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International anti-money laundering laws

Improving external accountability of political leaders

The full potential of anti-money laundering regimes (AML) as an anti-corruption tool is yet to be realised. At the international level, AML measures can provide a checks and balances mechanism for political figures who are 'untouchable' in their home jurisdictions. For that to take place, however, developed and developing countries need to improve AML systems by encouraging collaboration between financial intelligence units and anti-corruption agencies, harmonising laws on predicate offences and improving access to information on beneficiary ownership.

In the past 20 years, Anti-Money Laundering (AML) systems have been developed throughout the world. AML systems aim to reduce the proceeds of various predicate (underlying) crimes, such as drug trafficking, fraud and corruption, from being laundered. AML systems[1] may deter corruption by increasing the risks of detection of illicit conduct, punishment of malefactors, and recovery of illicit assets.

Although effective national AML systems should affect the level and incidence of corruption, the full potential of utilising AML as an anti-corruption tool has yet to be realised. A significant challenge is that corrupt political elites may subvert AML systems. Senior public figures, known as Politically Exposed Persons (PEPs), have powers that may enable them to block AML investigations (Chaikin and Sharman, 2007, 19). Depending on interests of the political elite, a properly functioning AML system may not be on top of their list of priorities. However, the globalisation of such systems represents a potential threat to strong corrupt politicians too powerful to be held to account by their home institutions. There has already been some success in the use of AML laws to recover illicit monies from former political leaders (StAR, 2007) but fewer experiences in which such regimes have been able to hold current political leaders to account (Global Witness 2009, US Senate 2010). The latter deserves more attention.

Harnessing AML systems to combat corruption

The Financial Action Task Force (FATF) Standards contain elements such as:

- Criminalisation of money laundering and financing of terrorism.
- Freezing and confiscation of the proceeds of crime.
- *Know your customer* (KYC) rules and procedures to prevent criminals or terrorists becoming customers of or dealing with private sector regulated entities, such as banks and investment companies.
- Monitoring procedures to detect suspicious transactions in light of KYC information.
- Reporting, by the private sector, of transactions of a suspicious nature, as well as other financial reports, such as large cash deposits and international wire transfers.
- Analysis by government agencies of reports filed by regulated entities, and the dissemination of the analysed product to local and foreign law enforcement and regulatory agencies.

All these measures may assist in the investigation and prosecution of corrupt public figures, and facilitate the freezing, confiscation, and repatriation of illicit proceeds. The practice of AML involves collecting and analysing large quantities of financial data, and results in a major increase in financial transparency. Consequently, AML has the potential to expose corruption – a crime dependent on secrecy and one where victims are often unaware of their loss. By making national AML systems more effective, the chances of detecting corrupt public officials increases, deterring others with similar inclinations.

Although the FATF Standards are not legally binding, as "soft law" they are extremely influential in the enactment of domestic laws and the practice of states. Peer review procedures – whereby experts carry out mutual evaluations of countries' compliance with the FATF Standards – highlight deficiencies in institutions, laws, and procedures. States are expected to follow up mutual evaluations by improving their AML systems. The Standards are treated by states and international organisations, as the minimum acceptable in this area. For example, the International Monetary Fund makes AML assessments based on the FATF Standards part of its Financial Sector Assessment Programs and in its Reports on the Observance of Standards and Codes (ROSCs).[2] The World Bank has tied its lending programmes to improved performance of countries in combating money laundering.

Implications for PEPs

As noted above, a critical feature of the FATF Standards is the requirement that all financial institutions know their customer, so that they do not unwittingly assist in the laundering of illicit funds. There is a requirement that customers will be classified according to their AML and counterterrorism financing (CTF) risk, with enhanced Customer Due Diligence measures applied to higher risk customers, such as PEPs.

