



FATF Report

Laundrying the Proceeds of Corruption

July 2011



THE FINANCIAL ACTION TASK FORCE (FATF)

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 and terrorist financing. Recommendations issued by the FATF define criminal justice and regulatory measures that should be implemented to counter this problem. These Recommendations also include international co-operation and preventive measures to be taken by financial institutions and others such as casinos, real estate dealers, lawyers and accountants. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

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1. INTRODUCTION

1. This typology originates from a practitioners' understanding that the fight against corruption is inextricably intertwined with that against money laundering; that the stolen assets of a corrupt public official are useless unless they are placed, layered, and integrated into the global financial network in a manner that does not raise suspicion. In some ways, a public official (known as a politically exposed person, or "PEP")¹ who gathers vast sums of money through corrupt means is far more vulnerable than some other criminals. A narcotics trafficker may reliably depend on being able to remain anonymous with his vast amount of money; a public official begins to draw unwanted attention as soon as he is associated with significant sums from unknown sources. Thus, the corrupt PEP's vulnerability presents an opportunity for those authorities engaged in both anti-money laundering/combating the financing of terrorism (AML/CFT) and anti-corruption (AC) enforcement.

2. This typology differs from other such typologies previously produced by the Financial Action Task Force (FATF) because it draws from publicly available work undertaken by experts. The body of work the project team analyzed represents deep AML expertise possessed by individuals and organisations around the globe. Indeed, the objective was to understand these works to draw conclusions from them. Broadly stated, the goal was to stand on the shoulders of others in order to better understand corruption, its mechanisms and vulnerabilities, through an AML/CFT lens.

Scope

3. Part of the mandate of the Working Group on Typologies (WGTYP) is to identify new threats and vulnerabilities and conduct research on money laundering and terrorist financing methods and techniques. FATF typology reports typically reveal, describe, and explain the nature of ML/TF methods and threats, thus increasing global awareness and opportunities for earlier detection. In light of its mandate, the project team focused only on the methods used to launder the proceeds of corruption. It does not attempt to describe the methods by which bribery and other corruption are effectuated, concealed, or discovered; such a discussion would be outside of the scope of this paper.

4. While there may be no internationally recognised legal definition of corruption, it is most commonly functionally defined as the use of public office for private gain. The United Nations,² the Organisation for Economic Co-Operation and Development (OECD),³ and the Council of Europe⁴ Conventions establish the offences for a range of corrupt behaviour. The conventions define

¹ The Glossary to the FATF 40+9 Recommendations describe PEPs as "individuals who are or have been entrusted with prominent public functions in a foreign country, for example heads of state, or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations [and] important political party officials ... The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories."

² United Nations (2004)

³ OECD (1997)

⁴ Council of Europe (1999)

international standards on the criminalisation of corruption by prescribing specific offences rather than through a generic definition or offense of corruption.⁵ The offenses can range from petty or systemic corruption, in which public officials or employees receive money to perform (or refrain from performing) official acts, to “grand corruption,” in which those at the political, decision-making levels of government use their office to enrich themselves, their families, and their associates.⁶

5. Because of time and resource limitations involved in this project, the project team restricted itself to an analysis of grand corruption. While there is no precise threshold -- by official rank or otherwise -- to distinguish grand from systemic corruption, the positions of the PEPs involved in the cases in our report ranged from senior legislators to governors to prime ministers and presidents. All of the cases examined involved behaviour that would constitute offenses falling under any of the relevant international AC conventions, as well as the generic definition described above. Where possible, the case studies identified the type of corrupt act from which the proceeds had been derived. The types of corruption involved bribe taking and kickbacks, of both foreign and domestic officials, but also embezzlement (in which money rightly belonging to the State was siphoned for personal use through a variety of means), extortion (in which the public official uses the threat of official power to receive money) and self dealing (in which the corrupt PEP has a personal financial interest in acts and decisions he makes in his official capacity).

Methodology

6. In conducting the analysis, the project team relied on case descriptions and analyses conducted by others. The touchstone in determining whether to include a case in this report was reliability. To assess this, the team considered the author of the analysis, the source of information, the availability of source documents, and finally, the purpose for which the analysis was conducted. Court opinions making factual findings on the details of a specific scheme, for example, were deemed to be highly reliable, as were documents prepared by law enforcement based on investigations. The project team also used case descriptions that clearly relied on firsthand source documents, such as some government reports and asset recovery lawsuits. As with other FATF typologies, a criminal conviction or official finding of culpability was not a requirement for inclusion, although in the vast majority of cases in the study that was the case. The purpose of including a case was not to draw conclusions about the culpability of the individuals involved; rather, it was to draw conclusions about the probable methods for laundering the proceeds of corruption.

