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Laundering the Proceeds of Corruption FATF Report • July 2011

In the past decade there has been increasing global attention on, and efforts made to combat, issues of corruption, or the “use of public office for private gain.” Most recently, problems of corruption and bribery in North Africa and the Middle East have dominated the world stage, with revelations that several former leaders have siphoned off billions of dollars worth of state funds. Whilst there clearly remains an ever present plethora of corrupt activities, there has also been continued progress made with the global anti-corruption (‘AC’) agenda, as evidenced by the 2010 G20 comprehensive AC action plan and the United Kingdom Bribery Act 2011.

In July 2011, the FATF published the typologies report ‘Laundering the Proceeds of Corruption’ which focuses on the methods used to launder the proceeds of corruption. The report highlights how the “fight against corruption is inextricably intertwined with that against money laundering; and that the stolen assets of a corrupt public official are useless unless they are placed, layered, and integrated into the global financial network.” The scope of the report is limited to the form of corruption known as “grand corruption”, which involves the political, decision-making levels of government using their official office to enrich themselves, their families, and their associates. The corrupt activities of Politically Exposed Persons (‘PEPs’), which are defined by the Financial Action Task Force (‘FATF’) as “individuals who are or have been entrusted

with prominent public functions in a foreign country”, are considered one of the largest categories of high-risk customers for money laundering purposes due to the very nature of their position and their access to significant public funds. Therefore the cases in the report cover a range of such PEPs, from senior legislators to governors to prime ministers and presidents involved in bribe-taking, kickbacks, embezzlement, and/or extortion.

As noted in the report, effectively combating corruption is significant due to its many negative and far reaching effects, including its contribution to increased levels of transnational crime, poverty, disease, and political instability; as well as its depressive effect on economic performance due to reductions in private investment and tax revenue. Additionally, corruption is often associated with the creation of an “unfavourable business environment” and capital flight. For example, in 2008 it is estimated that illicit financial flows of USD 1.26 to 1.44 trillion disappeared from poorer countries, with corruption playing an important role in this process.

Corruption: The global corruption problem and the AC framework

The global problem and impact of corruption is clearly vast and destructive; and as with other anti-money laundering (‘AML’) controls, AC efforts struggle to keep pace, detect, prevent and prosecute the myriad of complex 21st century forms of corruption.

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The global corruption problem

The report describes in detail the common methods used to launder the proceeds of grand corruption, the common features of grand corruption, and the vulnerabilities that lead to an increased risk of the laundering of the proceeds of corruption. These findings are briefly summarised below, providing a snapshot of the methods, features and particular vulnerabilities associated with grand corruption.

A. The most common methods used to launder the proceeds of grand corruption

The cases in the report reveal that the laundering of the proceeds of corruption can take a variety of forms, with the most prevalent forms outlined below:

1. **Bribe taking, or kickbacks**, occur when a private entity gives money to a PEP or associate, in exchange for some form of government concession, such as a contract or the right to extract resources from the state. For example, the former President of the Philippines Joseph Estrada received funds from gambling operators in exchange for their protection from arrest.
2. **Extortion** occurs when a corrupt PEP has a personal financial interest in the acts and decisions made in his official capacity; which then results in funds passing from the victim of extortion to the PEP. For example, the former Prime Minister of Ukraine Pavel Lazerenko, required entities wishing to do business in the Ukraine to split equally the profits of the enterprise in exchange for

his influence in making the business successful.

3. **Self-dealing and conflicts of interest** occurs when a PEP has a financial interest in an entity which does business with the state, and the PEP uses his position to ensure the state does business with the entity. For example, in a US State Department report, a West African PEP was responsible for selling the right to harvest timber from public lands whilst also owning the company awarded those rights.
4. **Embezzlement** from state funds occurs when a PEP siphons, for personal use, money belonging to the state. For example, the former President of Nigeria, Sani Abacha, directed his national security advisor to create and present false funding requests, the proceeds of which were then laundered for personal use.

B. The common features of grand corruption

The cases in the report highlight the following common features of grand corruption:

1. **Use of Corporate Vehicles and Trusts:** The cases show that PEPs are particularly likely to use such vehicles to launder the proceeds of their corrupt activities. As PEPs are often subject to public asset disclosure requirements and many other codes of conduct, these vehicles are one of the most effective ways to separate the origin of the illegal funds from the PEP controlling it.
2. **Use of gatekeepers:** Gatekeepers are individuals, such as legal and financial experts, that “protect the gates to the financial system”. Cases have shown that lawyers



The Global Corruption Problem, cont.

are often used to launder the proceeds of corruption by creating corporate vehicles, opening bank accounts, and using other means to avert AML controls (e.g. Haitian Duvalier case, Zambian Chiluba case).

