FINANCIAL ACTION TASK FORCE

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

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I. INTRODUCTION

1. Laundering the Proceeds of Corruption, the first FATF Working Group on Typologies (WGTYP) effort in the area of corruption, discussed the interrelationship between corruption and money laundering, discovered the most common methods used to launder the proceeds of corruption, and highlighted the vulnerabilities leading to an increased risk of corruption-related money laundering.[1] It listed some of the most significant grand corruption cases and created a useful historical understanding and reference point for further work in understanding the interrelationships between corruption and money laundering. Laundering the Proceeds of Corruption ultimately concluded that significant acts of corruption are fruitless without the politically exposed person (PEP) involved having a secondary capability to move and disguise the proceeds of his crime.

2. *Laundering the Proceeds of Corruption* identified areas in which future work could be done, including gaining an understanding of the correlation between certain risk factors and corruption. It also concluded that while effective anti-money laundering and countering the financing of terrorism (AML/CTF) systems can assist in the detection of the proceeds of corruption and prevent the perpetrators of corruption-related offences from enjoying the proceeds of corruption, historically, reporting institutions have not been effective in detecting corruption-related proceeds. This has occurred for a number of reasons, including that in a number of instances, reporting institutions have failed to engage in appropriate customer identification or otherwise failed to apply AML/CFT controls effectively. In some instances, they were actually complicit, and sometimes wilfully blind, in the laundering of funds.

3. This paper is written to assist reporting institutions – those financial and non-financial institutions that have a legal obligation to file suspicious transaction reports, or otherwise engage in AML/CFT due diligence – to better analyse and better understand specific risk factors that may assist them in identifying situations posing a heightened risk of corruption-related money laundering risk.[2] It seeks to answer the question: Are there specific types of business relationships, customers, or products which should lead a reporting institution to pay particular attention to the risk of corruption-related money laundering? As with all FATF typology projects, we seek to answer the question by looking to reported cases to see if we can detect commonalities. In addition, we draw on the industry's and academia's best thinking about risk, as reflected in the published literature, to determine what situations truly represent risk.

4. Within the FATF standards[3], Recommendation 12 requires a reporting entity to have in place appropriate risk management systems to determine whether a customer or beneficial owner is a PEP. It must also take specific measures, in addition to performing normal customer due diligence

1 FATF (2011).

2 We use the term "reporting institution" or "reporting entity" to mean those institutions that have a duty to report suspicious transactions under Recommendation 20, as well as those institutions, professions and individuals that are required to engage in the customer due diligence and record-keeping requirements of Recommendations 10 and 12 (regardless of whether they also have a reporting requirement).

3 FATF (2012)

measures for business relationships,[4] with foreign PEPs: senior management approval for establishing (or continuing) business relationships, take reasonable measures to establish the source of wealth or funds, and conduct enhanced ongoing monitoring. For domestic PEPs and persons entrusted with a prominent function by an international organisation, reporting institutions are required to apply the specific enhanced due diligence (EDD) measures set out in Recommendation 12 where there is a higher-risk business relationship. This scrutiny stands at the forefront of the effort to detect and deter the laundering of proceeds of corruption and is certainly necessary. The premise behind the effort is clear: customers in these categories can pose an inherently high risk for money laundering.

5. Understanding risk within the Recommendation 12 context is important for two reasons: First, Recommendation 12 requires a reporting entity to have "appropriate" risk management systems in place to determine whether the customer or the beneficial owner is a foreign PEP, and take "reasonable measures" to determine whether a customer or beneficial owner is a domestic PEP or an individual entrusted with a prominent function by an international organisation. To gauge whether a system is "appropriate," or whether "reasonable measures" have been taken, requires an assessment of risk. Second, understanding risk is important after identifying domestic PEPs or relevant individuals from international organisations, in order to assess what level of EDD is necessary.

6. Moreover, experience teaches us that combating corruption-related money laundering must be more than simply ensuring that PEPs receive an appropriate level of scrutiny. Rather, an effective AML scheme requires an assessment of corruption-related risk and protecting against the laundering of corruption proceeds across the spectrum of customers and business relationships, regardless of whether a FATF-defined PEP is involved.

7. Such an approach acknowledges the realities of the methods of laundering the proceeds of corruption. It is a rare case (although not unheard of) for a PEP to enter a financial institution and deposit (or transfer) significant amounts of suspicious money; such action would likely create unacceptable risks to the PEP of detection by reporting institutions. Instead, as *Laundering the Proceeds of Corruption* noted, corrupt PEPs will take great pains to disguise the identity and the source of the funds in order to place corrupt money in the financial system without suspicion. PEPs use corporate vehicles, sophisticated gatekeepers, cash, and countries with weak money laundering controls to disguise their funds. Their corrupt transactions will often involve an intermediary of some kind, (including family members and close associates), whether within the PEP's jurisdiction or beyond.[5] In some cases, corrupt PEPs will also try to control the mechanisms of detection and regulation within their home jurisdiction to "game the system" in order to disguise the proceeds before the money gets to another jurisdiction. In such cases, implementation of Recommendation 12 by other jurisdictions is necessary, but is not sufficient to detect and deter the movement of corrupt proceeds.

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4 Throughout this paper we sometimes refer to "accounts" and "account relationships" for ease of reference. However, AML requirements are broader than mere accounts and could be more accurately characterised, as Recommendation 10 does, as business relationships rather than mere accounts.

5 Does, Van der, *et al* (2011). For a detailed analysis of the role of intermediaries in international business transactions, see OECD (2009).

8. This paper's structure takes the factors relating to higher-risk situations set out in the Interpretive Note to Recommendation 10 and applies them specifically to corruption-related risks.[6] Because non-PEP customers may be a risk for corruption-related money laundering, depending on these factors, reporting institutions should take steps to understand such risk outside the context of identifying and monitoring PEPs. Indeed, Recommendation 1 considers a risk-based approach to be an "essential foundation" to any AML regime. Identification and verification of customers, understanding the nature and intended purpose of the business relationship and, as appropriate, the application of EDD where circumstances call for it, are at the heart of the FATF 40 Recommendations. They are designed to require reporting institutions to understand the level of ML/TF risk associated with the business relationship in order to mitigate it effectively. Most importantly, financial institutions are required to monitor relationships and transactions as appropriate, and take measures to understand and mitigate risk appropriately.

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[6] See FATF (2012), Interpretive Note 10, paragraph 15, "Higher risks:"

15. There are circumstances where the risk of money laundering or terrorist financing is higher, and enhanced CDD measures have to be taken. When assessing the money laundering and terrorist financing risks relating to types of customers, countries or geographic areas, and particular products, services, transactions or delivery channels, examples of potentially higher-risk situations (in addition to those set out in Recommendations 12 to 16) include the following:

(a) Customer risk factors:
- The business relationship is conducted in unusual circumstances (*e.g.* significant unexplained geographic distance between the financial institution and the customer).
- Non-resident customers.
- Legal persons or arrangements that are personal asset-holding vehicles.
- Companies that have nominee shareholders or shares in bearer form.
- Business that are cash-intensive.
- The ownership structure of the company appears unusual or excessively complex given the nature of the company's business.

(b) Country or geographic risk factors:
- Countries identified by credible sources, such as mutual evaluation or detailed assessment reports or published follow-up reports, as not having adequate AML/CFT systems.
- Countries subject to sanctions, embargos or similar measures issued by, for example, the United Nations.
- Countries identified by credible sources as having significant levels of corruption or other criminal activity.
- Countries or geographic areas identified by credible sources as providing funding or support for terrorist activities, or that have designated terrorist organisations operating within their country.

(c) Product, service, transaction or delivery channel risk factors:
- Private banking.
- Anonymous transactions (which may include cash).
- Non-face-to-face business relationships or transactions.
- Payment received from unknown or un-associated third parties

II. METHODOLOGY

9. As with all FATF typology efforts, we have used descriptions of known cases (whether or not adjudicated) to understand the types of transactions, accounts, customers, and the nature of the countries or regions that may present a heightened risk of corruption-related money laundering, and therefore an indicative set of risk factors.

10. As with prior FATF work in this area, we have defined corruption functionally rather than legally: it is the use of public office for private gain. It is generally thought to cover generically a number of different types of conduct, including embezzlement (in which money or property rightly belonging to the State is diverted to a public official for personal gain) and self-dealing (in which the corrupt official has a personal financial stake in the decisions he makes as a public official). It also includes bribery both of the "demand side," in which the public official takes the bribe (sometimes identified as "passive" bribery), as well as of the "supply side," involving the individual or entity who offers the bribe (sometimes called "active" bribery). The analysis is not limited to transactions involving PEPs as that term is defined within the FATF Recommendations, but rather also focuses on officials, (including family members and close associates), business relationships, and companies whose corrupt transactions could be under the purview of a reporting entity.[7]

11. Additionally, where appropriate and as noted, we have relied on studies and literature written by NGOs, academics and other experts in the field. As noted in *Laundering the Proceeds of Corruption*, there has been considerable analytical work done in this area by individual government agencies, FATF-style regional bodies, international organisations, multilateral and intergovernmental groups, as well as non-governmental organisations (NGOs).

12. Recent publications since *Laundering the Proceeds of Corruption* include '*The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*,' a study by the UNODC/World Bank Stolen Asset Recovery Initiative (StAR).[8] The report looks at how corporate vehicles are misused to conceal the proceeds of corruption and can be used to understand the nature of the problem and design policy recommendations to facilitate the investigative process by unravelling the complex world of corporate vehicles. In addition, a joint OECD/StAR analysis, 'Identification and Quantification of the Proceeds of Bribery,' focuses on the identification and quantification of the proceeds of active bribery in international business transactions.[9] It defines the principal types of proceeds of active bribery and analyses how they may be quantified. We also benefited from a pair of helpful works on the role of income and asset disclosure by public officials: StAR's '*Public Office, Private Interests: Accountability through Income and Asset Disclosures*'[10], and the World Banks' '*Income and Asset Declarations: Tools and Trade-offs*.'[11]

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[7] This analysis does not include the abuse of private office for improper personal gain, such as between two non-public entities or individuals.

[8] Does, Van der, *et al* (2011).

[9] OECD/StAR (2012).

[10] StAR (2012); Rossi, *et al* (2012).

[11] StAR (2009)

13. StAR also launched Asset Recovery Watch (ARW), a database which tracks efforts by prosecution authorities worldwide to go after assets that stem from corruption. To date, ARW contains nearly 180 entries related to 85 completed and active cases undertaken since 1980. It is the first systematic database of completed and active international asset recovery cases and can be accessed on-line.[12]

14. The UK's Financial Services Authority (FSA) recently published a comprehensive analysis of how UK banks deal with high money-laundering risk situations.[13] That analysis provided a compelling look at how reporting institutions are currently dealing with corruption-related risk. Switzerland, too, published a work discussing requirements within Switzerland regarding handling the assets of PEPs[14] and the French Autorité de Contrôle Prudentiel reported on the findings of its analysis of private banks' AML/CTF controls.[15] Additionally, the Egmont Group, the international forum for Financial Intelligence Units (FIUs), is conducting work on the role of the FIU in fighting corruption and recovering stolen assets. Each of these works has contributed significantly to this paper's understanding of corruption as it relates to money laundering.

