF Money Laundering Typologies Report 2003/2004)

526. An investigation into a senior government official Mr. A, an employee of state owned Company A, uncovered that he was in receipt of excessive payments into a number of accounts that he owned and operated. Mr A was the vice president of Company A and had a yearly income of over USD 200,000. The investigation revealed M. A had 15 bank accounts in several different countries through which over US$200 million had been transacted. Mr. A used the money placed in these accounts to gain political influence and to win large contracts from foreign governments on behalf of Company A.

527. The investigation discovered that a trust account had been created to act as conduit through which payments from Company A were then transferred to a number of smaller accounts controlled by Mr. A. Mr. A would then transfer money from these accounts or make cash withdrawals. The funds, once withdrawn were used to pay for bribes. The recipients of these payments included: heads of state and government, senior government officials, senior executives of state owned corporations and important political party officials in several countries and family members and close associates of Mr. A.

528. Further investigation into the financial transactions associated with the accounts held by Mr. A revealed that a shell company was being used to make and receive payments. In addition to account activity indicated there were irregular cash deposits (often more than one a day) and unusually large of cash withdrawals; one account revealed that in one six week period over USD 35 million had been withdrawn in cash. This was inconsistent with all the previous activity on the account. The investigators noticed that there was also a deliberate smurfing of the cash deposits into smaller amounts indicating Mr. A had an awareness of reporting requirements and was attempting to avoid them. The beneficial owners of payments from Mr A made both in cash and by wire transfer implicated several PEPs and associates of PEPs:

The senior politician, senior official

529. An intermediary received a payment of USD 50 million from Company A. The intermediary then transferred the money into two accounts held off-shore; the funds were then moved to company accounts that were also held offshore. The beneficial owners of these company accounts were discovered to be a former head of the secret service in Country B and a state secretary for the Ministry of Defence in Country C.

Wife of a PEP

530. Money was transferred from Company A to one of the bank accounts owned by Mr. A; Mr. A then placed funds into a solicitor's client account and an off-shore bank account. The beneficial owner of the off-shore account was the recently divorced wife of a PEP – Ms C. The account was provided with funds for the purchase a property valued at over USD 500 000, a car, the redecoration of Ms C's flat and a monthly allowance of USD 20 000.

Friend and associate of the PEP

531. Company A made a payment to a bank account in Country D. The bank in Country D was then instructed to make transfer the money to an associate of Mr A, who held an account in the same bank in Country D. The associate then 'loaned' the same amount of money to a PEP.

CASE 5: Laundering the proceeds of embezzlement

(*Source*: FATF Money Laundering Typologies Report 2003/2004)

532. The bank accounts of a petroleum minister (Mr. Y) of a former dictatorship under which numerous embezzlement offences had been committed were credited with a sum of USD 6 million in the space of a few months. This provided grounds for the case to be referred to the judicial authorities who decided to indict the minister. On investigation the FIU discovered that Mr. Y was operating under the cover of an alias. The recently opened account controlled by Mr. Y had been credited with a notary's cheque for over USD S575 000 corresponding to the sale of a property. This sum did not correspond in any way to the market value of the property.

Annex 3: Potential Obstacles to the Detection of Bribery of Foreign Public Officials by AML Systems

Christine Uriarte, OECD Secretariat, Anti-Corruption Division
17 September 2007

Introduction

533. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention) takes a multidisciplinary approach to combating the supply side of foreign bribery, including through the application of money laundering legislation where the predicate offence is the bribery of foreign public officials.[1] The provision on money laundering in the OECD Anti-Bribery Convention is intended to achieve two main goals.[2] The first goal is to remove the monetary incentive for bribing foreign public officials by making the bribe and the proceeds of bribing them subject to money laundering legislation. The second goal is to detect the bribery of foreign public officials when the financial system is used to launder the bribe and the proceeds of such bribery. However, to date anti-money laundering (AML) systems have detected very few potential cases of foreign bribery. Since AML systems are believed to be one of the key methods for detecting foreign bribery, an assessment of the potential obstacles to such detection could help to ensure the effective implementation of the OECD Anti-Bribery Convention and aid the global fight against transnational corruption.[3]

534. This paper looks at the findings and conclusions of the OECD Working Group on Bribery in its 2006 Mid-Term Study of Phase 2 Reports (Mid-Term Study) on the detection of foreign bribery by AML systems.[4] It uses these findings to help identify potential obstacles to detecting foreign bribery through AML systems, and proposes further analysis for overcoming these obstacles.