- 3. Use of domestic financial institutions:** Historically, much of the focus has been on the risk posed by foreign PEPs laundering their proceeds through foreign bank accounts. However, cases also confirm that domestic PEPs present a substantial risk for corruption-related money laundering as well. Furthermore, both foreign and domestic PEPs use domestic financial institutions to launder their funds (e.g. Philippines Estrada case, Nigerian Dariye case).
- 4. Use of offshore/foreign jurisdictions:** In nearly every case, foreign bank accounts were used as part of the corruption-related money laundering scheme; with the illicit funds typically flowing from a developing country to financial institutions in more developed countries. Each additional country employed by the launderers in the corruption-related money laundering scheme has the effect of multiplying the complexity and length of the subsequent AML investigation, and reducing the likelihood of a successful prosecution.
- 5. Use of nominees:** The cases indicate that the use of trusted associates, or family members, as 'nominees' is a common feature in the facilitation of the corrupt activities of PEPs (e.g. Nicaraguan Aleman case).
- 6. Use of cash:** In a significant number of cases, the corrupt PEP wanted the laundered funds to be in the form of cash; the PEP was then able to place the cash without attracting undue attention.

C. Vulnerabilities leading to an increased risk of the laundering of the proceeds of corruption

The report highlights a number of circumstances which lead to an increased risk in the laundering of the proceeds of corruption:

- 1. Control over the state:** A corrupt PEP has sufficient control over the state to allow money, for example, to be embezzled; and then the PEP has the sufficient power to launder the money with impunity (e.g. Peruvian Fujimori case).
- 2. Financial institution capture:** A corrupt PEP may directly or beneficially own a financial institution, and then launder funds through the financial institution with impunity (e.g.

Peruvian Montesinos case).

- 3. Ineffective enhanced due diligence:** Despite FATF Recommendation 5 setting out the general Customer Due Diligence (CDD) requirements and Recommendation 6 requiring Enhanced Due Diligence (EDD) for foreign PEPs, in many of the cases the financial institutions involved failed to conduct the required due diligence to determine if they were dealing with a PEP (e.g. in the Abacha case USD 2-4 billion was embezzled; with the US, UK and Swiss authorities later determining that inadequate due diligence had been conducted by the financial institutions in each jurisdiction).
- 4. Ineffective communication among states and financial institutions:** In many of the cases, the money was laundered using accounts in multiple jurisdictions, which were in turn being held by corporate entities registered in yet other jurisdictions (e.g. in the Abacha case money was held in 12 different jurisdictions). Furthermore, in all of the cases noted, there were no examples of a foreign Financial Intelligence Unit, regulator or law enforcement agency alerting the affected country of the corruption occurring. The report concludes that the scale, complexity and sophistication of the problem clearly requires better and more frequent communication among states.

The global AC framework

As noted in the report, the global AC framework includes the Merida Convention (United Nations Convention on Corruption), the Organisation for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the World Bank and United Nations Office on Drugs and Crime (UNODC) Stolen Asset Recovery Initiative ('StAR'), the Organisation of American States (OAS) Inter-American Convention Against Corruption, the Anti-Corruption Network for Eastern Europe and Central Asia (ACN), the Anti-Corruption Initiative for Asia-Pacific, and the Group of States against Corruption (GRECO).

In addition to the work of these international organisations, the report highlights that Non-Governmental Organisations, such as Global Witness and Transparency International, also play a significant and important role in reporting on global corruption, increasing awareness, and conducting research. Moreover, the report goes on to suggest that it would be helpful if in the future further study be conducted in the area of corruption, including in relation to red flag indicators;



identification, prevention and enforcement, particularly as it relates to AML; geographic and sector risk; asset recovery; and systemic or petty corruption.

The report further highlights how the prevention and detection of the proceeds of corruption is addressed by a broad range of the FATF 40+9 Recommendations (the standards for combating money laundering and terrorist financing). The report emphasises that whilst Recommendation 6, in relation to EDD for PEPs, is key to an effective AC regime, corruption-based money laundering also requires jurisdictions to effectively implement the following Recommendations:

- Recommendations 33 and 34 on transparency of legal persons and arrangements (corporate vehicles and trusts);
- Recommendations 26, 27 and 28 on competent authorities, their powers and resources;
- Special Recommendation IX on the use of cash couriers;

- Recommendation 12 on CDD and record-keeping (gatekeepers); and
- Recommendation 23 on regulation and supervision (the need for integrity within financial institutions themselves).