7. The project team compiled the data according to those involved, including the countries involved, the level of the PEP, and the nature of the corrupt act. For every case, the project team looked for the presence of methods generally used for the laundering of money, such as corporate vehicles (a category considered to include shell companies and trusts), foreign financial institutions, a financial institution that had been compromised or “captured” by a PEP by gaining ownership or management control over it, or the use of nominees, close associates, family members, or the use of false identities. The team also gathered data on the role of gatekeepers – lawyers, accountants, corporate formation agents, and the like – in furthering these schemes. Lastly, the team looked to

⁵ OECD (2008)

⁶ U4, the anticorruption resource centre sponsored by a number of governments, defines grand corruption as that taking place at the policy formulation end of politics. “It refers not so much to the amount of money involved as to the level in which it takes place.” www.u4.no/document/faqs5.cfm#grandcorruption. Others use the same distinction: “Petty corruption is usually about getting routine procedure followed more quickly – or not followed at all. Grand corruption involved influencing decision-makers.” Moody-Stuart, George (1996).

determine whether cash, common in other money laundering schemes, was used to launder the proceeds of corruption.

8. In addition to the vehicles used to launder the proceeds of corruption, the team considered whether specific vulnerabilities in the global AML/CFT system had allowed such activity to take place.

9. The data collected is summarised in the “Grand Corruption Case Inventory” matrix appended to this report as Annex 1. It represents a summary of 32 grand corruption matters, from which the project team was able to draw conclusions regarding the nature of money laundering and corruption. The source documents for this inventory consist of thousands of pages of materials, including analysis and supporting documents. A list of the materials reviewed is contained in the bibliography attached to this report.

10. Several caveats should be made. First, the methodology required that data come from cases that have been investigated and prosecuted (or subject to an asset recovery suit), or for which there was otherwise reliable information. No typology can explore those cases in which the proceeds of the corrupt act was successfully kept from view, either because of the sophistication of the scheme or the inability of the relevant jurisdictions to detect and investigate it. Other patterns in the flow of funds in corruption cases may have not yet been detected, and consequently not reported. A related effect is that the methodology will inevitably skew the data toward over-representing jurisdictions that are more actively engaged in the detection, prosecution or asset recovery of corruption. Jurisdictions unable or unwilling to investigate corruption will be underrepresented. As a result, conclusions can only be tentative about the larger geographical patterns found in the flow of funds derived from corruption.

11. Additionally, this report includes estimates of the size of the corruption involved in each case. Such estimates are by their very nature an approximation; it is a rare case in which law enforcement can precisely identify and substantiate the volume of the theft. While such estimates are necessarily imprecise, the project team thought it useful to give these estimates for context purposes.

2. WHY A TYPOLOGY ON LAUNDERING THE PROCEEDS OF CORRUPTION?

12. The 2009 FATF Strategic Surveillance Survey noted that PEPs are considered to be one of the largest categories of high-risk customers for money laundering purposes. PEPs pose a high risk for money laundering by the very nature of their position; they have access to significant public funds and the knowledge and ability to control budgets, public companies and contracts. Corrupt PEPs may use that knowledge and ability to award contracts in return for personal financial reward, or simply to create structures to siphon money from government coffers. Countries have varying levels of governance, culture, and legal controls, that can influence the degree to which corruption is present.

A. Corruption and the economy

13. In addition to the significant effects that corruption has on transnational crimes, poverty, disease, and political instability, it can also have an effect on the economy. While this is not the place to discuss the relationship between economic effect and corruption in great detail, below is a brief overview of the economic effects of corruption and the results of a study on the economic effects of corruption.

14. While some economists have discussed whether corruption “greases or sands” the wheels of economic growth,⁷ empirical evidence suggests that the negative effects of corruption are stronger than any possible positive effects.⁸ Corruption hurts economic performance by reducing private investment, by adversely affecting the quantity and quality of public infrastructure, by reducing tax revenue, by resulting in a shallower and less efficient financial system,⁹ and by reducing human capital formation.¹⁰ In addition to these inefficiency effects, studies note that corruption can also have adverse distributional effects as it hurts the poor disproportionately. Countries with high levels of corruption achieve lower literacy rates, have higher mortality rates, and overall have worse human development outcomes. Corruption deepens poverty by reducing pro-poor public expenditures, by creating artificial shortages and congestion in public services, and by inducing a policy bias in favour of capital intensity, which perpetuates unemployment.