The FATF Standards impose more stringent obligations on financial institutions where PEPs open up bank accounts (in opposition to the obligations imposed in the case of regular clients, who are not identified as PEPs). In addition to their normal due diligence obligations, financial institutions are required, by FATF recommendation 6, to:

- Have appropriate risk management systems in determining whether a customer is a PEP.
- Obtain senior management approval for establishing a business relationship with a PEP.
- Apply reasonable measures to determine the source of wealth and funds of a PEP.
- Implement enhanced ongoing monitoring of the business relationship with a PEP.

The purpose is to ensure that financial institutions are more knowledgeable about their potential PEP customers when deciding to accept them as customers, to provide increased surveillance of such customers, to prevent the institutions from being used to launder illicit proceeds, and to report such customers to the national Financial Intelligence Unit (FIU) when they engage in suspicious transactions.

The FATF Standards for PEPs should result in an increase in accountability of senior political figures, particularly since they also apply to the families and associates of PEPs, including companies beneficially owned or controlled by them. However, a fundamental weakness of the FATF Standards is that they only require enhanced due diligence obligations where *foreign* PEPs open up accounts; they do not impose enhanced due diligence obligations on domestic PEPs. This loophole has allowed corrupt governments to enact PEPs laws that do not apply to local politicians. Since the first stage of the money laundering process is frequently the placement of funds in a local financial institution, corrupt local politicians may not be detected at their most vulnerable point, when they enter the monies into the local financial system. It is important not to ignore the amount of illicit monies that corrupt politicians launder in their own jurisdiction.

However, article 52 of the United Nations Convention against Corruption (UNCAC) provides a basis for imposing AML requirements on domestic PEPs, since UNCAC makes no distinction between domestic and foreign PEPs. Thus the United Nations Office of Drugs and Crime and the World Bank consider that countries that implement UNCAC should consider applying their AML obligations to national PEPs (Greenberg, 2009A, 25-6). Although 144 countries have ratified UNCAC, only a small number of countries, such as Mexico and Singapore, have imposed legislative AML requirements on national PEPs. In some cases, this lacunae has been addressed by some multinational financial institutions which voluntarily enact policies requiring enhanced due diligence on both foreign and domestic PEPs.

Can international AML systems make current political leaders accountable?

Another big obstacle to strengthening the application of AML standards regarding PEPs is that these persons frequently enjoy a special status in their home jurisdiction. Armed with executive, legislative, judicial or military power, corrupt senior public figures have the capacity to undermine domestic AML systems. They may also avoid criminal investigation and prosecution in their home jurisdiction while they are in office because of their legal immunities. The effect of these privileges is compounded where PEPs have the capacity to compromise and corrupt the local judiciary.

Although politicians may enjoy immunities under local laws, it does not follow that a foreign country will recognise such immunities. For example, under the Nigerian Constitution the governors of Nigerian states enjoy immunity from prosecution while in office, but these immunities have no extraterritorial application. In several cases, the United Kingdom has prosecuted current Nigerian governors for corruption-related money laundering offences, in circumstances where there could be no prosecution in Nigeria (Chaikin and Sharman, 2009, 89-90). Legal immunities may have international consequences. For example, head of state immunity will usually prevent an existing head of state from being investigated for money laundering in a foreign country.

The above two paragraphs identify two separate weaknesses which have profound consequences. The first one refers to domestic power and privilege which is based on national law, while the second refers to immunities under international law. Both immunities may prevent the prosecution of corrupt leaders and the recovery of illicit assets. As mentioned above, national immunities are not usually recognised extraterritorially, while international immunities are part of international law viewed as necessary for the maintenance of peace. However, the widespread acceptance of AML laws is having an effect on international immunities, which have in the past prevented the freezing and seizure of assets. This is illustrated by the case in which the Swiss Federal Tribunal refused to unfreeze $84 million held in Swiss banks by the Kazakhstan government, despite Kazakh claims that the money was protected by the doctrine of sovereign immunity (see box on the next page). The significance of this case is that current senior political leaders cannot expect that they will enjoy automatic immunity when using foreign financial institutions. There is thus an opportunity for powerful political leaders to be held accountable for suspect funds which are held in foreign bank accounts and a significant increased risk of exposure of corrupt transactions.