12 Available at www1.worldbank.org/finance/star_site/star-watch.html, accessed 26 June 2012.
13 Financial Services Authority (2011).
14 FINMA (2011).
15 Autorité de Contrôle Prudentiel (2012).

III. FACTORS TO BE EVALUATED IN ASSESSING RISK OF CORRUPTION-RELATED MONEY LAUNDERING

15. Recommendations 10 (for all customers) and 12 (for PEPs), require that an institution identify its customer and the customer's beneficial owner, assess the risk of money laundering associated with the business relationship, and implement the level of due diligence commensurate with the perceived risk. Assessing the risk of money laundering, including the laundering of the proceeds from corruption, should involve a multi-factor analysis.

16. Factors influencing the level of money-laundering risk associated with a business relationship include customer risk, country or geographic risk, and product or financial instrument risks. Each of these risks will be discussed below. Understanding these risks and the factors that contribute to them allows reporting entities to better guard against corruption-related money laundering.

A. CUSTOMER RISK FACTORS

1. POLITICALLY EXPOSED PERSONS AND OTHER PUBLIC OFFICIALS

17. The measures within Recommendation 12 are intended to (1) ensure that reporting entities have risk-sensitive systems in place to identify new or existing PEPs and other high-risk customers, (2) put in place adequate measures to mitigate the risk that the entity is being used to launder the proceeds from crime, including corruption, and (3) report such customers to their country's FIU when they engage in suspicious transactions.

18. The PEP status in itself does not necessarily mean an individual is corrupt or that they have been incriminated in any corruption. Regardless, the continuing threat of money laundering by PEPs – both foreign and domestic – through reporting entities should be managed by understanding and addressing the potential money laundering risks associated with these customers and their transactions.

19. FATF has long understood the risks that corrupt PEPs pose to the financial system. As explained in the FATF 2003-2004 Annual Report:

> *[T]he 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 endemic, organised and systemic seem to present the greatest risk; however it should be noted that corrupt or dishonest PEPs can be found in almost any country.*[16]

[16] FATF (2004), p. 19.

20. Additionally, the Wolfsberg Group, a consortium of some of the world's largest money-centre banks, explained the nature of the PEP risk as follows: "PEPs potentially represent higher risk because they 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."[17] As noted in *Laundering the Proceeds of Corruption*, authorities have discovered a significant number of cases in which PEPs have been able to launder huge amounts of money through reporting institutions without scrutiny. Indeed, in many of these instances, the reporting entity was actively assisting the PEP in doing so.

21. As such, business relationships with PEPs represent increased risks due to the possibility that individuals holding such positions may misuse their power and influence for personal gain and advantage or for the personal gain or advantage of family and close associates. Such individuals may also use their families or close associates to conceal funds or assets that have been misappropriated as a result of abuse of their official position; and PEPs' families and close associates have sometimes found to be benefiting from corruption themselves. PEPs may also seek to use their power and influence to gain representation and/or access to, or control of legal entities for similar purposes.

22. FATF requires reporting institutions to treat every transaction with a foreign PEP as high risk. For example, Recommendation 12 requires enhanced ongoing monitoring of such business relationships. This would include, of course, funds transfers to PEP accounts, or to the accounts of their family members or associates, and to be alert to these transactions and the risk that they could constitute bribes to these individuals or the proceeds of other corrupt activity.

23. It is important, however, to understand that not all PEPs present the same level of risk. Reporting institutions should, in assessing risk of a PEP account holder, take account of these factors. As discussed further in this report, this risk will vary depending on numerous factors, including the PEP's country of origin, the industry/sector involved, and the products and services used. Risk will also vary depending on factors such as the nature of the position and the nature/purpose of the account. Moreover, even after risk is established, care must be taken to ensure that the account transactions are consistent with the stated purpose.

Nature of the Position

24. While all holders of public positions may have corrupt opportunities to a certain degree, those having substantial authority over or access to state assets and funds, policies and operations – including procurement awards, other public expenditures, use of government owned resources, and control over regulatory approvals, including the awarding of licenses and concessions – can pose a greater risk than others. Their actual vulnerability to corruption will vary, depending on the extent to which they exercise hierarchal control. These individuals also enjoy a special status in their country of origin because of their executive, legislative, judicial, administrative function, military and/or bureaucratic power. They are in a unique position of influence in their nation state and perhaps diplomatically when they are acting abroad.

[17] Wolfsberg Group (2006).

25. Significant grand corruption matters, such as those engaged in by Abacha[18] and Lazarenko[19], would never have been possible, at least to that scale, without the ability to control the mechanisms established to prevent and detect their crimes. By the time that the embezzled funds were layered and integrated into foreign financial institutions, the ability to be able to reasonably understand the source of the funds had been forever lost.[20] As the FATF has noted:

> *A PEP, acting either alone or in collaboration with other illicit actors, may in an autocratic regime have total control over all of the mechanisms of government (the judiciary, the police, military, and the regulatory bureaucracy), as well as the media. The same control that allows the PEP to stay in power is the same control that would allow him to disguise and move his money…. [I]n each of the most significant grand corruption cases we studied, the PEP had the ability to control the domestic government to prevent detection and allow the disguise and movement of money. Only after the PEP's controls were eliminated, for example through regime change, did the country have the ability to detect the extent of both the money laundering and the crime.*[21]

26. 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, specific corrupt individuals fell out of favour, or there was widespread public outcry after wrongdoing was publicly exposed. While the PEPs were in power, there was no real opportunity for domestic law enforcement agencies to investigate their financial crimes. Foreign FIUs, even if they had evidence of corruption, may hesitate to share such information to the originating country, given the futility of reporting suspicious transactions to the government responsible for them.[22] Moreover, some countries provide immunity to heads of government or other senior ranking public officials, and may only waive such immunity once the public official has left office. Such immunity may also discourage foreign entities or reporting institutions from reporting suspicious transactions.

27. Of course, such difficulties do not relieve reporting institutions of their obligation to take adequate measures (which may mean exiting the business relationship) to prevent money laundering. The recent report of the FSA on banks' management of high money-laundering risk situations found that a third of all banks included in the sample were willing to accept very high levels of money laundering risk if the immediate reputational risk was low (for example, if the allegedly corrupt office holder's tenure seemed secure). The FSA also found examples of firms dismissing serious allegations against customers, including allegations of corruption, if criminal charges against the customer had not been brought.[23]

28. While reporting entities are explicitly required by FATF to apply a higher standard of scrutiny to foreign PEPs, there is corruption risk associated with other public officials as well: in particular, some public officials who have an important role in significant procurement, export contracts, licensing and other activities with substantial economic consequences for the interest of their

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18 See Box 4
19 See Box 3
20 *Id.*
21 *Id.*
22 FATF (2012).
23 Financial Services Authority (2011).

parties, may be much more exposed to large scale corruption than their counterparts in less riskier sectors.[24]

Box 1: **Case Study on Bribery of a mid-level (non PEP) official**

Mr. X was employed as the procurement specialist by the Government of an East African country under a World Bank funded project. Mr. X duties included assisting implementing partner agencies in preparing the terms of references and bid documents, advertising and receiving bids and proposals, conducting the evaluation of the submitted bids and preparing the contracts for successful bidders. During the course of an investigation, two companies admitted that they had paid bribes to Mr. X in order to secure contracts, stating that the agreed fee was in the range of 4-10% of the contract value and that this fee was added into the cost of the works and concealed across multiple items. An analysis of the computer records of Mr. X identified a number of versions of documents used in the bid process, which showed companies were either excluded or added during the short listing or bid evaluation stage. In addition, other members of the bid evaluation committee confirmed that their signatures had been forged on reports, and that alterations on their evaluation sheets, used to score companies during the bid process, had been made without their knowledge. An analysis of available financial records showed that Mr. X's remuneration under his Government contract during this time was USD 120 000, yet in this same period, he had purchased and redeveloped land at a cost of USD 1.05 million and, had paid for the schooling of his children in a foreign jurisdiction.

Source: World Bank

Nature and purpose of the account or business relationship

29. Reporting institutions must assess the purpose for which the PEP is opening an account or establishing a business relationship, both to identify and assess the risks associated with the business relationship and to provide a meaningful basis for the monitoring of transactions. For example, why is it necessary for a senior official to have an account outside his home jurisdiction? There are, of course, a number of legitimate reasons for an official to do so. Like any other customer, the official may desire the stability, security and reasonable rate of return provided by financial products that may not be available in the official's home country. Other legitimate reasons, such as a child attending school within the jurisdiction, may exist. An inability to articulate a legitimate and economically-sound purpose for the account, however, should be evaluated with care, particularly in light of the universal recognition that accounts on behalf of senior foreign officials "pose significantly greater risks than do ordinary customers."[25] Should PEPs be reluctant to provide details and credible explanations for economic transactions (and corroborate it with supporting documentation), Recommendation 10 requires that the institution not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transaction report (STR) in relation to the customer.

24 These sectors are covered in further detail in the next section.
25 FATF (2011).

30. Reporting institutions' PEP obligations do not cease at account opening. The necessary 'enhanced on-going monitoring of the business relationship' must continue to take into account the original purpose of the account and the legitimacy of the funds flowing through it. This is key to an understanding of the corruption-related ML risk associated with a business relationship. For example, on-going monitoring allows the reporting institution to determine whether the funds used in the business relationship are in line with the income the firm would have expected the PEP to receive (based on, for example, official asset declarations or pay scales).

31. Moreover, ongoing monitoring can be used to update and review the original customer due diligence and risk assessment. For example, an increase in the number of transactions or a change in the nature of transactions that a PEP channels through the account can serve as an important indicator of the risk associated with a PEP relationship and may lead the reporting institution to review and update its risk assessment.

32. Information gathered on the customer and beneficial owner, the source of wealth and source of funds, and from transaction monitoring will assist a reporting institution in assessing whether the type of account, the customer's activity and transaction record matches the behaviour the reporting institution would expect in light of the customer profile, including their sources of funds and wealth. The StAR paper on PEPs describes some useful sources of information, including contracts, agreements for lease or sale, wills, court orders, financial disclosures by public officials, internet searches, and intelligence from referrals or credible in-country sources.[26] The utility of financial disclosure forms, often required by the PEP's home jurisdiction, is discussed in the section on geographic risk, below.