15. In addition, corruption is often associated with capital flight. Recent estimates of illicit financial flows estimate that USD 1.26 trillion to USD 1.44 trillion disappeared from poorer countries in 2008.¹¹ These numbers have increased and corruption plays a significant role in the illicit financial flows. In this way, capital flight that is connected to corruption constitutes a diversion of scarce resources away from domestic investment and other productive activities.

16. Studies posit a two-way relationship between corruption and economic development. First, corruption affects economic development. And secondly economic development also determines the

⁷ See Aidt, T (2009); Bardhan, P (1997); Pande, R (2008)

⁸ See Campos, Nauro, Dimova, Ralitzka, and Ahmad Saleh (2010)

⁹ Tresselt, Detragiache E. and Gupta P. (2005)

¹⁰ See Ndikumana, Léonce (2006)

¹¹ Greenberg T.S. *et al.* (2009), Kar D. and Curicio, C (2011). Approximately USD 50 billion of this is estimated to be the proceeds of corruption. See Baker, R.W. (2005), p. 172.

levels of corruption. The relationship between corruption and levels of economic development growth could also be represented by a vicious and virtuous cycle consisting of an additional element: institutions (governance, property rights, et cetera, including the AML regime). AML policies aimed at fighting corruption are thus a useful element in economic growth strategies.

17. There is also a strong correlation between corruption and income (GDP per capita). Richer countries have lower levels of corruption. Countries with the highest levels of corruption are developing countries and transition countries.¹²

18. The World Bank, in cooperation with the FIUs in Malawi (a low-income country) and Namibia (an upper-middle-income country), investigated the relation between corruption, money laundering (in the study referred to as ‘flows of ill-gotten money’) and economic development.¹³ A few elements were highlighted. First, corruption can be an important – the most important – source of ill-gotten money within a country. In both countries experts agreed that corruption is the largest source of ill-gotten money. Second, corruption was also widely seen as a major constraint for economic development, primarily because corruption brings about a diversion (“leakages”) of financial resources from the national budget to private spending purposes. These private expenses have in general much lower “multiplier effects” than expenses on for example education, agricultural fertilizers, health, and infrastructure.

19. The most prominent economic effect of corruption seems to be diversion of money from the government budget to expenses with lower multiplier effects. If money that is meant as an investment in economic development or poverty relief is diverted as result of embezzlement or other forms of public corruption towards private spending – it will in most cases incur a transfer towards expenditures with a lower multiplier effect, such as imported “Hummers” instead of medicines in the hospitals, or foreign fittings in newly built middle-class city mansions instead of school materials.

20. Indeed, many of the case studies that the project team collected recounted tales of munificent, obscene spending by PEPs from developing countries. In the asset recovery case mounted by Zambia, the court described the “cynical and unjustified” expenditures from stolen funds (moved through a shell company) to pay for the wardrobe of Frederick Titus Chiluba, then the President of Zambia. The court noted that the more than USD 1 million in payments to a single tailor was five times the total of the President’s salary for his ten years in office.¹⁴ The US Senate and, separately, the NGO Global Witness recounted in great detail the expenditures of another PEP from a West African country – a country with a per capita income that ranks as one of the highest in the world, yet 77% of whose population lives in poverty – spending millions on personal luxuries, including dozens of exotic automobiles. This included, in 2004, a single two-day period in which the PEP made payments of USD 80 000 to Gucci and USD 51 000 to Dolce & Gabbana, and a 2003 Paris-based shopping spree in which the PEP bought 30 designer suits.¹⁵ These types of expenditures do nothing to assist the economies of the countries involved, and represent the most visible symbol of the effects of corruption.

¹² See Svensson, Jakob (2005). However, corruption still varies across countries within the same income category. Svensson found a strong correlation between corruption and a) income (real GDP per capita); b) levels of education (years of schooling) c) openness (imports of goods and services as % of GDP); d) market freedom (number of business days to obtain legal status); and e) political freedom (freedom of media index).

¹³ Based on forthcoming World Bank report ‘Ill-gotten money and the economy’ (due in September 2011).

