The Role of Financial and Non-Financial Professionals in Facilitating Illicit Financial Flows

Charles Goredema

Research Consultant on Economic Crime in Africa

cgoredema233@gmail.com

A Summary of the Briefing

Context

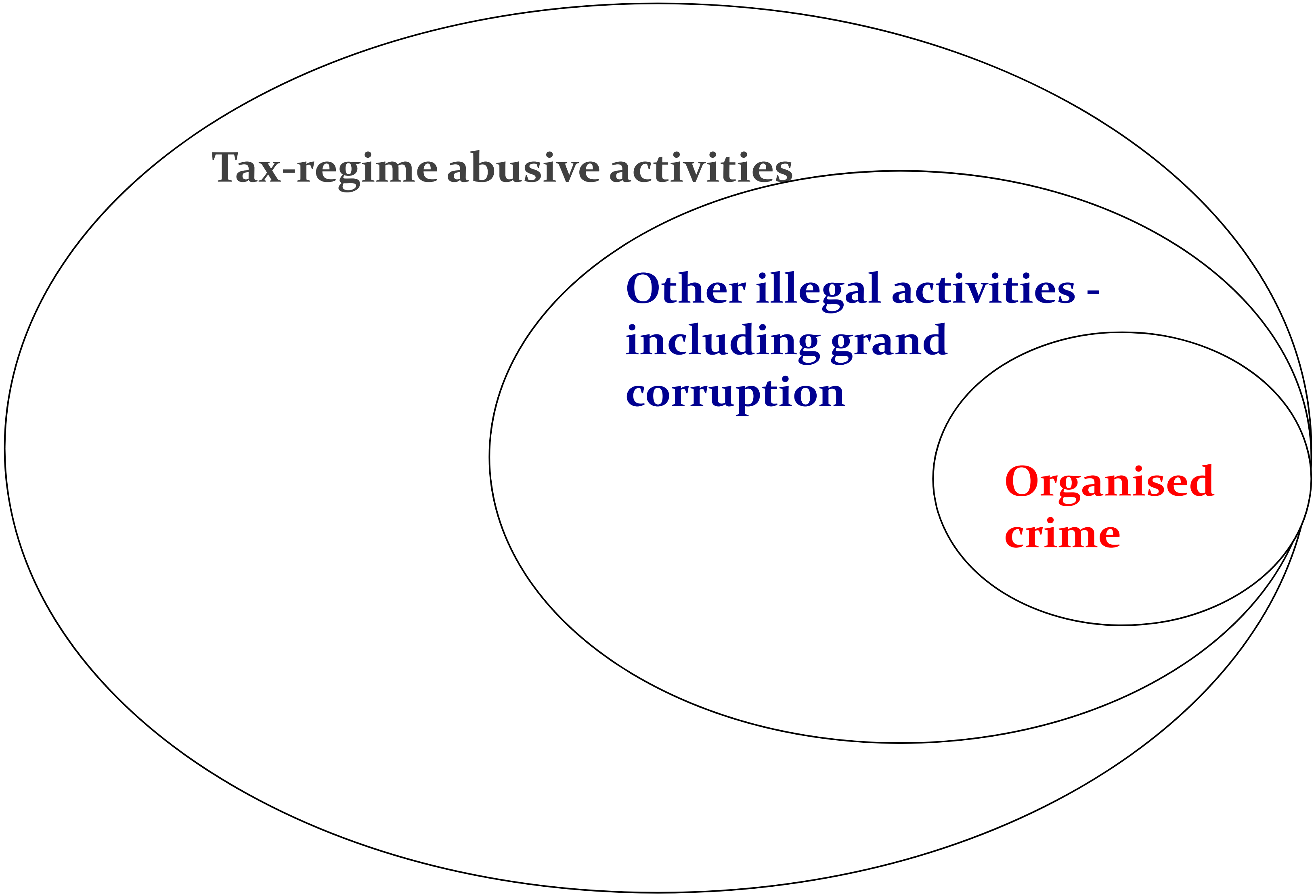
What are the issues?