2. LEGAL PERSONS AND LEGAL ARRANGEMENTS

33. Legal persons or arrangements, such as companies, trusts, and foundations (generally termed "corporate vehicles"), are associated with specific AML/CFT risks of which reporting institutions must be aware. Given that the vast majority of such clients and transactions are legitimate and commonplace features of everyday economic activity, the mere involvement of legal entities or arrangements in a transaction obviously cannot alone be used as a justification for inferring heightened risk. Nevertheless, certain elements, including those of the corporate vehicle itself, the client relationship, and the transactional activities within that context serve as useful 'red flag' indicators which are suggestive of money laundering risk and/or that a corporate vehicle is being used provide anonymous access to a financial system for its beneficial owner(s).

34. Broadly speaking, there are two particular classes of corporate vehicles risks, described below, that must be taken into consideration by reporting institutions when conducting risk-based assessments. The StAR paper on the misuse of corporate vehicles[27] more completely outlines work done in this area and provides some case studies and typological data.

[26] Greenberg, T.S., *et al* (2010).

[27] Does, Van der, *et al* (2011). See also OECD (2001).

Risks involving corporate vehicles as customers

35. Transactions conducted by clients who are themselves corporate vehicles contain an element of risk that corrupt PEPs or other criminals may be 'hiding' behind the client corporate vehicle while exerting influence through concealed mechanisms of ownership or control. Initial and ongoing due-diligence practices that allow reporting institutions to gain a thorough understanding of the customer provide the chance of obtaining a meaningful assessment of potential risk. For this due diligence to be meaningful, it must allow for an understanding of the natural person(s) who is the beneficial owner, and those persons of legal management or ownership positions who are able to exercise some measure of control over transactions that the corporate vehicle enters into. In higher risk scenarios, risk is identified only to the extent that the reporting institution scrutinises the identities and intentions of these natural persons. Only after such identification occurs can risk be mitigated, by either not accepting the business relationship or by putting in place measures such as monitoring and restrictions on transactions that are commensurate to the risk and facilitate the detection of unusual transactions.

36. Some of the identified indicators of risk in this context include the following elements:

(a) Corporate vehicles that are unnecessarily and unjustifiably complex multi-tiered entities (*i.e.,* those corporate vehicles whose management and ownership rights are in turn held by other corporate vehicles, especially when those are themselves located in a foreign jurisdiction(s), and/or those that have more than three layers yet cannot provide a professional opinion justifying an underlying legal or economic rationale).

(b) Corporate vehicles that are unnecessarily and unjustifiably complex multi-tiered entities (*i.e.,* those corporate vehicles whose management and ownership rights are in turn held by other corporate vehicles, especially when those are themselves located in a foreign jurisdiction(s), and/or those that have more than three layers yet cannot provide a professional opinion justifying an underlying legal or economic rationale).

(c) The involvement of trust and company service providers (TCSP) or designated non-financial businesses and professions (DNFBP) intermediaries that have failed to put in place effective AML/CFT practices, or come from unregulated, poorly regulated, or otherwise high-risk jurisdictions.

(d) The involvement of persons who purport to be the beneficial owner(s) of the corporate vehicle customer (for instance, by declaring themselves to be the beneficial owners on a beneficial ownership form for those institutions and jurisdictions which have put into place such a requirement) and yet over the course of the customer relationship appear to be acting on the instruction of additional, undeclared parties, excluding those who are merely providing advisory services in a professional capacity.

Box 2: **Case study on the use of corporate vehicles James Ibori**

James Ibori, who was Governor of Nigeria's Delta State from 1997 to 2007, inflated government contracts, accepted kickbacks and also directly embezzled state funds. His official salary was GBP 4 000 per annum; his formal asset declaration stated that he had no cash or bank accounts outside of Nigeria. Despite this, he bought several houses around the world including one in the UK valued at approximately GBP 2.2 million. The purchase of this house was hidden in a company name called 'Haleway Properties Ltd' which was an previously-formed company incorporated in Gibraltar and had been arranged by his wife, Theresa Ibori, through a UK based fiduciary agents. The beneficial owners of 'Haleway Properties Ltd' were James and Theresa Ibori, but the true ownership of the house was hidden through this company.

The mistress of Ibori was also responsible for the transfer of funds out of Nigeria, invested them on behalf of Ibori, and was used as a conduit to pay for properties in the UK. By the end of 2003, the mistress had deposited more than GBP 3 million into a trust fund in Guernsey for the benefit of the Ibori family. The administrators of the trust fund, consistent with the purpose for which it was established, expected that money would be deposited into the account from UK banks. When they received transfers from an unknown Nigerian company called "Sagicon," they requested further due diligence. Ibori's mistress obtained forged company accounts and incorporation documents, certified by a corrupt solicitor in Nigeria, to falsely show Ibori as a major shareholder of Sagicon. These false documents satisfied the Guernsey authorities.

Ibori and his associates also used multiple UK bank accounts to launder funds. In 2005, Ibori utilised the services of Bhadresh Gohil, a corrupt London-based solicitor, to launder his funds. Money had been transferred from Nigeria to a UK corporate bank account, which was beneficially owned by Ibori but controlled by his former special assistant. The special assistant transferred some USD 4.7 million from the UK account into a Swiss company account called Stanhope Investments, which was beneficially owned by Ibori. Once the funds were held in the Stanhope account, they were then transferred to yet another Swiss company bank account, which was beneficially owned by another client of the corrupt solicitor. The solicitor then transferred the USD 4.7 million back to one of his client accounts in London, effectively 'washing the money.' Once the money was in the solicitor's client account, it was then deposited into a Texas bank account and used for the deposit on the purchase of a private jet aircraft for Ibori. As a result of these schemes, in 2012, Ibori pleaded guilty to ten counts of money laundering and fraud in relation to an estimated USD 250 million of stolen state assets and was sentenced to 13 years imprisonment. Ibori's wife has also been convicted of money laundering.

Source: United Kingdom

Box 3: **Case study in use of corporate vehicles to hide assets: Pavel Lazarenko**

Pavel Lazarenko was the Prime Minister of Ukraine from May 1996 to July 1997; previously he had a number of other government positions, including governor and party official. During his time in government, Lazarenko engaged in five different corruption schemes, including extorting funds from businesses that wished to do business in Ukraine. Ultimately, Lazarenko fled the Ukraine for the United States, where he was charged and ultimately convicted of a number of crimes, including corruption-related money laundering. [1] It was alleged in the course of the criminal proceedings (and attendant non-conviction based forfeiture)[2] that Lazarenko was able to steal and launder in excess of USD 300 million. In addition to purchasing a controlling interest in a financial institution in Antigua, Lazarenko and his associates formed corporate vehicles in a number of other jurisdictions, and conducted transactions involving Antigua and Barbuda, Bahamas, Cyprus, Guernsey, Liechtenstein, Lithuania, Poland, the Russian Federation, Switzerland, Ukraine, the United Kingdom, and the United States.[3]

The use of these corporate vehicles allowed Lazarenko and his associates to avoid identification with the money while at the same time controlling it. For example, a multi-million dollar house in the United States was purchased with funds that flowed through a corporate shell account (Dugsbery) in the US, which in turn had received the funds from a corporate shell account (Lady Lake) in the Bahamas, which itself had been funded by a corporate shell account in Switzerland (CARPO-53). To give a sense of the scope and the ease in which corporate vehicles were used to transfer money, Lazarenko in one instance transferred USD 78 million through the issuance of two, sequentially numbered cheques, made payable to "bearer" from a US-based account of a Swiss bank (in the name of a corporation). Those cheques were then deposited into the accounts of two different corporations at a bank in Antigua.[4]

1. In addition to the charges in the United States, in 2000 Lazarenko was convicted in Switzerland of money laundering.
2. *In re Funds on Deposit at Bank Julius Baer*, civil forfeiture complaint, 1:04-cv-00798-PLF
3. *Id.*
4. *Id.*

Source: <u>Lazarenko v. United States</u>, court opinion No. 06-10592, 10 April 2009.

3. ECONOMIC SECTOR INVOLVED

37. The economic sector in which a customer or transaction is involved will also affect the level of risk. Corruption can occur in any sector, anywhere in the world. However, on the basis of a number of case studies and an analysis of their unique attributes, it appears that several sectors are more prone to corruption. The key sectors in this regard are identified and described below, drawing from detailed case studies and a review of other corruption studies. The fact that the specific economic sector or industry is not mentioned does not mean that it does not pose a risk.

A. Extractive Industries

38. Historically, there has often been a rough correlation between countries that obtain their wealth from extraction of natural resources, such as oil and timber, and the incidence of grand

corruption. Indeed, such a correlation has been noted by FATF in Laundering the Proceeds of Corruption as well as in the academic literature.[28]

39. When compared to countries that depend on the export of agricultural products, for example, mineral and oil exporting countries may be exposed to a higher degree of poor governance issues. The correlation between poor governance (of which corruption is one aspect) and a high level of dependence on exports from extractive industries may be very strong and has been shown in a number of economic studies.[29] While the cause and effects of the correlation between corruption (and poor governance generally) and an extractive economy are well beyond the scope of this typology, it is fair to say that the often largely unexamined revenues resulting from resource payments tend to loosen political accountability, fail to generate economic growth necessary for a stable electorate, and may create opportunity for corruption that would not exist in other economies. Resource payments typically are at a volume that dwarfs revenue payments from any other economic sector. In some countries, for example, over three fourths of the nation's revenue comes from oil.[30] The rate of increase of wealth can also be massive. One small West African country, for example, increased its gross national income 30-fold in just ten years.[31] The availability of such extraordinary wealth over such a short period of time can cause strain on fragile governing systems.

Box 4: **Case Study - Sani Abacha**

Sani Abacha was Nigeria's President from November 1993 to his death in June 1998. After a new regime came into power, it discovered by a special investigation panel set up by the successor government that Abacha and his family had stolen a staggering amount of money – estimated to be between USD 2.5 and 4 billion – from the Nigerian Treasury. The schemes to steal and subsequently launder the money varied. In one scheme, Abacha's National Security Advisor would simply make a letter request for funds for unspecified "security needs." Abacha would countersign his approval on the letter, and his national security advisor would present the letter for payment to the Nigerian central bank. Money was issued in traveller's cheques in blank (the first embezzlement of this type involved USD 2 million in Thomas Cook traveller's cheques being issued in a single day), cash, and wire transfers. Cash was deposited into Nigerian accounts of local business, smuggled overseas and deposited into foreign institutions, and wire transfers were deposited into accounts in false names, shell and bearer share companies, and trusts.[1] Another scheme involved an overbilling and kickback scheme, in which a corrupt confederate would supply goods to the government at grossly inflated prices and then kick back a portion to Abacha and his confederates. In one instance, the government of Nigeria paid USD 110 million for vaccines that were in fact worth less than USD 23 million.[2] In another instance, military vehicles were provided for USD 184 million, a price estimated to be between 40 and 500% of their true value. Abacha received approximately USD 100 million, wired to coded and company bank accounts in Switzerland, while the corrupt

[28] See, *e.g.*, Karl (2005), *p.* 22. This is not to say, of course, that all countries gaining significant revenue from oil or other natural resources pose an increase risk of corruption. Indeed, the experience of several countries with both substantial natural resource revenues and low perceptions of corruption show that one is not inevitably tied to the other. Botswana, for example, obtains significant revenues through natural resource extraction, yet is highly rated in corruption perception indexes.

