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U4 BRIEF

Profiting from corruption: The role and responsibility of financial institutions

This U4 Brief assesses how banks facilitate illicit capital flows from developing countries. The shortcomings of the existing regulatory frameworks are discussed, and recommendations are made for donor governments on what can be done to curb the flow of corrupt money out of the developing world.

Introduction

Why do donors prop up a country with aid if its revenues are flowing out the back door? Sustainable development can only be achieved when developing countries can rely on their own resources, rather than foreign aid. Hence, curbing illicit flows out of the poorest countries in the world, by building on existing anti-corruption and anti-money laundering frameworks, should be a key development priority.

In March 2009, Global Witness published the report *Undue Diligence: How banks do business with corrupt regimes*, which examines how some of the world's largest banks have facilitated corruption and state looting in natural resource-rich countries. This U4 Brief will draw on the case studies and analysis of *Undue Diligence* to assess the impact of banks' facilitation of corruption on poor countries. It will also discuss the shortcomings of the existing regulatory frameworks. The brief will offer recommendations for donor governments – many of which are also responsible for regulating the world's major financial centres – on what can be done to curb the flow of corrupt money out of the developing world.

For many of the world's developing countries, the greatest inflow of wealth is from natural resources. For example, in 2007, African exports of oil and minerals were worth $260 billion, roughly six times the amount of international aid of $43 billion (WTO 2007, 44; OECD 2008, 665). However, much of this wealth is being lost to corruption. Corruption exists not simply as the bribing of public officials – damaging as that is – but also as the wholesale theft of state assets.

Illicit capital flight out of the developing world is crippling the world's poorest countries and undermining the international efforts to eliminate poverty. These illicit financial flows are facilitated by global financial opacity, both in secrecy jurisdictions and in major financial centres. Loopholes in the international financial system and the complicity of financial institutions in the developed world create opportunities for illegal money transfers. As a result of the financial crisis, which was in part created by global financial opacity, governments are now starting to tackle these issues, particularly through the G20 process.

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How banks are complicit in corruption

Kleptocrats use the international financial system to launder the proceeds of corruption because the amounts stolen are often too large to simply hold in cash. The billions stolen by Mobutu Sese Seko of Zaire (now the Democratic Republic of Congo), Sani Abacha of Nigeria, and Augusto Pinochet of Chile are well known. However, corrupt politicians continue to abuse their positions to enrich themselves, facilitated by banks that are willing to take corrupt funds.

In money laundering jargon, senior public officials, their immediate family and close associates are known as "politically exposed persons" (PEPs). To say that someone is a PEP is not to say that they are corrupt, however. For example, every head of state is a PEP. But because of their position and potential access to state resources, PEPs are exposed to an increased corruption risk. PEPs can hold the power to influence the granting of government contracts or concessions, and therefore they are susceptible to bribery. Because of this, banks are required by anti-money laundering regulations to carry out extra checks on senior politicians and their family members, including identifying the source of their funds.

Despite a raft of anti-money laundering laws, some banks have continued to do business with corrupt regimes including those in the Republic of Congo, Equatorial Guinea, Gabon, Angola, Turkmenistan, and Liberia. These countries are rich in natural resources, yet the substantial revenues derived from these resources have been captured by small elites and used for their own benefit, robbing the countries of crucial funds needed for development and poverty alleviation. In the countries that Global Witness has investigated, this has created autocracy, conflict and sometimes even state failure (Global Witness 2009a).

The son of a president, oil revenues, and designer shopping

Denis Christel Sassou Nguesso is the son of the president of Republic of Congo, a West African state that earns at least $3 billion a year from its oil but where a third of the population does not live past the age of forty. He is responsible for marketing the state's oil.

Between 2004 and 2006, Denis Christel spent hundreds of thousands of dollars in luxury shops in Paris, Monaco, Hong Kong, and Marbella. His credit card bills were paid off from a bank account in Hong Kong that received the proceeds of Congolese oil (Global Witness 2009a).

Instead of being used to lift the people of Congo out of poverty, these funds sustained the lavish lifestyle of the president's son. Denis Christel's credit card bill for just one month, July 2005, came to $32,000. This could have paid for 80,000 Congolese babies to be vaccinated against measles, a major cause of child death in Congo.

> *"Christel's credit card bill for just one month could have paid for 80 000 babies to be vaccinated against measles"*

How did he do this? Global Witness has seen documents showing that Denis Christel set up a shell company called Long Beach in Anguilla, a British tax haven in the Caribbean. Denis Christel put his shares in Long Beach in a trust, which further disguised his ownership of it. He then opened a bank account for Long Beach with the Bank of East Asia in Hong Kong. Money derived from Congo's oil sales was paid into this account. Every month, the trust and company service provider that was fronting for him wrote to Bank of East Asia on Long Beach letterhead, instructing the bank to pay off Denis Christel's credit card bills.