---

1 The OECD Anti-Bribery Convention was adopted in 1997 and came into force in 1999. It is the only international instrument aimed at the supply-side of foreign bribery, and mandates the standards for the establishment of the offence of bribery of foreign public officials along with related obligations regarding the liability of legal persons, sanctions, jurisdiction, enforcement, statute of limitations, money laundering, accounting, mutual legal assistance and extradition. There are 37 Parties to the OECD Anti-Bribery Convention including seven non-OECD countries (Argentina, Brazil, Bulgaria, Chile, Estonia, Slovenia and South Africa).

2 Article 7 of the OECD Anti-Bribery Convention states that "each Party which has made bribery of its own public official a predicate offence for the purpose of the application of its own money laundering legislation shall do so on the same terms for the bribery of a foreign public official, without regard to the place where the bribery occurred".

3 The United National Convention against Corruption (UNCAC) (2003) also tackles transnational corruption, as well as several regional multilateral instruments, including the Organisation of American States Inter-American Convention against Corruption (1996), the African Union Convention on Preventing and Combating Corruption (2002), the Council of Europe Criminal Law Convention on Corruption (1999) and Civil Law Convention on Corruption (1999), and the Southern African Development Community Protocol on Corruption (2001).

4 The Mid-Term Study is a review and comparative analysis of the 21 Phase 2 country examinations completed by the Working Group on Bribery by the end of 2005. The Phase 2 country examinations, which involve an on-site visit to the country under examination, assess Parties' enforcement of the OECD Anti-Bribery Convention. Phase 1 reports review the compliance of Parties' implementing laws with the standards under the Convention. The Mid-Term Study and Phase 1 and Phase 2 reports can be found at: www.oecd.org/daf/nocorruption.

The Mid-Term Study of the OECD Working Group on Bribery as a Springboard for further Analysis

535. In June 2006, the OECD Working Group on Bribery published its Mid-Term Study, which represents a critical analysis of cross-cutting issues affecting the Parties to the OECD Anti-Bribery Convention. One area of the Mid-Term Study that was given significant attention was the enforcement of Article 7 of the Convention, which addresses money laundering,[1] due to the Working Group on Bribery's overriding concern that AML measures in the countries examined had uncovered few foreign bribery and related money laundering cases. Indeed, at the time of the Mid-Term Study, only three Parties had detected foreign bribery through suspicious transaction reports (STRs), representing approximately fifteen to seventeen potential cases of foreign bribery.[2] The Working Group could not attribute the low rate of detection of foreign bribery cases to a low rate of STRs, given that the number of STRs in the examined countries ranged from hundreds to tens of thousands and was rapidly increasing. In addition, only three Parties identified resource problems in their FIUs.

536. The Working Group concluded in the Mid-Term Study that, given the importance of AML systems for detecting and deterring the bribery of foreign public officials, the Working Group could follow-up with an assessment of why these systems had not been effective at achieving these goals. In addition, the Working Group already raised some issues in the Mid-Term Study that could usefully be addressed in such an assessment. These included the broad question of whether there are impediments to detecting money laundering in relation to foreign bribery through AML systems, as well as the following related issues: (i) the need to examine how Parties' AML systems apply to the laundering of the proceeds of the bribery of foreign public officials as opposed to the bribe; (ii) the application of offences of money laundering when the predicate offence takes place abroad; (iii) the need for money laundering typologies with foreign bribery as a predicate offence: and (iv) the need for feedback from financial intelligence units (FIUs) on the use of STRs in money laundering investigations and prosecutions.