Intermediaries and their role

Why intermediaries thrive

Towards a co-ordinated framework

Illicit Financial Flows: Underlying Sources



Context

- **Organised criminal activities** are estimated to contribute 35% to IFFs
- **Corruption and other forms of illicit enrichment** are estimated to contribute around 5% of IFFs
- **Commercial transactions involving multinational corporations** are estimated to contribute 60% to IFFs
- Most such transactions are intra-group, and entail the exchange of commodities and services at prices/costs that can be manipulated to facilitate income shifting and tax evasion

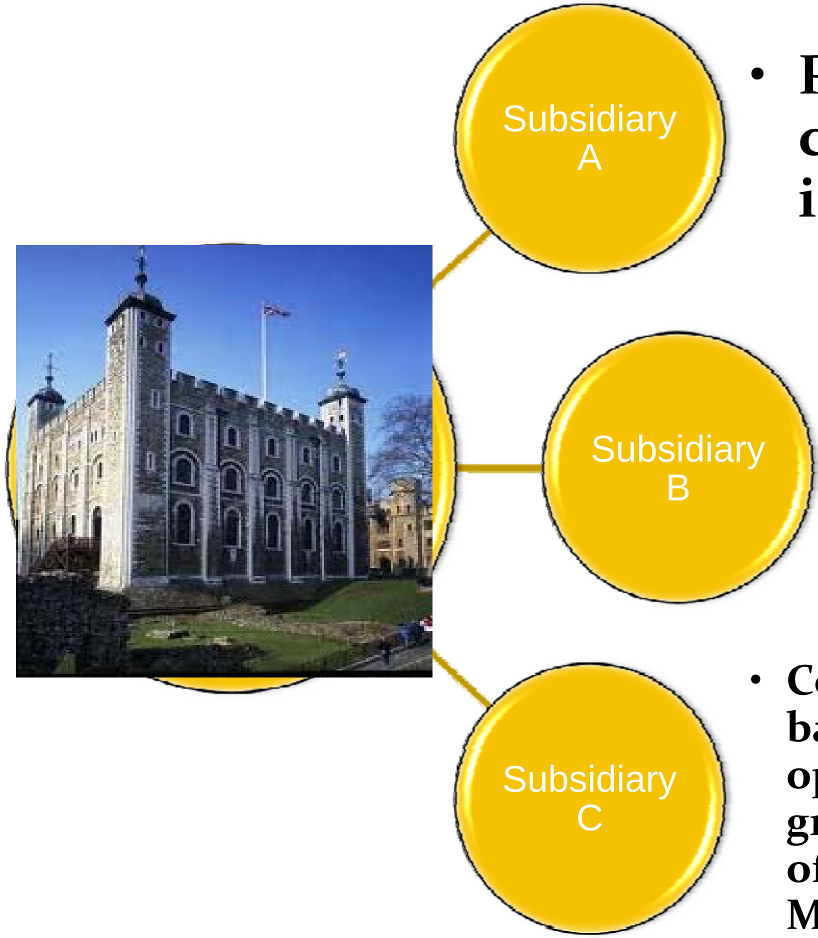
  Source: **GFI & AfDB -** *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009* (2013)

- More than 50% of international lending and about one-third of FDI is routed through international financial centres (secrecy jurisdictions)

Context

- International trade dominates most economies
- International trading transactions involve huge volumes, of commodities of various kinds that traverse vast geographical distances
- Corporations with a multi-national footprint are at the centre of the most important of such trading transactions
  - An estimated 500 MNCs control up to 60% of global trade
  - Some MNCs run budgets that are larger than many national budgets
  - Monopolies dominate certain sectors - e.g. minerals, energy, food & beverages and communications
- MNCs can structure themselves so as to disperse sources of income and the incidence of costs

The essence of transfer mispricing



- **Producing commodities in Country T**
  - **Providing management services to A, including brand registration but located in Country N**
- **Conducting banking operations for the group from offices in Country M**

The issues

- Identifying and tracking beneficial ownership of, and related party transactions within MNCs
- Matching ‘business footprint’ to tax contributions
  - Is information relevant to the calculation and collection of tax from international business transactions accessible to competent authorities?
- The contribution of professional intermediaries to tax derived illicit financial flows
- How can tax derived illicit financial flows be minimised?