Why was this possible? At present, banks have a duty to identify their customer and this includes finding out who is the beneficial owner of shell companies such as Long Beach. The beneficial owner is the person at the top of the chain of ownership, in this case Denis Christel. However, opacity in the financial system, and complex webs of shell companies, trusts and secrecy jurisdictions, can make it very difficult for banks to know exactly who they are dealing with.

In this particular case, however, Global Witness asked Bank of East Asia if it was aware that Long Beach was beneficially owned by the son of the President of the Republic of Congo. The bank said that it could not answer. It further stated that it could not comment on what checks it carried out on the Congolese oil revenues deposited in Long Beach's account to ensure that they were not the proceeds of corruption.

The letters instructing payments to the credit card name Denis Christel – so even if the bank had failed in its duty to identify the beneficial owner of the account, which we do not know, it certainly knew whose credit card bill it was being asked to pay. The letters were also stamped, presumably by the bank, "record of terrorists checked" (Global Witness 2009a, 57).

This means that the Bank of East Asia presumably ran Denis Christel's name through a list of terrorists, yet it seemingly failed to identify him as the son of the President of the Republic of Congo. The example demonstrates that the international campaign against terrorist financing has had some success: banks are now checking that their customers are not on the terrorist watch lists. However, there is no equivalent pressure on banks to ensure that they are not dealing with the proceeds of corruption.

This may soon change. In September 2009, the G20 called for stronger anti-money laundering standards to help curb the flow of the proceeds of corruption out of the developing world (G20 2009c). Such measures are long overdue. If the international donor community is serious about cracking down on corruption – which it appears to be, given the September G20 statement – it needs to make it much more difficult for corrupt politicians to hide their identity and stolen assets behind shell companies in secrecy jurisdictions.

Another president's son, fast cars, and the failure of international regulation

Because of its substantial oil revenues, Equatorial Guinea should be one of the richest countries in the world. However, the vast majority of the population live in poverty and since discovering oil in the 1990s the child mortality rate has actually increased (World Bank 2008).

In 2004, a US Senate inquiry exposed how Riggs, a venerable Washington bank, had being doing business with the corrupt regime of Equatorial Guinea. The inquiry uncovered numerous multi-million dollar transactions made out of Equatorial Guinea's oil accounts, which were under the personal control of the president. The inquiry made it clear that the Obiang family treated the country's oil revenues as their own personal property. The accounts were ordered closed and Riggs was forced to sell itself under humiliating circumstances and with great loss to shareholder value (Global Witness 2009b).

More than three years later, the British bank Barclays was still holding an account at its Paris branch for Teodorin Obiang, the president's son. An American bank had failed because it had held accounts for the Obiang family, yet a major European bank continued to do business with one of the family's most controversial members. Teodorin spends much of his time jetting around the world. In 2006, Global Witness revealed that he had bought a $35 million dollar mansion in Malibu, California. It would have taken Teodorin approximately 730 years to buy this property on his government salary of $4,000 a month as the Minister for Agriculture and Forests. In a South African court case relating to the seizure of other property, Teodorin stated that public officials in Equatorial Guinea are allowed to participate in joint ventures with foreign companies bidding for government contracts, and if successful, "a cabinet minister ends up with a sizeable part of the contract price in his bank account" (Global Witness 2009a, 8).

Teodorin also held accounts with BNP Paribas and CCF Banque Privée Internationale, owned by HSBC since 2000. Global Witness asked all the banks which held accounts for Teodorin what they could possibly have done to reassure themselves that the funds in Teodorin's accounts were not corrupt. They replied saying that they could not answer. To this day Teodorin has access to property and funds in the U.S. and elsewhere.

This case demonstrates, at a minimum, the need for greater international cooperation and information sharing to curb the abuse of the international financial system by corrupt politicians. More worryingly, it raises serious questions about how committed some of the world's largest banks are to turning down potentially corrupt funds.

The framework is already in place

The cases reviewed here show that despite a raft of anti-money laundering regulations, banks are still accepting these corrupt customers and their tainted funds. Why is this happening? Clearly, the existing international frameworks designed to prevent this are not working as effectively as possible.

The key way in which the international community seeks to prevent money laundering, including the proceeds of corruption, is through the Financial Action Task Force (FATF), an intergovernmental body with 32 members, plus associated regional bodies. FATF's membership includes most of the Organisation for Economic Co-operation and Development (OECD) countries, plus a number of financial centres. FATF sets the global anti-money laundering standards and conducts peer reviews, known as mutual evaluations, to monitor whether countries' anti-money laundering laws are in compliance with its recommendations. Its recommendations are not binding; instead they have force through political pressure and the threat of blacklisting.

During the late 1990s, FATF's recommendations, backed with the threat of sanctions for non-cooperative jurisdictions, ensured that the majority of countries in the world, including those who were not members of FATF, had basic anti-money laundering laws. In 2002, the IMF started conducting mutual evaluations which carry the same weight as FATF's. As a condition of doing this, the IMF demanded that FATF cease its relatively effective blacklisting process, as a number of IMF member states were in danger of being on the blacklist.

One of the key problems with FATF is that even its members are not fully compliant with its recommendations. For example, as of the last round of mutual evaluations, no country is fully compliant with Recommendation 6 that requires banks to do extra checks on senior politicians.