¹⁴ Attorney General of Zambia v. Meer Care, *et al*, (2007)

¹⁵ Permanent Subcommittee on Investigations (2010); Global Witness (2009a)

21. Corruption leads to a cascading series of public governance issues: it increases the tax burden and reduces services for those affected, lessens the impact of developmental assistance and undermines the confidence in the government and political structures in the affected country. It is no coincidence that the jurisdictions perceived to be the most corrupt are also the poorest, and that there is a positive correlation between corruption and the risk of becoming a failed state. To address this, the World Bank, the Inter-American Development Bank and the Asian Development Bank have only recently agreed to debar firms and individuals found guilty of corrupt practices.

22. Another effect from the perspective of the business community is that corruption presents an administrative and financial burden on firms. According to the World Bank's Enterprise Survey of Malawi in 2009, "corruption creates an unfavourable business environment by undermining the operational efficiency of firms and raising the costs and risks associated with doing business."¹⁶

B. Recent attention on corruption

23. Apart from the underlying economic rationale to take a closer look at corruption, a typologies study on corruption is also timely. In recent months the issue of corruption, and hunting for the proceeds of corruption, have been receiving worldwide attention. For example, following the regime changes in Egypt and Tunisia, the unrest in Libya and the removal of the President of Ivory Coast, in the first few months of 2011 financial centres all across the world have been quick to respond by freezing assets suspected to be illegally acquired. In addition the UN Security Council, in UNSCR 1970 and 1973, imposed an asset freeze on the assets of the Libyan leader, Muammar Ghaddafi, his entourage, several Libyan financial institutions, and the Libyan National Oil company. A complete list of the actions taken is contained in Annex 2.

24. Likewise, the G20 has ensured that corruption is at the forefront of a multilateral AC effort. In Pittsburgh in September 2009, the G20 called upon the FATF to "to help detect and deter the proceeds of corruption by prioritizing work to strengthen standards on customer due diligence, beneficial ownership and transparency." The G20's agenda is built around three pillars: (1) a common approach to building an effective global anti-corruption regime, the principles of which are enshrined in the provisions of the UNCAC; (2) specific commitments to show collective leadership by taking action in high priority areas that affect economies; and (3) a commitment to directly engage private sector stakeholders in the development and implementation of innovative and cooperative practices in support of a clean business environment. The G20 published a comprehensive AC action plan as an annex to the Leaders' Statement held in Seoul in 2010, and as part of a broad agenda to combat corruption, once again called upon FATF to continue to emphasise its AC agenda.¹⁷ In response, the FATF developed a paper outlining efforts by FATF to combat corruption. The FATF Corruption Information Note was developed to raise public awareness of how the effective implementation of FATF Recommendations, which are the global AML/CFT standards, help to combat corruption.¹⁸

25. Lastly, non-governmental organisations (NGOs) play an important role in reporting about global corruption, increasing awareness of the extent and impact of corruption, and conducting research and analysis about causes and potential solutions. For example, Transparency International has developed certain corruption measurement tools, which it uses to prepare global and country-specific reports, along with toolkits, working papers, policy positions and expert answers relating to

¹⁶ World Bank (2009)

¹⁷ G20 (2010)

¹⁸ FATF (2010a)

various aspects of corruption. Each year it publishes the *Global Corruption Report*,¹⁹ reporting on the state of corruption throughout the world and providing an in-depth look on a different corruption-related issue. Similar efforts by NGOs such as Global Integrity²⁰ and the World Justice Project's Rule of Law Index involve detailed statistical and socio-economic analysis of a country's legal framework and its effectiveness.²¹

26. Global Witness, an NGO that campaigns against natural resource-related corruption and conflict, prepares evidence-based case studies, such as *Undue Diligence: how banks do business with corrupt regimes*.²² This report analyzes how the banking sector facilitates corruption by doing business with suspicious customers in corrupt states and provides recommendations to prevent the use of banks to launder the proceeds of corruption. In addition, Global Financial Integrity conducts research and promotes policy changes and national and multilateral agreements that will curtail the flow of the proceeds of corruption. Its recent report *Illicit Financial Flows From Developing Countries: 2000 to 2009*²³ uses data to estimate the quantity and patterns of illicit financial flows coming out of developing countries. Finally, the U4 Anticorruption Resource Centre, a group established by a number of governments to assist in corruption challenges as it relates to developmental assistance, has published a number of useful issue papers and briefs.²⁴ While material published by these NGOs usefully analyze the issues involved in the laundering of the proceeds of corruption, for purposes of this typology they played a secondary role to the reports and analyses issued by governments, multilateral bodies, and courts.