[29] See, *e.g.*, Sala-i-Martin, X. and Subramanian, A. (2003) and the studies discussed within.

[30] McPherson, C. and MacSearraigh, S. (2007), *p.* 193.

[31] World Bank (2009a)

supplier's share of approximately USD 40 million was deposited into corporate accounts in Jersey.[3]

1. Daniel, T. and Maton, J (2012), Monfrini (2008).
2. Mohammed Sani Abacha, *et al.* v. Federal Office of Justice, Swiss Federal Supreme Court decision 1A.215/2004, 7 February 2005.
3. *AG v. Raj Arjandas Bhojwani*, Royal Court of Jersey, [2010]JRC116, 25 June 2010.

Source: Royal Court of Jersey

Box 5: **Case Study - Statoil Bribery**

Statoil is a public oil development company located in Norway. In 2002 and 2003, it paid bribes to an Iranian government official for him to use his influence to assist Statoil in obtaining certain contracts to develop an oil field in Iran and to open doors generally to further work inside Iran. The bribe was facilitated by the use of a "consulting contract" with an intermediary company organized in the Turks and Caicos Islands and nominally owned by a third party in the UK. The Iranian official, who was described as an advisor to the Oil Minister, and who was not named in the contract, facilitated Statoil's success in obtaining the contract by providing them with non-public business information, including copies of the bid documents from competing companies. The bribe payments – two payments totaling USD 5.2 million, were effectuated by wire transfers from Statoil through a US bank account to an account in Switzerland held by a company not named in the contract. The conduct was discovered in March of 2003 during an internal audit as a result of the payment being made to an entity not involved in the contract, and future payments were suspended in June 2003. The findings were subsequently disclosed in the Norwegian press in September 2003, and Statoil subsequently terminated the contract.

Source: Deferred Prosecution Agreement and Statement of Facts, United States v. Statoil, ASA (2006)

40. In an effort to combat resource-related corruption, an international group supported by a number of countries and companies, the Extractive Industries Transparency Initiative (EITI), has been established. Countries wishing to participate must meet five requirements, including independent auditing of extraction payments and publication of the results whereas supporting companies have to publish what they pay to the government, among other commitments. Countries and companies that demonstrate that they meet these requirements are deemed to be EITI compliant.[32] EITI maintains a list of supporting companies, consisting of 61 of the world's largest oil, gas and mining companies, which support the Initiative and submit International-level Company Self-Assessment Forms. The EITI, properly implemented, may serve to increase the transparency of public finances, and reporting institutions may wish to be aware of the initiative.

41. The Dodd-Frank Act in the United States has also introduced mandatory requirements for extractive industry companies listed on the US stock exchanges to report payments made to governments. The EU is currently discussing similar requirements, covering not just oil, gas and mining companies, but also primary-forest logging companies.

32 A list of participating countries can be found at EITI's website: http://eiti.org, accessed 26 June 2012.

Box 6: **Case Study - Bonny Island Refinery Project, Nigeria**

The Bonny Island Project involved the development of a very large liquefied natural gas (LNG) processing and transportation facility on Bonny Island, Nigeria. As a result of French, US, and Nigerian investigations, it was revealed that a series of contracts awarded by the Nigerian government, collectively valued at over USD 6 billion, were obtained as a result of corrupt payments to Nigerian officials. Specifically, four companies from the United States, Japan, France and Italy, formed a joint venture to obtain the Bonny Island contracts, and formed three special purpose Portuguese corporations to engage in operations. The joint venture then employed two intermediaries to bribe government officials. One intermediary formed a Gibraltar corporation, through which USD 130 million of bribe money from the joint venture was funnelled. The second intermediary, a Japanese global trading company, received USD 50 million to bribe government officials. The money that moved from the joint venture to the intermediaries was disguised as money received as a result of consulting contracts and moved via wire transfer from accounts in the Netherlands to accounts controlled by the intermediaries in Monaco and Switzerland. The money was ultimately paid to government officials through wire transfers to Swiss accounts controlled by the corrupt officials and by very large cash deliveries, including the delivery of up to USD 1 million in currency at a single time.

Source: US federal court documents, United States v. Jeffry Tesler and Wojciech Chodan, H-09-098 (2009), United States v. Kellogg Brown & Root LLC, H-09-071 (2009), available at www.justice.gov, accessed 26 June 2012

B. Government Procurement Activities

42. Public procurement activities are significantly vulnerable to corruption. A number of factors contribute to this. First, the sheer scope of some of government acquisition projects can lead to the ability of some of the funds involved merely to "slip through the cracks." Second, the specialised nature of the contracts prevent an analysis of whether the government is paying a fair price for its goods, or whether the price has been inflated as a result of corrupt activities. Third, in many countries, government procurement activities are not transparent and are highly competitive, which can lead to collusive activity.

43. Public procurement can be characterised as a process flow starting with procurement planning and proceeding in sequence to product design, advertising, invitation to bid, prequalification, bid evaluation (broken down further into technical and financial evaluation), post-qualification, contract award and contract implementation. Each link in the chain is potentially vulnerable to corruption.[33]

44. Government purchasing procedures can be split into these main stages: drawing up the order, placing the order, and fulfilling the relevant contracts. Each of these stages presents risks for corruption. In determining the contracting requirements and creating a purchase order, for example, the following steps may present risks:

- determining the priority of government purchase applications;

[33] United Nations (2010).

- market research;
- selecting the order placement procedures;
- selecting the quality requirements and technical specifications of the project;
- setting a timeline for the purchases.

45. The following steps may present risks when placing the order:

- drawing up of tender documentation;
- announcement of procurement;
- the period of preparing participant applications;
- reviewing of applications;
- concluding the contract.

46. The following steps may pose risks of corruption when fulfilling the contract:

- contract administration;
- accepting the purchase;
- guarantee period.

47. Within the broader rubric of government contracts and procurement, several specific types of procurement appear to pose a particularly high risk of being associated with corruption-related money laundering.

i. Defence Industry

48. A number of factors may lead to increased risks of corruption in the defence contracting field. Firstly, there may be less transparency in the bidding process because the subject matter of the work relates to national security and is therefore protected by laws and regulations dealing with secrecy and confidentiality. In the Montesinos case discussed in *Laundering the Proceeds of Corruption*, for example, much of the funds siphoned off from the Treasury were disguised as part of the military and intelligence budget; the secretive nature of the expenditures would prohibit inquiry by anticorruption units, civil society or the media. Second, the nature of legitimate defence contracting work often leads to highly specialised requirements. Unlike commonly-available goods and services in other sectors, the defence industry is often called on to produce highly specialised goods, systems or services. This in turn can lead to fewer controls on the contracting procedures, the necessity to change specification during the life of the contract, and the inability of investigators to determine whether the contract price may have been inflated. Each of these factors can increase corruption risk in procurement. Lastly, as with other sectors, the industry often uses agents and intermediaries, which raises the possibility that such individuals are present merely to funnel bribes between the corrupt contractor and the government official.[34] In light of these factors, and the number of cases that involve this type of procurement, reporting entities may wish to consider

[34] OECD (2009); Wolfsberg Group (2006).

whether they wish to take appropriate measures to counteract the risk of corruption-related money laundering in this area.

Box 7: **Case Study - Zambian embezzlement scheme using specious arms contracts**

In the late 1990's and early 2000's, then-President of Zambia, Frederick Jacob Titus Chiluba, and his director of the Zambian Security Intelligence Services, Zavier Franklin Chungu, entered into a scheme to embezzle over USD 70 million from the Zambian Treasury. In one aspect of the scheme, Chiluba and Chungu, through an intermediary, appeared to contract with a Bulgarian company for the purchase of military equipment, including helicopters, aircraft and weapons. USD 20 million, in a number of tranches, was paid by the Zambian Treasury to two accounts in Belgium and Switzerland to satisfy the contract. In reality, no arms were ever delivered, and the money that had been transferred into the accounts was dissipated by Chiluba, Chungu and their associates. The withdrawals from the accounts, purportedly set up to purchase arms from Bulgaria, included USD 7.6 million being withdrawn in cash. Some cash withdrawals were quite large, including one USD 1.3 million withdrawal. Other transfers were to law firms associated with the Zambian president and his associates.

Source: Attorney General of Zambia v. Meer Care, [2007] EWHC 952 (Ch) (UK court opinion, 2007).

ii. Human Health Activities

49. The health sector is an attractive target for corruption, with an estimated USD 5.3 trillion spent on health services each year and a global pharmaceutical market value of approximately USD 750 billion. Transparency International estimates that in some countries up to two thirds of hospital medicines supplies are lost to corruption and fraud.[35] A number of factors exist within both the pharmaceutical and medical device industry which may contribute to a higher risk of corruption. Corruption in the pharmaceutical and medical device sector can occur throughout all stages of the business chain, from research and development to dispensing and promotion. The large number of steps in the production and dispensing of medical products can allow for numerous opportunities for corruption. Other factors that may lead to increased risks of corruption in the pharmaceutical and medical device industry include the fact that health care entities in many countries are government entities, and those running them can be considered public officials. Moreover, many of the items for which healthcare facilities contract may be highly specialised and, as a result, (as with defence procurement) they are not susceptible to ordinary procurement processes. Thus, human health activities are another area in which reporting institutions may wish to impose specific safeguards against corruption-related money laundering.

[35] World Health Organisation (2010).

Box 8: **Two case studies regarding human health activities**

Case study one: The contractor and the corrupt official collude so that the medical equipment is purchased at a considerably inflated price. The scheme can be detected by an analysis of the money flows resulting from the transaction. In this instance, the contractor immediately (or via an intermediary) splits the contract payment into two streams: The first stream involves funds earmarked to purchase the equipment from the manufacturer or dealer for the lowest price possible, and the second stream involves the remaining funds, which are deposited with a financial institution, part of which the corrupt official will receive as payment once the money has been laundered.

Case study two: This scheme uses two affiliated intermediaries in supplying high-value foreign-made medical equipment: the first party is a domestic company which acts as the contractor and the second party is an offshore company through which the purchase of equipment is made at the manufacturer's actual price. Once the contractor receives payment for the contract, the majority of funds are transferred to the offshore company's account. The amount transferred to the offshore company, which is controlled by the briber, is the difference between the contract price and the actual price of the equipment. A share of this amount constitutes the corrupt income. Specifically, funds may be transferred to foreign accounts belonging to the corrupt official, affiliated individuals and organisations under their control, or to other individuals connected to the corrupt official, their associates and organisations.