The risk of criminal investigation and prosecution of corruption increases when a political leader departs from office. Former political leaders may be made accountable for their illicit conduct in several jurisdictions. Under international AML systems, the criminal offence of money laundering applies to the proceeds of predicate offences that take place in a foreign jurisdiction. Many states make it a criminal offence to launder the proceeds of foreign corruption. For example, in 2004 a US jury convicted former Ukrainian Prime Minister Pavlo Lazarenko of money laundering, corruption and fraud. US law allowed Lazarenko to be prosecuted for offences involving stolen property and extortion which had occurred in Ukraine. A critical factor

In 1999, a Geneva magistrate froze $84 million in bank accounts held by offshore corporations that were controlled by senior Kazakh officials. The US government alleged that the accounts contained illicit kickbacks sourced from multinational oil companies. Kazakh officials denounced the freezing order as a violation of sovereign immunity, arguing that the accounts were official government accounts opened on the basis of a government decree. The Federal Tribunal, Switzerland's highest court, ruled that 'funds held in a privately-owned offshore account, claimed by the head of state of Kazakhstan to be public money, could not be considered a priori to be state funds deposited for legitimate purposes'. This judicial decision precipitated negotiations between the Kazakh, Swiss and US governments, which ultimately resulted in the return of the monies to Kazakhstan to be used for development purposes under World Bank supervision (World Bank, 2008).

leading to a successful prosecution of Lazarenko was the voluminous evidence of his illicit conduct in Ukraine. The US prosecution was important because the "US government helped Ukraine enforce its own laws where Ukrainian courts had failed" (Spence, 2005, 1186). It also has a potential deterrent effect in that foreign public officials who launder corrupt proceeds in the US face risks of criminal arrest and prosecution, as well as seizure and confiscation of assets.

AML requirements have resulted in several cases where developed countries have identified foreign politicians and public servants as having substantial funds in bank accounts that benefit from secrecy features. For example, Switzerland alone has frozen assets of former Heads of State of several countries, such as Argentina, Peru, Ukraine, Kazakhstan, Ethiopia, Gabon, Haiti, Ivory Coast, Liberia, Mali, Nigeria, Zaire (now the Democratic Republic of Congo), Pakistan, Iraq and Philippines. Over the past 20 years, Switzerland has returned approximately US$1.6 billion of illicit PEP funds to developing countries (Gossin, 2007, 137). These examples highlight the importance of all countries improving their national AML systems and enforcement.

Overcoming obstacles to external accountability

International aid agencies can assist states in overcoming obstacles to external accountability:

Bank and corporate secrecy

Investigations into corruption-related money laundering have frequently been stymied by secrecy laws in international financial centres. Bank secrecy has been identified as the single biggest obstacle to international co-operation in criminal matters (US Senate 2008). Anti-money laundering requirements in the FATF Standards and the UNCAC are designed to remove secrecy as an obstacle. Indeed, the FATF Standards expressly provide that "financial institution secrecy laws do not inhibit implementation of the FATF Recommendations." Under UNCAC, financial institutions' secrecy laws may not be utilised as a ground for refusing to provide mutual legal assistance to foreign countries in corruption cases. Consequently, in theory bank secrecy should no longer be an insuperable obstacle to obtaining financial information in international money laundering cases involving corrupt proceeds (Chaikin and Sharman, 2009, 134-7). A related challenge is the lack of transparency of corporate ownership and control which facilitates the concealment of corrupt proceeds. FATF Recommendation 33 provides that "countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities." But this recommendation is more honoured in its breach than in its compliance. In some developing countries, corporate registry systems are so under-resourced that the basic infrastructure for complying with Recommendation 33 is absent.