C. Other initiatives and studies analyzing and reviewing the investigation and prosecution of corruption.

27. A number of governments, multilateral bodies and NGOs are engaged in AC studies. The project team reviewed material relevant to this report, both to obtain the case studies and to understand the underlying policy issues involved. The project team acknowledges its debt to those who have conducted these analyses.

1. The global anticorruption framework

28. In the policy arena, a number of institutions have been involved in the discussion concerning corruption and money laundering, and has published a number of works, providing analysis and advice to the public and private sector since 2004. The World Bank and United Nations Office on Drugs and Crime (UNODC) launched the Stolen Asset Recovery Initiative (StAR) in 2007. StAR works with developing countries and financial centres to prevent the laundering of the proceeds of corruption and to facilitate more systematic and timely return of the proceeds of corruption. StAR also produces papers, advocates for global collective action, and works with stakeholders to foster action in the deterrence, detection and recovery of stolen assets.

29. One such paper produced by StAR is *Politically Exposed Persons, A Policy Paper on Strengthening Preventive Measures*.²⁵ Further, StAR is preparing to launch the International Asset

¹⁹ Transparency International (2011)

²⁰ www.globalintegrity.org

²¹ World Justice Project (2011)

²² Global Witness (2009b)

²³ Global Financial Integrity (2011)

²⁴ www.u4.no/index.cfm

²⁵ Greenberg, T.S., *et al* (2009)

Recovery Case Database, an indexed summary of international cases that will assist in research and analysis of asset recovery cases.

30. The United Nations Office on Drugs and Crime (UNODC) is responsible for assisting its member states in the implementation of the UNCAC and promotes an anti-corruption agenda by providing technical assistance and resource materials. The UNCAC provisions, which are largely mandatory for party states, cover five main areas: prevention, criminalisation and law enforcement measures, international cooperation, asset recovery, and technical assistance and information exchange. Additionally, one chapter, significant for those in the battle to recover assets, deals with the recovery of assets, a major concern for countries that pursue the assets of former leaders and other officials accused or found to have engaged in corruption. Member states have also committed to a mutual evaluation process, which UNODC is responsible for implementing.

31. The Inter-American Convention against Corruption, adopted in March 1996 by the Organization of American States, was one of the first multilateral anticorruption agreements. Its purpose is to strengthen legal mechanisms and to promote cooperation among signatories in the areas of detecting, preventing, and deterring corruption. It supports implementation efforts through the Mechanism for Follow-Up on the Implementation of the Inter-American Convention against Corruption (MESICIC), through a process of reciprocal evaluations.

32. The Anti-Corruption Network for Eastern Europe and Central Asia (ACN) is one of the outreach programmes of the OECD Working Group on Bribery established in 1998. It involves 23 countries in the region, as well as OECD member-states, international organisations, civil society and business representatives. Over the past 12 years, the ACN has been the main vehicle for sharing OECD experience in the area of prevention and fight against corruption and promoting anticorruption reforms in this region. In 2003 the ACN launched a special anti-bribery programme for the ex-soviet countries – the Istanbul Anti-Corruption Action Plan which applies the OECD methods of peer review. The evaluation process among other things looks into anti-money laundering aspects of the enforcement action to combat corruption. In addition, the ACN carries out thematic peer learning with a component on strengthening capacity for effective investigation and prosecution of corruption. The training seminar which will cover the issue of links between corruption and money laundering, including typologies for laundering of the corruption proceeds, will be organised in Kyiv, Ukraine in June 2011.²⁶

33. The OECD Working Group on Bribery in International Business Transactions, as the monitoring mechanism and States Parties to the OECD Anti-Bribery Convention, has routinely examined certain elements of the AML framework in the 38 States that are parties to the Convention. The offence of bribery of foreign public officials must be a predicate offence to money laundering, if it is a predicate offence for domestic bribery, in accordance with Article 7 of the Convention. The Working Group's monitoring process includes examining cases of bribery of foreign public officials that have been detected by FIUs in the context of AML frameworks, along with measures taken by countries to identify and confiscate the instrument and proceeds of bribery of foreign public officials. To date, according to enforcement data published by the Working Group, 199 individuals and 91 entities have been sanctioned under criminal proceedings for foreign bribery in 13 party states to the Convention.