The other international framework with anti-money laundering provisions is the United Nations Convention against Corruption (UNCAC). UNCAC requires its signatory states to have a basic anti-money laundering regime, designed to "deter and detect all forms of money laundering" (United Nations 2003, 16). The Convention has a number of more specific provisions, including enhanced monitoring of high-value accounts held by senior politicians or their family members. UNCAC's anti-money laundering articles are similar to FATF's recommendations, although in some cases they are less detailed, or require a lower level of compliance. However, UNCAC's effectiveness at curbing money laundering is undermined by the failure of the States Parties thus far to agree to an effective review mechanism. FATF, in partnership with its associated regional bodies, has remained the primary vehicle for setting and measuring compliance with the global anti-money laundering framework, due to its detailed mutual evaluations process.

Other international organisations play a more tangential role in the fight against money laundering. For example, the OECD is working to increase transparency in secrecy jurisdictions. However, Global Witness and other NGOs argue that the OECD's standards are far too weak to adequately tackle this problem.

A movement for change

In April 2009, the G20 declared that "the era of banking secrecy is over" as it announced a crackdown on secrecy jurisdictions (G20 2009a). The G20 also agreed that "FATF should revise and reinvigorate the review process for assessing compliance by jurisdictions with [anti-money laundering and countering the financing of terrorism] standards" (G20 2009b). According to Global Witness, this has been interpreted by FATF as a call to renew the blacklisting process in some form. FATF is also examining its recommendations and the way they are assessed in time for the fourth round of mutual evaluations starting in 2010/2011.

In September 2009, the G20 called for FATF "to help detect and deter the proceeds of corruption by prioritising work to strengthen standards on customer due diligence, beneficial ownership and transparency" (G20 2009c). The statement may help to generate the political will needed if FATF is ever going to seriously tackle the flow of the proceeds of corruption out of the developing world. By singling out FATF, the G20 has ensured the organisation's survival as the primary international forum for combating money laundering. It is important that donor governments within FATF make the most of these opportunities.

The way forward

The cases of Denis Christel and Teodorin Obiang show how, despite an international anti-money laundering framework, banks are still willing to do business

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with corrupt politicians, thus aiding the looting of government revenues and keeping the world's poorest countries poor.

In the wake of the global financial crisis, however, there is a political appetite to reform the international financial system by imposing tougher regulation on banks. In many cases, governments that give substantial amounts of aid are also responsible for regulating the world's financial centres. This gives donor governments the opportunity to ensure that the banks which they regulate are not facilitating corruption in countries to which they are giving aid.

Recommendations

This U4 Brief suggests a number of recommended actions that donor governments can take to curb the crippling flow of dirty money out of the developing world:

General recommendations

Donor governments and agencies should recognise that illicit flows out of the developing world, including the proceeds of corruption, are a major hindrance to development. This is not simply about the looting of aid money, serious though that is. Corruption, facilitated by banks that are willing to take looted assets, destroys state revenues and seriously hinders sustainable development, and is thus a much bigger problem than the misappropriation of aid.

Illicit flows out of the developing world are a cross-ministerial issue for all governments. Development agencies should work with their counterparts in treasury, justice, foreign and trade ministries to coordinate their approach to this problem.

Donor agencies should help to develop recipient countries' capacities to investigate and prosecute money laundering offences. Such assistance should be combined with resources to help recipient countries recover the proceeds of corruption held overseas, including through submission of mutual legal assistance requests.

Specific recommendations on the financial system

The UNCAC could provide an effective global anti-corruption framework. However, without an effective review mechanism it remains toothless. A review mechanism would highlight which countries are falling to implement UNCAC's provisions and increase political pressure on them. State Parties must agree to an effective review mechanism.

Anti-money laundering laws that require banks to identify their customers and to turn down illicitly-acquired funds are failing to prevent banks from doing business with corrupt regimes. Governments should strengthen regulations to require banks to accept funds only if they have identified who controls the funds. Where a bank has identified that its customer is a senior public official, it should not accept funds if there is significant suspicion, either internal or public, that the source of funds may be illegal activities, including corruption.

Corrupt politicians can hide behind a web of tax havens, shell companies and trusts. The only way to ensure that these are not abused is transparency over ownership and control of corporate vehicles and other legal entities. Governments should publish an online registry of the beneficial ownership of companies and trusts.

Following the G20 statement in September 2009, member governments should use their position within FATF to make tackling corruption a priority and to ensure that FATF members comply with its standards. FATF should name and shame those jurisdictions, including its own members, who are not effectively implementing its standards. This is not just about having laws on the books, but about how those laws are enforced. Compliance with Recommendation 6, which requires banks to carry out extra checks on senior politicians and their family members, should be seen as an essential requirement to avoid being on any revived blacklist.

FATF should use the preparation for the fourth round of mutual evaluations to ensure that tackling corruption is a priority. This should be reflected in FATF's recommendations and in the way which compliance is measured. ■

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