537. This paper attempts to build on the conclusions in the Mid-Term Study, by asking: What specific features of the bribery of foreign public officials might be obstacles to its detection by AML systems, and what might be done to overcome these obstacles? In order to address this question, this paper looks at how the following three common features of foreign bribery, which differentiate the offence from many other predicate offences, might significantly impact on its detection through AML systems: 1. the generation by the offence of two types of illicit funds—the bribe payment and the proceeds of bribery; 2. the occurrence of the offence abroad; and 3. the relative newness of the offence.

---

1 This part of the Mid-Term Study was written by William Loo, Administrator, Anti-Corruption Division, Directorate for Financial and Enterprise Affairs, OECD.

2 On the other hand, although Parties had not been systematically canvassed about the number of domestic bribery cases detected through their anti-money laundering systems, at least six Parties had detected approximately 40 potential such cases.

Three Unique Features of Foreign Bribery that might be Obstacles to Detection through AML Systems

Offence generates Two Kinds of Illicit Proceeds: the Bribe and the Proceeds of Bribery

538. The offence of bribing a foreign public official can generate two types of illicit funds—the bribe payment and the proceeds obtained as a result of the bribery.[1] Whether the offence generates one or both of these kinds of funds depends on the extent to which the offence has progressed. For instance, an offer or promise to bribe might not generate either kind of funds,[2] whereas in cases where the bribe payment has been given to the foreign public official, proceeds from the bribery offence might be generated if the foreign public official actually received and responded to the bribe payment. Thus the effective detection of foreign bribery offences through AML systems depends not only on the detection of the proceeds of bribing a foreign public official but also the bribe payment.

539. Indeed, AML systems might be able to detect foreign bribery more easily through the identification of bribe payments to foreign public officials than the proceeds from bribing them. One reason is that the proceeds of bribery are more difficult to detect and quantify than bribe payments. Many Parties to the OECD Anti-Bribery Convention have expressed concerns about how to identify the proceeds of bribing for purposes of applying money laundering offences or confiscation measures. This is likely because the proceeds of bribing a foreign public official often arise from a contract with a foreign government secured through bribery, including for example public procurement contracts for major infrastructure projects, contracts to provide essential services or equipment to a foreign government, or a contract to obtain the rights to extract oil or gas in the foreign country. Since the contract from which the proceeds are generated would likely appear on its face legal and enforceable, there would not necessarily be any reason for a financial institution to suspect that the proceeds flow from the commission of a predicate offence, and thus an STR might not necessarily be triggered.

540. In addition, the bribery of a foreign public official does not always result in an act by the foreign public official that generates proceeds *per se*. For instance, the purpose of foreign bribery might be to obtain a reduction of taxes or customs duties, a preferable exchange rate or a waiver of a fine.

541. Since the bribe payment will frequently be easier to identify and quantify in a foreign bribery transaction than the proceeds of bribing, it is essential that countries' AML systems are on the look-out for bribe payments. The Mid-Term Study of the OECD Working Group on Bribery indicates that the AML systems of certain Parties cover the laundering of the bribe and the proceeds of bribing foreign public officials and a few Parties only cover the laundering of bribe payments. However, it is not known at this stage whether in practice proceeds of crime for the purpose of AML systems would include the bribe payment to a foreign public official in relation to the supply side of foreign bribery (*i.e.* the conduct of the briber), or if they would only be considered the proceeds of crime in relation to the passive side (*i.e.* the conduct of the foreign public official). It is also not known whether AML systems are on the lookout for bribe payments in order to detect the offence of foreign bribery committed by the briber.

---

1 Note that Commentary 28 on Article 7 of the OECD Anti-Bribery Convention states that"…When a Party has made only passive bribery of its own public officials a predicate offence for money laundering purposes, this article requires that the laundering of the bribe payment (to the foreign public official) be subject to money laundering legislation".

2 Article 1 of the OECD Anti-Bribery Convention requires each Party to establish "that it is a criminal offence to offer, promise or give" a bribe to a foreign public official.