Source: Russian Federation

iii. Large Infrastructure Projects

50. Again, as with some aspects of defence procurement, large infrastructure contracting has several features that may make it more susceptible to corruption. Among those are the specialised nature of the provision of work and the necessity for continuing maintenance and upkeep, complex supply chains, often the presence of state-owned or state-controlled enterprises, and the "big ticket" nature of the work, which increases the incentive for corruption and allows for room for corrupt payments to be hidden. The *2011 Transparency International Bribe Payers' Index*, ranks 'public works contracts and construction' as the sector in which companies are perceived to be most likely to accept bribes internationally.[36] Indeed, these projects carry a particularly high risk associated with corruption related money laundering due to their large scale which makes the tracking of payments more complicated and the inflated costs and bribes easier to conceal.

51. A number of global initiatives are working towards ensuring greater transparency and accountability in this area. The Construction Sector Transparency Initiative (CoST), for example, seeks to achieve transparency through the public disclosure of information at various stages of the construction project cycle in a way that helps stakeholders to hold the project agency accountable for value and quality. This initiative was piloted in eight countries between 2008 and 2011 and is being scaled up to become a global initiative. Disclosure covers, for example, the purpose and value of the project for beneficiaries, project scope and cost, the agencies and firms involved, the award of

[36] Transparency International (2011b), *p.* 15.

contracts, and variations in the cost, scope, and delivery time during construction. An assurance process adds value to the disclosure by verifying the information and highlighting issues in plain language so that citizens and oversight agencies can understand and react when appropriate. While no one factor will be determinative of risk, and such assessments are inherently contextual, such activities such as the CoST may provide useful information to reporting institutions concerned about certain entities or transactions.[37]

Box 9: **Piarco International Airport**

The fraud involving the construction of a large airport in Trinidad and Tobago reflects the enormous sums involved in such projects and the risks that corruption will taint the process. The government of Trinidad and Tobago, in the construction of the Piarco International Airport, followed a competitive bidding process to ensure a fair price. Unbeknownst to the government, however, the project manager they hired to oversee the construction corruptly arranged for certain companies to rig the bidding in exchange for kickbacks. The contractors, who operated a construction company and architectural firm in the United States, submitted a competitive bid for work in the construction of the airport. A Trinidadian government assessor believed the bid was too high and requested that a second bid be conducted. Based on this, the targets of the investigation utilized a shell company to submit a second, much higher bid for the work. As a result of this much higher second bid, the contract was awarded to the targets of the investigation. The winning bids were twice the cost of original estimates and the government overpaid approximately USD 25 million for two subcontracts alone. It is estimated that the total fraud involved more than USD 100 million. Once the corrupt contractors were paid by the Trinidadian Government, they laundered the proceeds by layering them through a series of shell companies in the Bahamas, Liechtenstein and the United States, and kicked back money to officials in the Trinidadian government as well as to the corrupt project manager.

Source: United States v. Gutierrez, No. 05-20859 CR-HUCK (November 17, 2005) superseding indictment; US Committee on Homeland Security and Governmental Affairs (2009).

C. Privatisation

52. Corruption risks have been identified where a government is either selling or transferring something with large economic value to private operators, generally through the process of privatisation. Historically, privatisation has been correlated with corruption.[38] The methods by which this occurs vary, but include rigging the privatisation process itself.[39] Again, the particularly significant factor here is the degree of transparency of the government processes – the more open and transparent the administrative assessment and decision making processes are, the more difficult it is to manipulate, falsify and corrupt them for personal benefit.

37 www.constructiontransparency.org, accessed 28 June 2012.
38 Kaufmann, D & Siegelbaum, P (1997).
39 Bjorvatn, K & Soreide, T (2005).

D. Developmental and Other Types of Assistance

53. Just as an increased corruption risk arises with regard to business activities to obtain oil and other natural resource revenues, due to the many government interactions that arise by nature of these types of activities (e.g. the need to obtain government approvals), economists have posited that activities related to other types of so-called "windfall revenue," including significant amounts of foreign aid, may also give rise to a risk of corruption and, consequently, a risk of corruption-related money laundering.[40]

Box 10: **Corruption Related to Developmental Assistance**

In April 2010, Macmillan Publishing Limited ("MPL") was debarred from participating in World Bank funded tender business for a minimum period of three years after it was established that employees of the company engaged in a scheme in which they gave cash and other items of value to officials of the Ministry of Education, Science and Technology, South Sudan (MOEST) in an effort to influence the officials to ensure that Macmillan was awarded a World Bank contract valued at USD 2.35 million supply of school text books. This influence initially resulted in a request by MOEST to sole source the contract award to MPL, a request which the World Bank refused.

Following a subsequent investigation across three East African countries covering the period 2002-2009, it was impossible to be sure that the awards of tenders to the MPL in those jurisdictions were not accompanied by a corrupt relationship. Accordingly, it was plain that the Company may have received revenue that had been derived from unlawful conduct. The Director of the Serious Fraud Office (SFO) took action in the High Court, which resulted in an Order for MPL to pay in excess of GBP 11 million in recognition of sums it received which were generated through unlawful conduct related to its Education Division in East and West Africa. The Order was made under Part 5 of the Proceeds of Crime Act 2002.

The investigation revealed some of the methods used to establish a relationship with key government officials who were able to influence the outcome of the contract evaluation process in their respective countries. This included the use of local agents or country representatives who received payments transferred to private and business bank accounts which were then withdrawn in cash and paid to government officials. In addition to this other bribery methods such as gifts, such as travel and holidays, were used.

Source: United Kingdom

B. COUNTRY OR GEOGRAPHIC FACTORS

54. Some countries pose different risks than others. One factor in assessing the risk of corruption-related money laundering involves a consideration of geographic risk factors, such as a customer's links to jurisdictions associated with higher levels of corruption. Indeed, the interpretive note to Recommendation 10 states that country or geographic risk factors (including whether a country has been identified by credible sources as having significant levels of corruption) is an

40 Hartford, T & Klein, M (2005); Svensson (2000).

element of assessing risk.[41] While no rigid formula can exist for determining whether a country falls into a high-risk category, there are a number of factors that could be considered by reporting entities in making their determination.

1. Understanding the International Anti-Corruption Framework

55. Over time, generally agreed-upon anti-corruption (AC) standards and best practices have arisen, largely in the form of AC multilateral treaty provisions. For example, the provisions within the United Nations Convention against Corruption (UNCAC) are generally thought to represent the international standard for anticorruption policy; its provisions are sufficiently important to an effective AML/CFT regime that its ratification is required under FATF Recommendation 36. Properly implemented, AC controls work to reduce the level of corruption by making it more difficult both to move the funds undetected, as well as to engage in corrupt activities in the first instance.

56. The UNCAC includes a requirement in its asset recovery provisions for financial institutions "to verify the identity of customers, to take reasonable steps to determine the identity of beneficial ownership 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 associates."[42] This is similar to, although somewhat broader than, FATF's Recommendation 12 regarding PEPs. Its rationale recognizes the tight links between corruption, particularly grand corruption, and money laundering.

57. Moreover, the UNCAC has a number of provisions that, if properly implemented, would complement a jurisdiction's AML program. Although not mandatory (as it is with FATF Recommendation 29), the UNCAC urges ratifying states to consider establishing an FIU and a regime of mandatory reporting of suspicious transactions.[43] Moreover, it sets forth a broad and progressive set of requirements for preventing corruption, including procedures regarding the employment of public servants,[44] transparency in public procurement contracts,[45] measures to strengthen the judiciary and prosecution services.[46] The United Nations Office on Drugs and Crime (UNODC), the guardian of the UNCAC, has produced a number of tools for assisting countries in the implementation of these measures.[47]

58. The provisions of the UNCAC are useful, of course, only to the extent that countries implement its provisions. More than 160 countries have ratified the treaty, although it is unknown how many of those countries have implemented the major provisions of the treaty. UNCAC's Conference of States Parties (CoSP) have agreed to a peer review process, known as the Mechanism for the Review of Implementation of the Convention. The CoSP have established a review schedule, providing for review of the implementation of the UNCAC in two review cycles of five years each.

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41 Interpretive note to Recommendation 10, paragraph 15(b). See also Wolfsberg Group (2006); Wolfsberg Group (2011a).
42 United Nations (2004), Article 52, Section 1.
43 United Nations (2004), Article 58
44 United Nations (2004), Articles 7(a), 8,
45 United Nations (2004), Article 9
46 United Nations (2004), Article 11
47 UNODC (2004).

While criminalisation will be assessed in the first review cycle, preventive measures and asset recovery will be addressed only in the second cycle.[48] The Executive Summaries of the country review reports are publicly available on the UNODC web page in six languages. Thus, while ratification of the UNCAC is some evidence of a nation's willingness to combat corruption, financial institutions and other governments should not rely on the mere fact of ratification to assure themselves that the provisions called for in the UNCAC have actually been implemented.

59. As FATF described in *Laundering the Proceeds of Corruption*, a number of other organisations have developed international instruments and mechanisms designed to prevent corruption. Some of these, like the UNCAC, contain their own peer assessment of an individual country's progress in implementing the provisions. These include:

- Organization of American States' InterAmerican Convention against Corruption (IACAC) and the Mechanism for Follow-Up on the Implementation of the IACAC (MESICIC), in which committees of experts engage in a peer review process to evaluate the implementation of the Convention, and publishes reports concerning member states;[49]
- The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions is narrower than other multilateral treaties, in that it prohibits ratifying states only from engaging in bribery in international business transactions. However, it contains anti-money laundering provisions similar to FATF and UNCAC standards. Its Working Group on Bribery in International Business Transactions (WGB) engages in a peer review process and publishes reports concerning implementation efforts;[50]
- The Council of Europe's Group of States against Corruption (GRECO) monitors compliance with the Criminal Law Convention on Corruption and the Civil Law Convention on Corruption through a published peer-review process.[51]
- The EU Convention against Corruption involving officials of the European Communities or officials of Member States of the European Union, which covers active and passive corruption at the internal level of Member States as well as at the EU level. The European Commission has recently announced its intention to establish a specific EU monitoring and assessment mechanism, the "EU Anti-Corruption Report," to be combined with EU participation in GRECO.[52]

48 UNODC (2011).
49 www.oas.org/juridico/english/fightcur.html, accessed 28 June 2012
50 www.oecd.org/document/24/0,3746,en_2649_37447_1933144_1_1_1_37447,00.html accessed 28 June 2012
51 www.coe.int/t/dghl/monitoring/greco/default_en.asp
52 http://ec.europa.eu/home-affairs/news/intro/docs/110606/308/1_EN_ACT_part1_v12[1].pdf accessed 28 June 2012

60. Many of these reports are publicly available. Depending on the risks involved and other factors, institutions may wish to use these materials to better understand the corruption-related money laundering risks of specific countries.

2. Specific Anti-Corruption Measures

61. In addition to an overall AC system, certain specific measures are of particular interest to reporting institutions attempting to assess country risk. These include financial disclosures by public officials and disclosure of public contracts. These contribute not only to an effective AC effort, in that it creates both deterrence against corrupt officials, but also increases the effectiveness of the ability of reporting institutions and other countries to detect the laundering of the proceeds of corruption.