There are a number of areas in which international aid agencies could provide assistance in tackling secrecy, and that will have positive effects on commerce, anti-corruption and anti-money laundering:

- Sponsoring technical studies to identify national bank, corporate or commercial secrecy laws that impede the investigation of corruption and money laundering, and encourage changes in law in accordance with the FATF Recommendations.
- Fund the creation of an effective government corporate registry infrastructure that not only efficiently collects information about registered companies as required by law but also has an enforcement capacity so that registries are updated.

Predicate offences, PEPs and money laundering

The Swiss and US experiences in dealing with foreign PEPs highlight the importance of all countries improving their national AML systems. In the absence of a level playing field in AML, money launderers will exploit differences in national laws and implementation to conceal their illicit assets. It was only after Switzerland created the offences of insider trading and organised crime that it was able to co-operate in cases of money laundering involving these offences. However, tax crimes continue to be problematic with most states refusing to include tax evasion as a predicate offence for money laundering (Chaikin 2009). Corruption, and in particular corruption of foreign PEPs, is another offence that many countries have not treated as a predicate offence.

International aid agencies should encourage states to:

- Harmonise the predicate crimes underlying the money laundering offence, and include all important financial crimes, including all corruption offences provided for in UNCAC.
- Strengthen national AML laws and policies so as to deter the introduction of illicit monies into the domestic financial system.
- Increase scrutiny on PEP's financial conduct, for example, by requiring also non-financial businesses and the professions (e.g. lawyers, accountants) to apply their AML rules to national PEPS.

Prosecution and forfeiture

Bringing corrupt politicians to account in their home jurisdictions is also difficult because of weak law enforcement institutions, including anti-corruption and anti-money

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laundering agencies. This obstacle may be rendered less significant if corrupt politicians face real risks of prosecution in foreign countries and the freezing and return of illicit assets to the victim country.[3] However, in order for a country to pursue foreign corrupt politicians for money laundering offences, it will be necessary to obtain evidence from the home jurisdiction of that politician. As mentioned before, it may be difficult to obtain such evidence in the case of current politicians who have the power to subvert the investigatory process.

There are a number of measures that may improve prosecutorial and forfeiture capacity:

- Strengthen the independence of AML and anti-corruption agencies and increasing their collaboration with similar agencies in other jurisdictions. This will improve their ability to collect evidence to be used in foreign criminal prosecutions and foreign forfeiture cases.
- Empower AML agencies, such as Financial Intelligence Units, to transmit financial intelligence to anti-corruption agencies so as to detect and investigate corruption. This may require changes in laws and practices.
- Encourage anti-corruption agencies to be more proactive, for example, cross-checking financial disclosures by senior public servants and politicians with data collected under AML. This greater integration of data will assist in the detection of breaches of anti-corruption laws.

The practical assistance that international aid agencies may give could include support to joint training exercises by AML and anti-corruption agencies.

Conclusions

The spread of international AML systems has created new opportunities for developed and developing countries to deter and detect corruption, and to recover illicit assets stored abroad. But so far, AML regimes have not been fully deployed to combat financial crimes such as corruption. It is important that national governments explicitly recognise and take concrete measures to improve their AML systems as a tool to combat corruption. Whereas previously, national public figures may have avoided any accountability for their corrupt behaviour, international AML systems may now be tapped to prosecute corrupt politicians in foreign countries and to recover illicit monies.

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Notes

1. Under the leadership of the Financial Action Task Force (FATF), a standard-setting body established by the G8, international AML standards have been agreed to by more than 180 countries. The FATF 40 Recommendations on Money Laundering and 9 Special Recommendations on Terrorist Financing, which are referred to as the FATF Standards, cover a wide range of legal and institutional matters.
2. ROSCs summarise the extent to which countries observe certain internationally recognised standards. These comprise accounting; auditing; anti-money laundering and countering the financing of terrorism (AML/CFT); banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation. They are used to help sharpen the institutions' policy discussions with national authorities, and in the private sector (including by rating agencies) for risk assessment. Short updates are produced regularly and new reports are produced every few years.
3. The enactment of non-conviction based asset forfeiture schemes may improve the prospects of asset recovery (Greenberg 2009B).