Offence Normally takes place Abroad

542. It is to be expected that the offence of bribing a foreign public official will often take place abroad in the country of the foreign public official. This presents certain challenges to the detection of the predicate offence by AML systems. In particular, in such cases evidence of the predicate offence will have to be obtained from a foreign jurisdiction. From a legal point of view, one of the most important challenges to obtaining international mutual legal assistance (MLA) for an offence committed abroad is satisfying the requirement of "dual criminality".

543. In summary, dual criminality is the condition whereby the conduct for which MLA is requested must have constituted an offence in both the requesting and the requested countries. Dual criminality is subject to varying degrees of strictness of interpretation depending on the country applying it. Some countries do not even provide such a condition. At the other extreme, some countries require that the conduct is considered the exact same offence in both countries. In these cases both the requesting and requested country would need to have an offence of bribing a foreign public official for assistance to be available. Most countries interpret the condition somewhere between these two extremes.

544. Many countries have adopted a "conduct-based" approach, which means that the conduct in question must constitute an offence in both countries, although not necessarily the same offence. In other words, where the requested country has an offence of bribing its own public officials, it should be able to provide MLA if the requesting country is seeking assistance for the bribery of one of the requested country's own officials. Thus for these countries, the condition of dual criminality should at least in theory only impede the provision of MLA where it is sought for the bribery of an official from a third country. Since the United Nations Convention against Corruption (UNCAC), which is open to ratification by all countries and regional economic organisations, requires the criminalisation of the bribery of foreign public officials, once State Parties to the UNCAC have implemented this requirement, countries with a "conduct-based" approach to dual criminality should also be able to provide MLA in this situation.

545. Due to the various interpretations of dual criminality requirements, the FATF 40 Recommendations advocate a broad approach to their interpretation for the purpose of rendering MLA[1] However, according to the Mid-Term Study of the OECD Working Group on Bribery, more information is needed on the conditions needed to apply AML systems where the predicate offence of foreign bribery takes place abroad. Thus it is not possible at this stage to adequately assess the overall effect of dual criminality requirements on the detection of foreign bribery offences through AML systems. It is also not possible to anticipate what will be the impact of the UNCAC in this respect until State Parties are well-advanced in implementing the mandatory foreign bribery offence.

[1] Recommendation 37 of the FATF 40 Recommendations states: "Countries should, to the greatest extent possible, render mutual legal assistance notwithstanding the absence of dual criminality.

Where dual criminality is required for mutual legal assistance or extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within the same category of offence or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence".

Relatively New Offence

546. The OECD Anti-Bribery Convention only came into force in 1999, and as a result, for the majority of the thirty-seven Parties to the Convention, the offence of bribing a foreign public official is a relatively new offence in their criminal laws.[1] Before then, the bribery of foreign public officials was generally accepted as a normal cost of business, with several countries allowing the tax deductibility of bribes.[2] Since the United Nations Convention against Corruption (UNCAC) did not come into force until the end of 2005, the foreign bribery offence is even newer for State Parties to the UNCAC that are not Parties to the OECD Anti-Bribery Convention or other multilateral instruments that address foreign bribery. The relative newness of the foreign bribery offence, in comparison to most of the other types of predicate offences for the purpose of money laundering, raises the issue of whether this could be an impediment to the detection of foreign bribery through AML systems.

547. When a predicate offence for the purpose of money laundering is relatively new, it is unlikely to be effectively detected by AML systems unless steps have been taken to provide the actors in those systems with an adequate level of awareness of the offence. Awareness of the foreign bribery offence could be provided through various means and at various levels of AML systems—from international to national to the reporting entities themselves. Beginning at the international level, the FATF 40 Recommendations designate "corruption and bribery" as a predicate offence, which presumably includes the bribery of foreign public officials.[3] However, in the absence of an express reference to the bribery of foreign public officials, it might not necessarily be clear that the term "corruption and bribery" is intended to cover more than the bribery of a domestic public official, which in contrast to foreign bribery is not a relatively new offence in most countries.