Financial disclosures by public officials

62. In many countries, one or more categories of public officials and political persons are required by law to periodically submit a declaration of their assets and/or business interests.[53] Disclosing the value of assets and liabilities, together with the amount of a public official's income, makes it possible to detect unexplained wealth variations and illicit enrichment. A public official's disclosure of interests, commitments, and business connections may help detect potential conflicts of interest. These disclosures are important tools because they address both the prevention and detection sides of corruption: it is a transparency tool that promotes a public official's accountability and may increase trust in public institutions; and it is a mechanism that may provide information and even evidence for corruption investigations and prosecutions.

63. Requiring public officials to disclose their assets and income (including whether the official is the beneficial owner of assets) can also serve other purposes, such as deterring public officials from receiving bribes and obtaining assets (at least those that can be traced to them), and assisting in the detection and prosecution of individuals whose financial disclosure statements are false. More importantly, such financial disclosures can provide for a baseline of a reporting institution's risk assessment and monitoring of a PEP (and his or her family members): assets or transactions that deviate from the PEP's financial disclosure should lead to closer inquiry and inspection by the reporting institution to satisfy itself that these additional funds stem from legitimate sources, or to report suspicious transactions where appropriate. They can also be used by FIUs in analysing suspicious transactions.[54]

Disclosure of public contracts

64. Likewise, the UNCAC requirement of transparency in public contracts can reduce corruption in the first place, and as importantly for AML purposes, provides a reference point from which reporting institutions can engage in EDD. Funds stemming from a closed and secret government-

[53] Domestic laws vary with regard to this. See World Bank/StAR (2012); Rossi *et al* (2012). Financial disclosure is not a mandatory requirement under the UNCAC, *cf*. article 52, paras. 5 and 6.

[54] The World Bank and StAR Initiative have produced excellent papers on the use of asset and income disclosures for identifying and monitoring PEPs. See World Bank/StAR (2012); Rossi, I., *et al* (2012); and Greenberg, T.S, *et al* (2010).

contracting regime should be viewed with more concern than those funds subject to a transparent process. As noted in the section on sector risk, government contracting poses risks where the process is not open to scrutiny by others.

Box 11: **Case study of asset reporting to assist in detection of corruption related money laundering: US Congressman Randal Cunningham**

Randal "Duke" Cunningham was a United States Congressman representing a district in Southern California. A former fighter pilot of some distinction, he was a member of the powerful Appropriations Committee, whose function it was to develop a budget. Congressman Cunningham's prior military experience allowed him to have significance in the military budget. As part of his duties, he had the ability to insert special requirements, known as "earmarks" into defense budgets, requiring that the military purchase a certain good or service. Some of these earmarks also mandated the use of "no-bid" contracts, which would circumvent the normal open bidding process, purportedly because the good or service was highly specialised or classified.

Cunningham accepted bribes, typically through asset transactions, in exchange for no-bid earmarks. In one instance, a defense contractor was able to receive millions in no-bid contracts by purchasing the Congressman's home from him at an inflated price so that Cunningham could purchase a more expensive house. To disguise the transaction, the contractor used a corporate vehicle to purchase Cunningham's house. The contractor paid additional money to the Congressman, disguised through cheques made payable to a corporate entity that Cunningham had previously established. Other similar bribes included the purchase of a yacht, nominally owned by a third party but in fact owned and used by Cunningham, and the purchase of antiques and other furniture.

Investigators in the case were aided by the fact that Cunningham was required to disclose his assets and his income. An examination of those records showed that Cunningham's net worth skyrocketed in a few short years, but that his net income had not. Moreover, Cunningham had listed the corporation used to accept some of the bribe money on his asset disclosure form, which enabled investigators to conclude that money paid to that corporation was attributable to him.

The case also demonstrates the difficulty with "no-bid" contracts. Some of the earmarks that the Congressman granted were nothing more than vehicles by which money could be kicked back to him: the contractor would be awarded the contract for an inflated price and would deliver some of the money back to the Congressman. Finally, the investigation was greatly assisted by the combined efforts of highly specialised AC units within the Federal Bureau of Investigation as well as the Defense Criminal Investigative Service, which had expertise in government contracting as well as tracing the clandestine flows of money.

Source: US court documents, United States v. Randall Cunningham, Case no. 05-cr-2137 (2006).

3. Internationally-Recognised Anti-Money Laundering Standards

65. As noted in *Laundering the Proceeds of Corruption,* the stolen assets are useless to the corrupt public officials unless it can be converted into a useable form. Tight money laundering controls have the capacity to detect corrupt assets moving through the system or, even better, deter an official

from engaging in the corrupt activity in the first place. Compliance with the FATF 40 Recommendations should be a significant factor to consider in assessing the risk of corruption-related money laundering. The FATF standards were designed to reduce risk by increasing effectiveness along the gamut of governance – detection and prevention, investigation and prosecution, and domestic and international information sharing. A jurisdiction compliant with the FATF Recommendations poses a far lower risk of money laundering generally – including corruption-related money laundering – than a jurisdiction that does not.

66. By effectively implementing the FATF Recommendations, countries can protect the integrity and increase the transparency of the financial system as well as enhance international co-operation on AML/CFT measures. The Standards contain elements such as domestic cooperation among policy makers, FIUs, law enforcement, and supervisors (Recommendations 1 and 2); preventive measures for the financial sector and other designated sectors (Recommendations 9 through 23) and measures to facilitate international cooperation (Recommendations 36 through 40). All these measures assist in the detection, investigation and prosecution of corruption-related money laundering by corrupt officials, and facilitate the freezing, confiscation and repatriation of the illicit proceeds.

67. Moreover, FATF has two mechanisms by which compliance can be assessed. The first is the process of mutual evaluations, in which FATF members and those countries that have joined a Regional FATF-Style Body (FSRB) have agreed to be assessed by other members and have the results published. The second is the process followed by the International Cooperation Review Group (ICRG), through which countries that are identified as high risk and/or non-cooperative are publicly identified, and with which the ICRG establishes working plans that are closely monitored and that must be met by the relevant countries in order to guarantee a sound AML/CFT regime. Both processes provide valuable sources of information regarding the quality of the AML/CFT regime which then informs the risk of corruption-related money laundering.

68. Additionally, as the FATF evaluation process moves into the fourth round of mutual evaluations with a goal toward assessing effectiveness as well as technical compliance, reporting institutions will have the opportunity to engage in a risk analysis that moves beyond checking for mere technical compliance and into an understanding of the types and levels of risk a specific jurisdiction may hold.

4. Corruption Indexes

69. Numerous governments, NGOs, and multilateral groups have an interest in determining the level of corruption-related risk in a specific country's government or institutions. Donor countries and NGOs, for example, may attempt to determine corruption-related risk in determining the distribution of aid resources. As a result, a host of corruption measurement indexes have been developed; some measure the perception of corruption within a specific jurisdiction, while others measure specific factors which should be present (or absent) in a country with less of a corruption problem.[55]

[55] A good analysis of the various types of corruption indexes is contained in UN Development Programme (2008).

Transparency International Corruption Perception Index

70. Unique among all crime problems is the AC community's use of "perception indexes" to measure the significance of the threat. The logic of its use is that corruption is inherently hard to detect: the parties involved, except in the case of extortionate conduct, have a vested interest in keeping their criminal arrangements covert, and the victims, generally the population of the jurisdiction of the corrupt official, are unaware of its victimisation. Bank robberies get reported and, regardless of whether the thief is caught, the public knows of the crime. Corrupt acts can siphon far more money from the public than a bank robbery, and not only does the thief escape, but the victims are often unaware that they have been robbed.

71. As noted in *Laundering the Proceeds of Corruption*, Transparency International publishes a list of countries ranked according to their perceived levels of corruption, known as the Corruption Perceptions Index (CPI). Ranking over 180 countries, the CPI aggregates business opinion surveys about administrative and political corruption, particularly with regards to bribery of public officials, kickbacks in public procurement, embezzlement of public funds, and the efficacy of public sector anticorruption efforts.[56] The CPI attempts to eliminate perception bias by drawing on different assessments and business opinion surveys carried out by independent and reputable institutions. Additionally, Transparency International periodically releases the Bribe Payers Index, in which developed countries and industry sectors are rated on the perception that they engage in bribery. The OECD, GRECO, the World Bank, and many reporting institutions make use of the Transparency International Index in their work, and numerous FATF mutual evaluations explicitly cite them.[57] The Wolfsberg Group has characterised the Transparency International as an example of a credible source in determining whether a country has a significant level of corruption.[58]

72. These indexes, as their proponents acknowledge, have their limitations.[59] They measure perceptions of administrative and political corruption, rather than crime itself, and cannot accurately measure a government's willingness and efforts to attack corruption, nor the likelihood that an individual business transaction or customer is involved in a corrupt activity. Nor can they be used to compare year-on-year improvements in the area of corruption and are insufficiently precise that conclusions that one country is "more corrupt" than another should be avoided. As such, it is best to treat the CPI and other perception indexes as a tool to assess corruption risks, which should be complemented with other evidence and analysis.[60]

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56 Transparency International (2011a).

57 See, *e.g.*, *FATF Mutual Evaluation of India* (2010) *p.* 12, *FATF Mutual Evaluation of Brazil* (2010) *p.* 8; *FATF Mutual Evaluation of Austria* (2009) *p.* 17; *FATF Mutual Evaluation of Mexico* (2008) *p.* 14; OECD (2006); OECD (2003); Council of Europe (2010); Greenberg, T.S., *et al.* (2010).

58 Wolfsberg Group (2006).

59 As a paper from the OECD noted:

> "More than users seem widely to perceive, however, even the most carefully constructed of these indicators lack transparency and comparability over time, suffer from selection bias, and are not well suited to help developing countries identify how effectively to improve the quality of local governance. Users – mainly people located outside developing countries – thus tend to use, and widely misuse, these indicators to compare the quality of governance both among countries and over time. "
> Arndt, C. and Oman, C. (2006).

See also, Galtung (2006).

60 Transparency International itself warns against reading too much into their index:

Other Corruption Perception Indexes

73. Several other perception indexes exist, which attempt to assess perception of factors broader than mere corruption. One is the Worldwide Governance Indicators (WGI), which attempts to measure the quality of a jurisdiction's governance.[61] The index describes governance as "the traditions and institutions by which authority in a country is exercised," including the method of selection and monitoring of the government, its capacity to formulate and implement sound policies, and the level of respect for certain institutions within the country.[62]

74. The quality of the governance of a jurisdiction has been shown to have a positive correlation on the risk of corruption. Those governments with weak governance are more susceptible to corruption; conversely, those countries with a high level of governance are able to deter, detect and prosecute corruption to a greater degree than other countries. The OECD refers to "weak governance zones" as areas in which "governments are unable or unwilling to assume their responsibilities. These 'government failures' lead to broader failures in political, economic and civic institutions that, in turn, create the conditions for endemic violence, crime and corruption and that block economic and social development."[63] Indeed, in the context of bribery by business organisations, the OECD has set forth a checklist of issues or questions that businesses should be asking themselves with regard to weak governance zones. These include an awareness of the potential risk, steps to be taken in dealing with local political officials, and management systems that should be put into place when conducting business in weak governance zones.[64]

75. In measuring the quality of governance, the WGI relies on six perception indicators: 1) voice and accountability, 2) political stability and absence of violence, 3) government effectiveness, 4) regulatory quality, 5) rule of law, and 6) control of corruption. Taken together and when assigned a value, these interrelated factors can paint a portrait of the quality of the governance of a country.