34. In 1999, governments in the Asia-Pacific region launched the Anti-Corruption Initiative for Asia-Pacific under the joint leadership of the Asian Development Bank (ADB) and the Organisation

²⁶ More information can be found at www.oecd.org/corruption/acn

for Economic Co-operation and Development (OECD). Under this initiative, 28 countries and economies of the Asia-Pacific region have committed to action against corruption: they have jointly developed the Anti-Corruption Action Plan for Asia and the Pacific and work together towards its implementation. The Action Plan sets out the goals and standards for sustainable safeguards against corruption in the economic, political and social spheres of the countries in the region. The Initiative supports the member governments' efforts through fostering policy dialogue, providing policy analysis, and capacity building. The ADB/OECD has produced a substantial body of work relating to corruption.²⁷ The ADB/OECD 2007 Regional Seminar on Making International Anti-Corruption Standards Operational produced a series of articles and case studies that were especially valuable to the project team.²⁸

35. The Council of Europe adopted between 1997 and 2003 a series of international instruments,²⁹ including Resolution 97(24) on the twenty guiding principles for the fight against corruption, and the Criminal Law Convention on Corruption which require *inter alia* to adopt measures for the seizure and deprivation of the proceeds of corruption offences, to interlink anti-corruption and anti-money laundering efforts, to prevent legal persons being used to shield corruption offences. The various instruments follow a global and comprehensive approach (in particular, they make no distinction between domestic, foreign and international bribery when it comes to bribe-takers). Also, they all are subject to monitoring by the Group of States against Corruption (GRECO),³⁰ which was established in 1999 as a mutual evaluation and peer pressure mechanism (it is currently composed of the 47 Council of Europe member States, Belarus and the United States). The implementation of recommendations for improvements is examined through a specific compliance procedure. To date, 45 countries have been evaluated in the context of the Second Evaluation Round on the above-mentioned requirements and a number of improvements have been recommended as regards for instance the legal framework and practices on financial investigations and confiscation / temporary measures, the actual contribution of the AML preventive mechanisms to the detection of corruption (*e.g.*, need for guidance and training on the recognition of corruption-related money laundering), access to financial information, the adequacy of registration mechanisms and supervision of legal persons etc.

36. GRECO's mandate does not include typologies but a certain amount of pertinent information on characteristics of corruption and money laundering is available in the evaluation reports. It would also appear that quite often, statistics on convictions and proceedings concerning corruption give only a limited and partial image of the countries' efforts in this area since criminal law bodies use other – non-corruption related – criminal law provisions which are easier to apply (breach of trust, abuse of office, misuse of corporate assets etc.); these do not always entail all the legal consequences attached to a conviction for bribery or trading in influence (confiscation, ML predicate offence, professional disqualification etc.).

²⁷ These can be found at: www.oecd.org/corruption/asiapacific/publications.

²⁸ ADB/OECD (2007a)

²⁹ Resolution (97) 24 on the twenty guiding principles for the fight against Corruption; Criminal Law Convention on Corruption (ETS n° 173); Civil Law Convention on Corruption (ETS n° 174), Recommendation No. R (2000) 10 of the Committee of Ministers to Member states on codes of conduct for public officials (including a model code), Additional Protocol to the Criminal Law Convention on Corruption (ETS n° 191), Recommendation Rec(2003)4 of the Committee of Ministers to member states on common rules against corruption in the funding of political parties and electoral campaigns.

³⁰ www.coe.int/greco

2. Other studies

37. FATF Working Group on Typologies itself started to look at the issue of PEPs as it relates to corruption in the context of a report on private banking in 2001, and further focused on PEPs in its 2003-2004 typologies report. Recently, the FATF *Global Money Laundering and Terrorist Financing Threat Assessment* (2010) analyzed PEPs in the context of the overall threat environment. The assessment also noted that jurisdictions with high levels of corruption were at risk for abuse by money launderers, thereby highlighting the dual nature of the threat posed by corruption: that it is a harm of itself, and it also engenders money laundering for a host of other crimes.