548. At the national level, the Mid-Term Study of the OECD Working Group on Bribery shows that only a few Parties to the OECD Anti-Bribery Convention list specific predicate offences, including the bribery of foreign public officials, in the relevant legislation. Instead, most countries designate predicate offences in terms of their punishment threshold, or use a generic designation such as "all indictable offences" or "any crime". The generic approach, although desirable from the point of view of capturing a wide-range of predicate offences, does not necessarily alert actors in AML systems that the bribery of a foreign public official constitutes a predicate offence.

549. Within AML systems themselves, including FIUs and reporting institutions, adequate awareness-raising on foreign bribery as a predicate offence has not taken place in many countries. For instance, according to the Mid-Term Study, few Parties had produced money laundering typologies that address the bribery of foreign public officials or provided training on detecting foreign bribery. It is notable that one country that had produced typologies on foreign bribery succeeded in detecting several potential foreign bribery cases through its AML system. In another country that detected some foreign bribery cases through its AML system, the central bank had distributed relevant typologies, and several of its financial institutions had provided training on detecting foreign bribery.

550. Another method for raising awareness of the foreign bribery offence within AML systems is through feedback from the law enforcement authorities on the outcome of STRs to FIUs and from

---

1 A noteworthy exception is the offence of bribing a foreign public official under the United States Foreign Corrupt Practices Act, which came into force in 1977.

2 Pursuant to the Commentaries on the OECD Anti-Bribery Convention, Parties accept the 1996 Recommendation of the Council on the Tax Deductibility of Bribes to Foreign Public Officials, which recommends that "those Member countries which do not disallow the deductibility of bribes to foreign public officials re-examine such treatment with the intention of denying this deductibility…"

3 The Glossary to the FATF 40 Recommendations lists "corruption and bribery" as one of the "serious offences" recommended to be considered a predicate offence for money laundering. This designation has remained unchanged since 1996.

FIUs to reporting entities. The Mid-Term Study cites effective feedback in some countries, but the amount of feedback in the other countries was considered inadequate or unclear. Improving such feedback could have a number of benefits, including sensitising actors in AML systems to the types of predicate offences that are not being effectively detected, thus enabling them to address how AML systems could better detect these offences.

Conclusions

551. As seen in this paper, the bribery of foreign public officials presents unique challenges to detection through AML systems. This paper attempts to identify three potential obstacles to the detection of the offence of bribing a foreign public official by AML systems that are related to the unique features of the offence.

552. The first potential obstacle is the difficulty in detecting the proceeds of bribing a foreign public official. The paper canvasses the reasons why it could be more difficult to detect the proceeds of bribery than the bribe payment, and suggests that AML systems may need to increase their focus on identifying bribe payments. The second potential obstacle in detecting foreign bribery arises because the offence normally takes place abroad in the country of the foreign public official. Due to the extra-territorial aspect of the offence, it will frequently be necessary to obtain evidence of the offence from the foreign country through international mutual legal assistance (MLA). The laws on MLA often impose a "dual criminality" requirement, which is subject to varying degrees of strictness of interpretation in the various countries. The third potential obstacle is the relative newness of the foreign bribery offence in the majority of countries, and the challenges that this creates for detection if the actors in countries' AML systems do not have adequate awareness of the offence. This paper explores three different levels at which awareness of the foreign bribery offence can be provided – international, national and the reporting entities—and concludes that adequate awareness-raising has largely not taken place. It also concludes that improving feedback from law enforcement authorities to FIUs and from FIUs to reporting entities could help actors in AML systems address how these systems could better detect foreign bribery.

553. It will not be possible to overcome these potential obstacles to detecting the bribery of foreign public officials through AML systems without further research and analysis to fully appreciate their overall significance and how they can be best overcome. The Mid-Term Study of the OECD Working Group on Bribery is an important starting point for identifying and tackling these problems.

554. Economic crimes are naturally difficult to detect, because of the complexity of the transactions, the increasingly diffuse nature of corporate decision-making, and the availability of various mechanisms, such as offshore centres, to dissimulate the illegal proceeds. Since the bribery of foreign public officials presents further challenges to detection, it requires greater effort to detect through AML systems than many other predicate offences. However, in light of the devastating economic, social and political effects of foreign bribery, there is a serious need to overcome these challenges.