76. Many of the six factors reported by the WGI have relevance in a risk-based analysis to determine the risk of corruption-related money laundering. "Voice and accountability," for example, roughly corresponds to the presence or absence of "control over the State," which Laundering the Proceeds of Corruption noted was a significant risk factor for the presence of corruption-related money laundering, as it allows the government elites to essentially "rig the game" by preventing AML and AC authorities from effectively functioning.[65] Likewise, the presence of free media and the right of free speech and association present a powerful check on corruption. Certain studies have shown that increased public access to information through the media can decrease corruption.[66] In the case studies involving US Congressman Randall Cunningham, and Peruvian insider Vladimiro

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"The CPI is mostly an assessment of perception of administrative and political corruption. It is not a verdict on the levels of corruption of entire nations or societies or of their policies and activities. Citizens of those countries/territories that score at the lower end of the CPI have shown the same concern about and condemnation of corruption as the public in countries that perform strongly." Transparency International (2011d).

61 World Bank Group, "Worldwide Governance Indicators," available at http://info.worldbank.org/governance/wgi/index.asp accessed 28 June 2012

62 Kaufmann, D., Kraay, A., and Mastruzzi, M. (2010).

63 OECD (2006) at 9.

64 Id.

65 FATF (2011).

66 Reinikka, R & Svensson, J (2003).

Montesinos, the press first brought to light the corruption, which provided both the evidence and the impetus for criminal investigations into the conduct.

Box 12: **Case Study - The Montesinos matter and the importance of a free press**

Alberto Fujimori and Vladimiro Montesinos, the President and intelligence service advisor in Peru in the 1990s, were estimated to have stolen more than USD 2 billion from the state through a variety of schemes, including overbilling and kickbacks in defense contracts. They then used shell corporations to launder the money, with multiple corporate vehicles in a number of jurisdictions, each holding bank accounts in other jurisdictions to disguise the source and ownership of the money.

The corruption was uncovered as a result of Montesinos videotaping some of his bribes in order to ensure compliance. The tapes were leaked and aired on local television, resulting in the immediate flight of both Montesinos and Fujimori. The press attention, in addition to bringing the corruption to light, also assisted in the recovery of the stolen assets. Once the videotapes received worldwide attention, financial institutions in the US, Switzerland and Panama immediately froze suspect assets. One Peruvian scholar who studied the issue noted that "the peculiarity that Montesinos videotaped his meetings made the case attractive to the international media, which in turn severely increased the risk of financial institutions…. [A] lesson to be learned: the greater the international attention and press coverage of the case, the greater the chances of getting initial information from foreign financial institutions."

Source: Jorge, G. (2007)

77. Similarly, the existence of government effectiveness, described in part as "the quality of public services, the quality of the civil service and the degree of its independence from political pressures… and the credibility of the government's commitment to such policies," is a useful measure in determining the potential of and motivation for corruption within the government. Another measure, the Rule of Law, which is defined in part as "the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts" has a direct correlation to determining the level of enforcement of the existing corruption laws within a jurisdiction. The last measure, of course, control of corruption, directly measures perceptions of corruption, and has a correlation to any assessment that a reporting institution may conduct to determine country or geographic risk.

78. Likewise, the Basel Institute on Governance has developed an AML Risk Index, similar to the WGI, that assess countries' risk levels regarding money laundering and terrorist financing. It is an index of indexes: integrating 15 other independent indexes into an overall score. In doing so, the index considers adherence to AML/CFT standards, perceived level of corruption, financial transparency, political financing, judicial strength and other categories.[67]

[67] http://Index.baselgovernance.org, accessed 28 June 2012

Non-perception based indexes

79. Another type of index does not rely on perception, but rather gathers information its authors believe are useful measurements in corruption-related areas. For example, the Business Anti-Corruption Portal[68] provides a comprehensive and practical business tool with targeted, but by no means exclusive, support to small and medium enterprises operating within emerging markets or developing countries. The Portal comprises of several elements, including information on international and regional anti-corruption conventions and initiatives.

80. It also includes 60 country profiles in six regions which detail the regulatory environment, sector specific business and corruption risk analyses, facts about anti-corruption legal/institutional frameworks and implementation, public and private anti-corruption initiatives and ratification status of international conventions. This section provides an overview of the occurrence and the type(s) of corruption that particular countries may encounter. The sector information provided is both quantitative and qualitative using established corruption indices alongside descriptions of corrupt transactions and further links to narrative sources of information. The anti-corruption tools inventory also provides corruption cases, reporting, sector-specific anti-corruption resources and other useful links.

81. The source of information feeding into these tools is rooted in practical experience. The digested data and information, all of which is publicly available, is based on research by international finance institutions and public and private organisations. The Portal is free of charge to access and is a referred tool by several major international organisations, including the OECD, the UN, the World Bank, the IFC and Transparency International. To ensure the validity of the data presented Country Profiles are updated annually or biannually.

82. Additionally, the World Justice Project's Rule of Law Index provides an analysis of a country's legal framework and its effectiveness.[69] Global Integrity, another NGO funded partly by countries and multilateral organisations, including the United Nations, created an index which gathers quantitative and qualitative data to measure the health of a country's anti-corruption and good governance institutions, mechanisms, and practices. It publishes both an overall country list and report, and also maintains a list of countries that are most at risk for grand corruption.[70]

83. Reporting institutions may wish to refer to such indexes, or engage in a similar analysis.

84. Likewise, NGOs can provide useful specific information on corrupt activity within a jurisdiction. Groups like Global Witness, Global Financial Integrity and others have investigated, documented, and publicised corrupt acts by governments around the world. Such reports, in addition to those published by the media, can provide important, but again not exclusive, information from which to assess corruption risk.

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[68] The Business Anti-Corruption Portal is a public-private partnership between the governments of Austria, Denmark, Germany, the Netherlands, Norway, Sweden, and the UK together with Global Advice Network, a Nordic private consultancy company specialised in anti-corruption, anti-fraud, sustainability and business development (www.business-anti-corruption.com/) accessed 28 June 2012

[69] World Justice Project (2011).

[70] Global Integrity (2011).

C. PRODUCT, SERVICE, TRANSACTION OR DELIVERY CHANNEL RISK FACTORS

85. FATF has recognised that specific products, services, transactions or delivery channels may pose a greater risk of money laundering. Examples include private banking, anonymous transactions (which may include cash), non-face-to-face business relationships or transactions, and payment received from unknown or un-associated third parties.[71]

86. Corrupt public officials use similar money laundering techniques as those used by organised criminals to conceal the proceeds of corruption. For example, the use of cash, wire transfers and/or the creation of offshore shell corporations and trust accounts is present in nearly all recent cases of grand corruption. In the business bribery context, the use of intermediaries is often present. Additionally, a wide range of products and services offered by financial institutions have been found to be vulnerable to abuse by PEPs. These include private banking, retail banking products, correspondent and concentration accounts, transactions with non-client corporate accounts, and wire transfers.

Private banking

87. Private banking is typically distinguished by the size of the accounts involved and the presence of a one-on-one private banker or relationship manager assigned to manage the assets of each client. They can either be independent banks or exist as a bank within a larger bank. Private banking accounts can be attractive to money launderers and particularly those wishing to launder the proceeds of corruption because of the high net worth of the customer, the offshore nature of many of the facilities offered, and the type of products and services available. These services are likely to attract money launderers who look for adequate ventures to move large sums of money without attracting notice.

88. Additionally, the reporting institution's desire for a lucrative business relationship from high net worth individuals may make it difficult for compliance officers to convince their boards to turn down dubious customers, due to the profitability of the business. One study noted that the return for a bank can be as high as 20 to 25 percent.[72] The FSA, in its recent analysis of banks' management of high-risk business relationships, provided a number of case studies. In many of these instances, banks failed to put in place adequate safeguards to mitigate money-laundering risk or engaged in a business relationship despite information alleging that the funds used in the business relationship were the proceeds from crime, including corruption.[73]

89. The United States Senate has also highlighted these risks in its comprehensive study of abuses taking place within the US financial sector. It found a number of situations in which private bankers or relationship managers not only failed to understand the financial transactions they were conducting, but actively assisted the public official by creating shell corporations.[74]

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71 FATF (2012), Interpretive Note to Recommendation 10.
72 Permanent Subcommittee on Investigations (1999) *p.* 6.
73 Financial Services Authority (2011) *p.* 77-84.
74 Permanent Subcommittee on Investigations (1999).

Box 13: **Case study - Private banking risks: Augusto Pinochet**

Augusto Pinochet was the de facto leader or president of Chile from 1973 to 1990, the Commander-in-Chief of its armed forces from 1990 to 1998, and a Chilean Senator from 1998 to 2002. Notwithstanding a modest declared income, he had an estimated net worth of between USD 50-100 million and managed to deposit over USD 10 million into accounts in the US and UK in a two-year period. Pinochet was a private banking customer, and the US-based bank set up offshore shell corporations and a trust. These corporations, established in jurisdictions that at the time had weak AML controls, were listed as the nominal owners of the US bank accounts and other investment vehicles that benefited Pinochet and his family. The bank's KYC documentation listed only the corporations, not Pinochet, as the owners of the accounts, despite the fact that the bank knew that Pinochet was the beneficial owner (since the bank itself had set up the corporations). Additionally, the bank, in reaction to a global freeze order issued by a Spanish investigating magistrate, changed the names of accounts to eliminate Pinochet's name. Moreover, in internal communication within the bank, employees were careful not to mention Pinochet by name, but rather by code names.

Source: Statement of Offense, United States v. Riggs Bank, Cr. 05-035 (2005); Permanent Subcommittee on Investigations 2004.

Transactions between non-client corporate vehicles and client's accounts

90. Earlier, we discussed the risks that corporate vehicles can pose as customers. Of course, transactions between a reporting entity's customer and other corporate vehicles pose considerable transaction risks as well. Funds of unknown, unexplainable and potentially illicit origin may be introduced into a client account from a corporate vehicle or alternatively distributed from the client's account to a corporate vehicle for illicit purposes. In this case, scrutiny of and record-keeping of the identity of non-client parties to the transaction and the justification for the transfer provides the only chance of obtaining a meaningful assessment of potential risk, from which measures can be taken to mitigate it.