Conclusion

The corruption-related money laundering cases in the report show that corrupt PEPs use a variety of methods to launder illicit funds, viz. through corporate vehicles and trust companies; whilst also relying on the help of gatekeepers and nominees to facilitate the laundering. Furthermore, such PEPs clearly abuse their power to acquire state assets, control law enforcement, and capture banks. The cases highlight that when financial institutions fail to follow AML procedures, particularly CDD, it can give corrupt PEPs easy access to the global financial system. There is clearly a pressing need for the AML standards to be properly implemented by financial institutions, as well as stringent enforcement of the AML laws and regulations by the regulatory authorities or supervisors.

NAMLC Agency and Ministry Updates

Customs

During the third quarter of 2011, 2 currency seizures were made by the Joint Intelligence Unit (JIU) of HM Customs. On 17 July, \$6,700.00 was seized from a Bermudian at L. F. Wade Airport, and on 11 September \$3,039.00 was seized from an American at L. F. Wade Airport. Bermuda Customs continues to share information with the BPS, the FIA, US Customs and Border Protection, Canada Border Service Agency and relevant authorities in the Caribbean.

Bermuda Monetary Authority (BMA)

During the third quarter of 2011, the AML unit conducted one onsite examination on a licensed trust company; four onsite examinations on licensed investment business and one onsite examination on a bank. The onsite findings of the trust and investment industry groups continue to show the same trends as those onsite conducted in 2010, namely that industry does not understand the requirement to produce anti-money laundering and anti-terrorist financing (AML/ATF) risk-based policies and procedures.

The BMA has continued with its outreach programme, and during this quarter conducted one successful outreach seminar to investment businesses which focused on AML/ATF policies and procedures.

Financial Intelligence Agency (FIA)

A total of 82 Suspicious Activity Reports (SARs) were filed with the FIA in the third quarter of 2011, as compared to 56 filed during the same quarter of 2010. The majority of the SARs filed highlight the continuing trend of suspicious currency exchanges involving Bermuda dollars being exchanged for US dollars (USD). As an example, from July to September 2011 withdrawals of over \$1 million USD were reported to the FIA as suspicious activity. In this quarter, the FIA made 21 disclosures containing 47 SARs; with 17 of those disclosures made locally and the remaining four disclosed to overseas entities. This compares to eight disclosures relating to 19 SARs made during the third quarter of 2010. The FIA is engaging in continuous dialogue with its partners to enhance the quality of the FIA disclosures, and the FIA continues to seek feedback regarding the quality of the information disseminated and the scope of the dissemination.

In keeping with the FIA's training and outreach mandate, the FIA, along with the Financial Crime Unit (FCU) of the Bermuda Police Service (BPS), hosted an officer from the Montserrat Financial Intelligence Unit. The officer was provided with an abbreviated version of the Tactical Analysis Class, and was also given a demonstration of GoAML.



At the 19th Egmont Group Plenary held in Armenia, the FIA director was selected as the English speaking representative of the 33 jurisdictions within the Americas group. As a result, FIA Bermuda now has a seat on the Egmont Committee and will represent that body as an observer at the CFATF Plenaries and ministerial meetings. FIA Bermuda participated in many projects within the Egmont Training and Legal working groups, including the review of FATF Recommendations 26 and 40, the Donors and Providers Contact Group, and the creation of the Advanced Tactical Analysis Class.

Ministry of Finance

Bermuda signed three Tax Information Exchange Agreements (TIEAs) from July to September 2011 — with the Czech Republic, the Republic of Argentina and the Republic of South Africa; bringing the total number of signed TIEAs to 29.

Department of Public Prosecutions (DPP)

The DPP successfully applied for a total of \$32,707.94 to be forfeited and deposited into the Confiscated Assets Fund in the third quarter of 2011. Furthermore, there are currently two money laundering trials pending before the Supreme Court of Bermuda, with a total of seven defendants.

The Department of Public Prosecutions' Specialist Section continues to work closely with law enforcement in providing advice and assistance in matters relating to the proceeds of crime; and during this quarter drafted two requests for assistance to the USA in an ongoing money laundering investigation.



The Bermuda Police Service (BPS)

During the third quarter of 2011, there were three new seizures including the first under the new 'street seizures' provisions of section 50 of the Proceeds of Crime Act 1997. The Financial Crime Unit (FCU) of the BPS also assisted in the investigation and arrest of a number of Bermuda subjects involved in the importation of large amounts of drugs and ammunition. Additionally, the FCU provided training to the following: i) Joint Intelligence Unit and HM Customs personnel on the cash seizure provisions; ii) the Bermuda Bar Association on cyber fraud prevention; and iii) the HSBC Compliance Department on AML. The FCU also provided a three-week training programme to an FIU officer from Montserrat. The FCU completed two overseas requests for information on behalf of the Attorney General's Chambers.