Who are the Professionals involved?

Financial Intermediaries include –

- Financial institutions, notably bankers
- Investment advisers
- Insurers
- Estate agents,
- Forex dealers,
- Money remitters

Non-financial intermediaries include:

- Lawyers
- Trust & estate practitioners
- Dealers in precious metals

Multiple levels of intermediaries and consultants are frequently used to:

- Provide a useful conduit to commit acts of corruption while concealing the parties involved
- Create a false paper trail and channel illicit payments through multiple jurisdictions

***R v Sole* 2004 (2) SACR 599 (Les HC)**

Underlying environment in which intermediaries thrive

- Excessive red tape
- Punitive fees from government departments
- No infrastructural or funding support from the state
- Absence of co-ordination among state departments
- Embedded patronage systems, particularly in:
  - Political activity funding
  - Extractive resource exploitation sector

- Source: http://www.bulawayo24.com/index-id-business-sc-economy-

Typologies of Transgression

Four possible scenarios:

1. Where the intermediary institution involved is a corrupt one from inception. The originators set out to use it as a vehicle to conceal tax evasion or to convert proceeds of crime.
2. Where the institution becomes corrupted by changes in ownership or changes in the economic/regulatory environment subsequent to its establishment.

Typologies of Transgression

3. Where the institution has ‘willing or rogue employees who provide (money laundering) services on an *ad hoc* basis within its ranks. The management is not corrupted, but corrupt insiders abuse the institution.

4. Where the institution facilitates money laundering transactions unwittingly, either because it does not have mechanisms to detect money laundering or because of dereliction in applying existing mechanisms.

Source: Peter Reuter & Edwin Truman, *Chasing Dirty Money: The Fight Against Money Laundering* ([illegible]) IIE

The challenges

The critical issues are

- Who must monitor the ownership and conduct of intermediaries?
- How must intermediaries be monitored?
- Who has the capacity to act in the event of transgression?

In a nutshell……

- The most problematic cases have trans-border dimensions
- Effectiveness of responses depends on maximum inter-state cooperation
- Competing imperatives create disparities in prioritisation:
  - To keep entry and exit channels of financial pipelines relatively free, open and confidential
  - To monitor these points as the optimal stages at which to detect illicit funds
- Lack of institutional and administrative capacity to effectively implement existing measures (equipment, personnel etc)
- Corruption