38. The FATF-Style Regional Bodies (FSRBs) have likewise addressed this issue, in depth and for some time. The Asia Pacific Group (APG), for example, first looked at the issue of corruption from a typologies standpoint in 2003-04 with a series of case studies, and then followed up with successive typologies in 2004-05, 2007, 2008 and 2009.³¹ The 2007 effort was particularly substantive, resulting in a research paper, *APG/FATF Anti-Corruption AML/CFT Research Paper*, by Professors David Chaikin and Jason Sharman.³² Additional case studies upon which the project team relied were conducted by the Eurasian Group (EAG),³³ Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG),³⁴ and Inter Governmental Action Group against Money Laundering in West Africa (GIABA).³⁵

39. Individual governments have published studies on corruption as well, either as part of their legislative or regulatory functions, as well as in the course of investigating and prosecuting corrupt individuals. Such case studies reveal useful details concerning the manner by which the proceeds of corruption are moved. The US Senate, for example, published three highly detailed reports, spanning over a decade, which illustrated the use of the international financial system to secrete money.³⁶ Those reports, complete with case studies and supporting financial documents, reveal a treasure trove of data on the movement of corrupt money. FinCEN, the US FIU, recently published a report regarding foreign corruption as well.³⁷ The Swiss and UK governments have each published reports in the aftermath of various corruption scandals.³⁸ Likewise, there have been a number of legal cases, both civil and criminal, whose court opinions have outlined in great detail the inner workings of this phenomenon.

³¹ APG typologies can be found at: www.apgml.org/documents/default.aspx?DocumentCategoryID=6

³² Chaikin., D. and Sharman., J. (2007)

³³ EAG (2009)

³⁴ ESAAMLG (2009)

³⁵ GIABA (2010)

³⁶ US Senate, Permanent Subcommittee on Investigations (PSI), (1999, 2004 and 2010)

³⁷ See Financial Crimes Enforcement Network (2011)

³⁸ Financial Services Authority (2001 and 2011); Swiss Federal Banking Commission (2000)

3. AN ANALYSIS OF THE MOST COMMON METHODS USED TO LAUNDER THE PROCEEDS OF GRAND CORRUPTION

40. Laundering of corruption proceeds can take a variety of forms, depending on the nature of the corrupt act. In the grand corruption context, the most prevalent forms of proceeds are those arising from 1) bribe-taking or kickbacks; 2) extortion; 3) self-dealing and conflict of interest; and 4) embezzlement from the country's treasury by a variety of fraudulent means. Understanding the typical methods by which PEPs unlawfully obtain proceeds assists in understanding how those funds could be laundered.

41. In bribery, money flows from a private entity, generally speaking, to a PEP or associate in exchange for the grant of some sort of government concession: a contract for goods or services, for example, or the right to extract resources from the state. The proceeds of the bribery flow from the bribe giver to the corrupt PEP or an associate, possibly through a shell company or trust in which the PEP is the beneficial owner; it may never touch the home country of the corrupt PEP. A good example of this is found in the Bangkok film festival case, in which two promoters were able to bribe certain Thai officials to obtain the rights to sponsor and manage a government-funded film festival in Thailand.³⁹ The bribes were paid simply by means of the wire transfer of funds from US-based accounts, where the promoters were located, into offshore accounts in third countries maintained by family members of the PEP. The bribes never passed through Thailand, although that was the locus of the corrupt activity.

42. However, as noted later in the section on the use of cash, sometimes funds are retained in the country where the corruption takes place. For example, Joseph Estrada, then the President of the Philippines, often received cash or check payments from gambling operators in exchange for their protection from arrest or law enforcement activities. This money was simply deposited into domestic accounts in the name of a fictional person or in corporate vehicles established by Estrada's attorney, and then used for a variety of expenses.⁴⁰ Likewise, in the case of the bribery of US Congressman Randall Cunningham, who was a senior legislator with significant control over military expenditures, a military contractor bribed him both by checks to a corporation controlled by Cunningham, but also by agreeing to purchase real estate owned by Cunningham at a vastly inflated price.⁴¹

43. Proceeds are also generated through extortion schemes. In such schemes, funds are passed from the victim to the PEP. This can be done within the country or elsewhere. Pavel Lazarenko, former Prime Minister of Ukraine, regularly required entities that wished to do business in Ukraine to split equally the profits of the enterprise with him in exchange for his influence in making the business successful. These businesses would transfer a share of ownership to Lazarenko associates or

³⁹ United States v. Green, *et al.*, (2010) court documents. Kickbacks and bribes generally have no legal distinction. In ordinary parlance, a kickback typically refers to the payment of a percentage of a specific contract, while bribery is simply the unrestricted payment of money.