91. For example, a reporting institution that allows large or structured unexplained monetary transfers, which fail to align with the industrial profile of the client's account, is significantly exposed to money laundering risk. The risk is compounded, for example, when the funds come from unknown and/or foreign corporate vehicles and the reporting institution records such transactions only as *"foreign money deposit – April 13th 20XX."* Furthermore, this type of documentation cannot provide useful account information to authorities who may later seek to investigate.

Box 14: **Case study regarding transactions with unknown corporate vehicles - Equatorial Guinea**

A US bank had opened accounts for the Government of Equatorial Guinea in which oil companies doing business in Equatorial Guinea could deposit royalty payments. The President of Equatorial Guinea and several of his relatives, who were also ministers within the government, were signatories on the accounts, which often had balances of tens of millions of dollars. The US bank, in the course of doing an AML review, discovered that USD 35 million had been transferred from an oil account to two foreign corporations. In a two and a half year period, for example, over USD 26 million had been wired to bank accounts in Spain held by an Equatorial Guinea corporation, Kulunga Company, SA. Likewise, USD 8 million had been transferred from the oil accounts to bank accounts in Luxembourg held by Apexside Trading Limited, another Equatorial Guinea corporation.

The US bank maintaining the oil accounts had no information regarding the beneficial owners of the Equatorial Guinea corporations, nor the purpose of the transactions. The banks in Spain and Luxembourg, when asked about the beneficial owners of Kulunga and Apexside, refused to disclose the information on privacy grounds. When the US bank officials asked the Equatorial Guinea President, and other officials, as to the nature of the transaction, they declined to answer. Ultimately, the bank terminated the relationship with Equatorial Guinea. These transactions are now the subject of a criminal complaint in Spain.

Source: Criminal complaint (Spain), ADPHE v. Obiang Family, (2008); Permanent Subcommittee on Investigations (2010); Guilty Plea and Statement of Offense, United States v. Riggs Bank (2005).

Wire Transfers

92. Wire transfers to and from an account of a political official, their relatives or associates, where activity is not consistent with legitimate and expected activity, are deemed high risk as it allows for quick and complicated movement of substantial funds across jurisdictional lines.

Box 15: **Case study involving the wire transfer for significant asset purchases**

Teodoro Nguema Obing Mangue, a government minister from Equatorial Guinea (and son of the President) with an official salary of less than USD 100,000 per year, is alleged to have amassed a personal fortune of over USD 100 million. He was able to purchase these assets as a result of the use of a number of wire transfers in a circuitous route. Money for the purchase of a USD 30 million mansion in Malibu, California, for example, moved in six different USD 6 million wire transfers from a personal bank account in Equatorial Guinea, to a bank in France, and then to the United States. The funds for the purchase of a USD 35 Gulfstream jet traveled by a similar route –from Equatorial Guinea, through a wire transfer to France, then to a correspondent account in the US, and the finally to a second account in the US. Each of these large purchases used a corporate vehicle to disguise the ultimate owner of the asset.

Source: Complaint for forfeiture in rem, United States v. One Gulfstream G-V Jet Aircraft (2011);Complaint for forfeiture in rem, United States v. Real Property, Malibu, California (2011); Global Witness (2009); Permanent Subcommittee on Investigations (2004).

Retail Banking

93. Retail banking covers a range of products/services. The abuse of these products/services is enabled by factors such as the sheer size and scope of the international financial system and the complexity of banking arrangements and products which allows for concealment of corrupt proceeds. The Wolfsberg Group notes that given the diversity of products and services involved, the huge client base, the nature and large numbers of transactions, retail accounts can be risky particularly as it relates to petty corruption.[75]

Use of Cash

94. As noted in *Laundering the Proceeds of Corruption*, cash is a favourite method of laundering corruption related proceeds. Notwithstanding the significant risks involved in doing so, it appears that PEPs are willing to engage in significant cash transactions with reporting institutions. .*Laundering the Proceeds of Corruption* highlighted a number of instances in which PEPs engaged in significant cash transactions with reporting institutions. This included the deposit of nearly USD 13 million over a three year period into accounts controlled by a foreign PEP (and his wife), often in million dollar, shrink-wrapped, increments.[76] In another instance, the daughter of a foreign PEP was able to place USD 1 million in cash, in USD 100 bills, wrapped in plastic, into a safe deposit box at a reporting institution. As illustrated in the case studies involving Abacha, Chiluba, and Bonny Island, described in the previous section, cash has been used in other instances of grand corruption.

[75] Wolfsberg Group (2011).
[76] FATF (2012) at 24-25.

Box 16: **Case study on use of cash: Diepreye Alamieyesiegha**

Diepreye Alamieyesiegha was elected Governor of Bayelsa State Nigeria in 1999 and re-elected in 2003. In asset declarations in 1999 and 2003, Alamieyesiegha failed to reveal, as he was required to, that he controlled numerous accounts in London with millions of pounds of deposits.

In 2005, Alamieyesiegha was arrested on a flight to the UK and interviewed at a London police station. One of his London properties was searched and GBP 1 million cash was found in numerous locked bags in a locked bedroom. During his interview he denied being involved in corruption and claimed the cash was his "strategic reserve." An analysis of the UK-based accounts associated with Alamieyesiegha showed both cash deposits and account activity highly inconsistent with its stated purpose. For example, shortly after opening one account, there was a sharp rise in deposits from GBP 35 000 to GBP 1.5 million. In 2003, Alamieyesiegha also instructed a London-based fiduciary/trust company and service provider to register a company in the Seychelles of which Alamieyesiegha was the sole shareholder and director. This company then opened an account with a UK bank. The bank had predicted a turnover of GBP 250 000, but in the first 14 months the account received deposits totalling approximately GBP 2.7 million; contrary to the characteristics of a functioning business did not have any outgoings. GBP 1.6 million came from a bank in Nigeria from a contractor to Bayelsa State. Additionally, at least one of those accounts received cash deposits, often in increments of GBP 10 000 to 15 000.

Source: Court documents, Federal Republic of Nigeria v. Santolina Investment Corporation, et al., HC05-C03602 (2006).

Correspondent and Concentration Accounts

95. The use of correspondent accounts can involve significant risk of corruption-related money laundering. The FSA noted the risk inherent in correspondent accounts:

> *The facility for banks to process transactions with speed, accuracy and efficiency via correspondent banking relationships does, however, lead to money laundering risk. The vast numbers of payments being processed through the system, and the speed at which such payments must be made, makes it extremely difficult to identify and intercept suspicious payments. . . . [C]orrespondents often have no direct relationship with the underlying parties to a transaction and are therefore not in a position to verify their identities. In addition, they often have limited information regarding the nature or purpose of the underlying transactions, particularly when processing electronic payments or clearing cheques.*[77]

96. Finally, concentration accounts can also pose a risk for corruption-related money laundering. These accounts, which are used by banks to hold funds temporarily until they can be credited to the proper account, can be used to purposefully break or confuse an audit trail. Often used in conjunction with a private banking relationship, it has the effect of separating the source of funds

[77] FSA (2011) at 43.

from its intended destination, and can stymie efforts to associate a customer's name and account number with specific account activity.[78]

Box 17: **Case study involving the use of concertration accounts: Raul Salinas**

Raul Salinas, the brother of the then-president of Mexico, used the private banking division of a large multinational bank to secretly transfer over USD 67 million in embezzled funds from Mexico to the United States and then on to London and Switzerland. A US-based bank official introduced Salinas' then-fiancée to a bank official at the Mexico City branch of the bank. The fiancée, using an alias, would deliver cashier's cheques to the branch, where they were converted to dollars and wired to the United States. However, they were not wired to a specific US account; rather, the funds were wired to a concentration account — a business account set up by the bank itself, generally used to hold money temporarily before crediting the funds to the proper account. The banker would then wire the money from the concentration account to accounts held for the benefit of Salinas in London and Switzerland. By using the concentration account, the banker had assured that the transfer would obfuscate Salinas' relationship to the funds.

The Salinas case also highlights the use of corporate vehicles—in this instance set up by the bank itself—to hide the beneficial owner of the money. The bank provided Salinas with a shell corporation, established in a jurisdiction that at the time had weak money laundering controls, as the owner of the Swiss and London accounts. That shell company, in turn, had for its board of directors three other shell companies from another jurisdiction with weak money laundering controls, and as officers and principal shareholders yet three more shell corporations. The bank itself controlled all six of those shell corporations, whose only purpose was to be able to disguise the beneficial ownership of the money. Later, the bank established a trust, identified only by a number, to own the shell corporation, with Salinas as the secret beneficiary.

Source: Permanent Subcommittee on Investigations (1999) p. 99.

IV. CONCLUSION

97. Though risk profiles—and thus levels of scrutiny—may vary significantly, reporting institutions must be capable of detecting and investigating a wide-range of potentially suspicious transactions. They must be able to do so regardless of whether a party to the transaction has been identified as a PEP.

98. The Wolfsberg Group in its guidance in this area stated that corruption proceeds "often follow patterns of behaviour common to money laundering associated with other criminal activities."[79] The case studies presented here, and those documented in the earlier study, *Laundering the Proceeds of Corruption*, confirm that corruption-related money laundering can use many of the same techniques as other types of money laundering, particularly the use of corporate vehicles and trusts, gatekeepers, nominees and family members and cash.

78 Permanent Subcommittee on Investigations (1999) at 99.
79 Wolfsberg Group (2011).

99. Reporting entities must be on the lookout for those patterns present in typical money laundering: transactions that vary from those the client would be expected to make, that appear to lack a legitimate business purpose, or are by their very nature higher risk. Any activity that increases the potential to wipe identifying information or commingle funds in a transaction warrants additional review from the reporting institution. Moreover, any transaction which appears to be overly and uselessly complex, with an unclear economic purpose, involving multiple parties or tools—such as multiple corporate vehicles and/or nominees, or transactions involving multiple jurisdictions for no apparent economic purpose—should be cause for further investigation.

100. Where a PEP has been identified, FATF considers business relationships with foreign PEPs to be inherently high risk, and therefore any accounts beneficially owned or controlled by a foreign PEP should be considered to be subject to enhanced scrutiny under Recommendation 12. Thus, substantial cash or wire transfers to and from an account of a customer identified as a PEP, particularly where activity is not consistent with legitimate and expected activity should be investigated and resolved.

101. Other customers, such as officials who have a role in public office with major financial implications, access to public funds more generally, or are involved with companies or persons doing business with those countries or economic sectors judged to pose a higher risk of corruption, should be considered higher risk.

102. Additionally, the foregoing discussion makes clear that certain characteristics—customer types, countries and regions, and product/services—when taken together and in the context of what is understood about corruption-related money laundering, should also be considered higher risk. A corporate vehicle involving a high risk industry, in which the role of the beneficial owner in a transaction is unclear, for example, could also be considered a higher risk, regardless of whether a PEP has been identified.

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