SUNSTANTIVE GLOBAL TREATIES

Integrated substantive & procedural international criminal law

BILATERAL & REGIONAL TREATIES

Facilitate the exchange of information and mutual assistance

NATIONAL INFRASTRUCTURE

Political will

Legislation

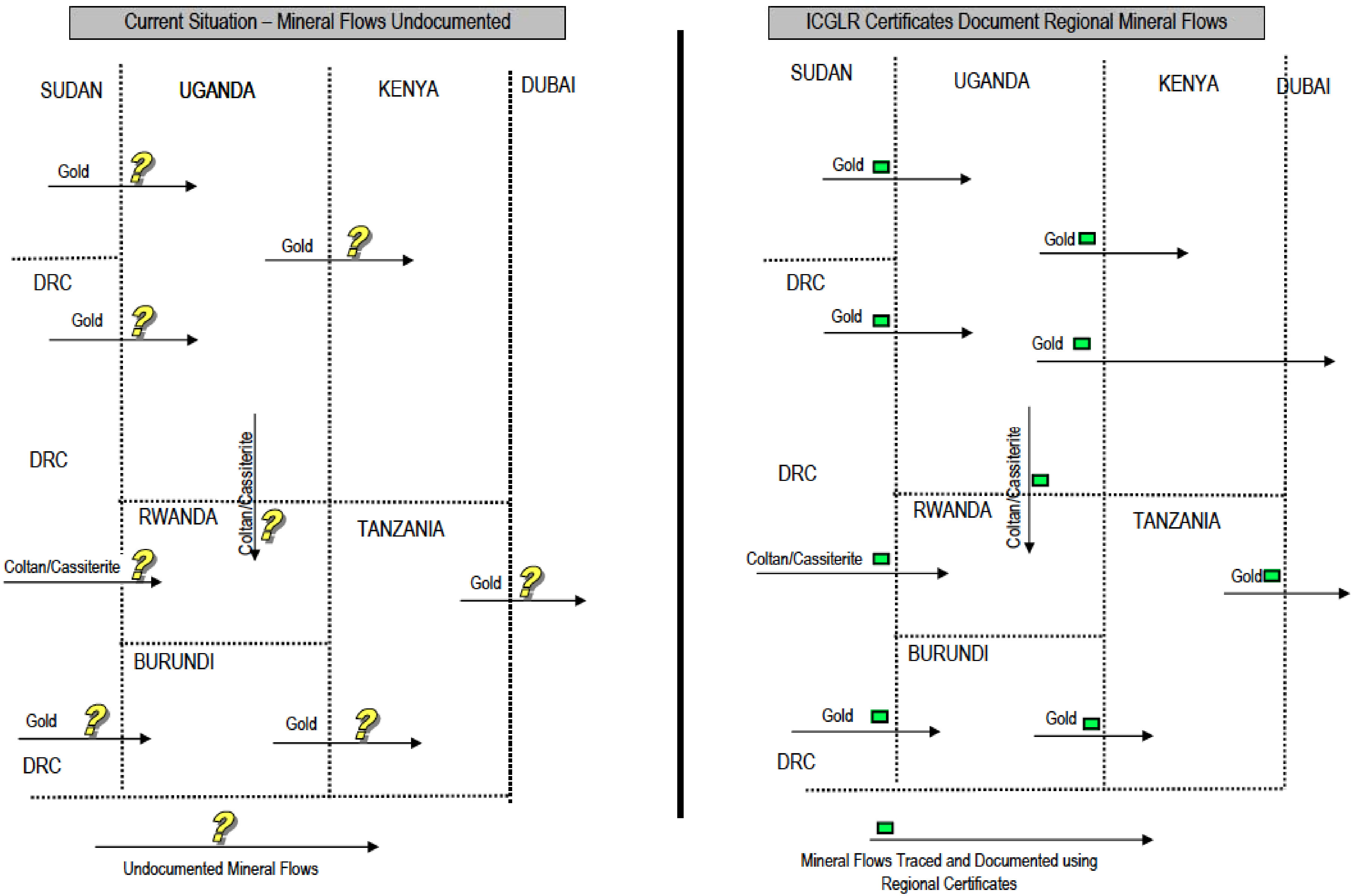
Competent mandated institutions

National Integrity Regime

Required spheres of interaction

The efficacy of the system hinges on:
Capacity of staff and information processing systems
Awareness and training of investigators, prosecutors, presiding officers

Figure 2: ICGLR Certificates – Carrying Information Across the Region



What can Law Enforcement do?

- Enforce the law less selectively and less sporadically
- Find and close the information gaps
- Foster cooperation, globally eventually, but initially among sectors relevant to illicit flows, and affected jurisdictions
  - Better co-ordinated public sector responses to illicit financial flows
  - Public-private partnerships against organised crime
- Criminalise racketeering and develop the necessary jurisprudential regime
- **Autonomy, technical expertise and resources**
- Support emerging global initiatives to reduce tax malpractices
  - In particular access to information on beneficial ownership