Office of NAMLC

During the third quarter of 2011, the NAMLC Chair Ms. Lister, in her role as Chair of the CFATF Financial Advisory Group (FAG), presented a paper, which was part of the initiatives to enhance the operation of the organisation, at the Special Ministerial Council Meeting held in Miami. As the Chair of the CFATF Working Group on FATF Initiatives (WGFI), Ms. Lister also attended the meetings relating to the updating of the FATF Standards, FATF's Expert Group A, and the Working Group on Evaluation and Implementation (WGEl), which were held in Rome. Additionally, the Chair presented to industry on the FATF's second consultation paper on the proposed updates to the FATF Standards, highlighting the potential impact on Bermuda's AML/ATF framework.

The Chair and Senior Legal Counsel, Ms. Foggo, met with the AML/ATF Supervisor for the professional firms for the Bermuda Bar/Institute of Chartered Accountants Board (ICAB) Supervisory Board. A timetable was agreed for key actions to culminate in a proposed 1 January 2012 commencement date for bringing the relevant firms into scope. Also during this quarter the Office partnered with the BPS, which involved Ms. Foggo, meeting with an officer seconded from Montserrat and an Officer of the FCU to provide an overview of Bermuda's AML/ATF Regime.

The Office of NAMLC continued to play a key role in the updating of the Bermuda Sanctions Regime, and provided assistance to Government House, the UK Foreign and Commonwealth Office (FCO) and the Ministry of Justice in respect of key overseas territories orders in relation to Libya, Tunisia, Syria, Egypt, and Belarus.

Global and Regional News



GLOBAL NEWS

Israel Signs Letters of Intent with Financial Intelligence Units

The Israel Money Laundering and Terror Financing Prohibition



Authority (IMPA) signed letters of intent with the financial intelligence units (FIUs) of the US, India and Albania at the 19th Egmont Group Plenary

held in Armenia from 11–15 July 2011.

IMPA has already signed letters of intent with the FIUs of Australia, Angola, Argentina, Belgium, Canada, Croatia, Cyprus, Denmark, Finland, Georgia, Luxembourg, Romania, Russia, and South Africa. The letters of intent enable IMPA to work jointly with these countries to improve their intelligence and enforcement capabilities, while also creating global standards for financial information security.

Sri Lankan Parliament Approved Two Key Amendment Bills

On 21 September 2011, the Sri Lankan Parliament passed amendments to the Prevention of Money Laundering Act (PMLA) No. 5 2006 and Convention on the Suppression of Terrorist Financial Act (CSTFA) No. 25 of 2005.

The amendments will strengthen the AML/CFT regime in line with the international standards, and will also assist with the implementation of AML/CFT initiatives undertaken by the Financial Intelligence Unit, law enforcement agencies and prosecutors.

Nepal finalised five-year AML-CFT Strategic Plan

Nepal's Department of Money Laundering Investigation has finalised a five-year Anti-Money Laundering and Combating the Financing of Terrorism (AML-CFT) strategic and action plan. The AML-CFT plan focuses on improving Nepal's money laundering and terrorist financing framework, and ensuring the necessary mechanisms for international assistance and cooperation are in place.



REGIONAL NEWS

Grenada committed to developing further strategies to curb terrorist financing

On 18 September 2011, the Grenadan Minister of Foreign Affairs, Karl Hood, told a high level United Nations Symposium on International Counter-Terrorism Cooperation that although Grenada currently plays a role in counter-terrorism initiatives, there is still a need for the development of further strategies to curb terrorist financing.

Speaking in his capacity as Chair of the Inter-American Committee Against Terrorism (CICTE), the sole counter-terrorism hemispheric body comprising all the independent nations of the Americas, Minister Hood said that despite the difficulties in combating terrorist financing "...we must find avenues to address the problem at its core, by meeting the social and human needs of young persons and minimising the spread of the ideological concepts that drive terrorist activities."

Minister Hood also emphasised the need for global intelligence linkages among partnering states for the sharing of real time intelligence, and re-iterated Grenada's commitment to continuing to partner with small and developing states to prevent safe havens and avenues for terrorists.



Organization of American States

Saint Lucia steps up legislation to deal with money laundering

The Saint Lucian Ministry of Justice and the Attorney General's Chambers are working to implement the international standards on money laundering and terrorism financing. In a government press release, the Attorney General, Arana Francis, QC, highlighted the strides Saint Lucia is making to comply with the Financial Action Task Force's (FATF) policies and the efforts being made to bring the national system into compliance with the 40 + 9 Recommendations.

Upcoming AML/CFT and Related Training Opportunities

MoneyLaundering.com 17th Annual International Anti-Money Laundering Conference (ACAMS, Association Sponsor)

19–21 March 2012 • Hollywood, Florida • <http://moneylaunderingconference.com/2012/default.asp>

Caribbean Regional Compliance Association Conference

1–2 March 2012 • Port of Spain, Trinidad and Tobago • www.crcaconference.com

we are on the web

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