⁴⁰ People of the Philippines v. Estrada (2007), court decision

⁴¹ United States v. Cunningham (2006), court documents

family members, and money would be wired from the victim companies to offshore accounts controlled by Lazarenko.⁴²

44. Self-dealing occurs when a PEP has a financial interest in an entity which does business with the state. The PEP is able to use his official position to ensure that the state does business with the entity, thereby enriching the PEP. A US Senate report noted a situation in which one West African PEP was responsible for selling the right to harvest timber from public lands, while at the same time owning the same company that had been awarded those rights.⁴³ In such situations, money would flow from the affected country's accounts or central bank to accounts owned by the corporation or entity owned or controlled by the PEP.

45. Finally, embezzlement schemes are used in a number of corruption cases. Money flows can occur in a number of ways, using a variety of methods. In the case involving former governor of Plateau state in Nigeria, Joshua Dariye, for example, a grant for environmental contracts was made from the federal government to the State, and the money was deposited into a bank account established by the State. Dariye used his influence to cause the bank to issue a bank draft creditable to an account at a different Nigerian bank that Dariye had established under an alias about ten months previously.⁴⁴ In the case involving Sani Abacha, then the President of Nigeria, Abacha directed his national security advisor to create and present false funding requests, which Abacha authorised. Cash "in truckloads" was taken out of the central bank to settle some of these requests. The national security advisor then laundered the proceeds through domestic banks or Nigerian and foreign businessmen to offshore accounts held by family members.⁴⁵

46. Thus, it would appear that all stages of the money laundering process – placement, layering, and integration – are present in the laundering of proceeds regardless of the manner of corruption. The specific methods by which the funds are actually laundered are discussed below.

A. Use of Corporate Vehicles and Trusts

47. The project team's review of the case studies showed that every examined case featured the use of corporate vehicles, trusts, or non-profit entities of some type. That this is the case should perhaps not be surprising; corporate vehicles and trusts have long been identified by FATF as posing a risk for money laundering generally, and are addressed in Recommendations 33 and 34.⁴⁶ WGTYP long ago noted in its 1996-1997 Report on Money Laundering Typologies of the common use of shell corporations, and the advantages they provide in concealing the identity of the beneficial owner and the difficulty for law enforcement to access records.

48. WGTYP issued a report detailing the risks of misuse of corporate vehicles and trusts in October 2006.⁴⁷ The intervening ten years changed little. As that report noted, "[o]f particular concern is the ease with which corporate vehicles can be created and dissolved in some jurisdictions, which allows these vehicles to be . . . misused by those involved in financial crime to conceal the

⁴² United States v. Lazarenko (2006), court decision.

⁴³ Permanent Subcommittee on Investigations (2010), pp. 24-25.

⁴⁴ Federal Republic of Nigeria v. Joshua Chibi Dariye (2007) (UK) court documents.

⁴⁵ Okonjo-Iweala, *The Nigerian Experience* (2007) unpublished World Bank case study.

⁴⁶ In preparation for the fourth round of mutual evaluations, the FATF has recently started a review of some key components of the Recommendations, including transparency of legal persons and arrangements. In February 2012, the FATF plenary will consider the WGEI recommendation on amending the standards related to the transparency of legal persons and arrangements.

⁴⁷ FATF (2006)

sources of funds and their ownership of the corporate vehicles.” This point was again made more recently in FATF’s 2010 typology, *Money Laundering Using Trust and Company Service Providers*.⁴⁸

49. These typologies, as well as other publically available information, set forth the money laundering risks that corporate vehicles and trusts present, regardless of the predicate crime. Features of corporate vehicles that enhance the risk of money laundering include:

- the ease with which corporate vehicles can be created and dissolved in some jurisdictions;
- that a vehicle can be created as part of a series of multi-jurisdictional structures, in which a corporation in one jurisdiction is owned by one or more other corporations or trusts in other jurisdictions;
- the use of specialised intermediaries and professionals to conceal true ownership;
- the ease in which nominees may be used to disguise ownership, and corporations;
- and other vehicles whose only purpose is to disguise the beneficial owner of the underlying asset.⁴⁹

50. Moreover, each jurisdiction has its own set of requirements regarding identification of the beneficial owner and the circumstances under which that information may be accessed. As discussions within the FATF regarding clarification of the standards related to beneficial ownership have demonstrated, few jurisdictions collect beneficial ownership information at the time of company formation, increasing the challenges of international cooperation. Each of these features has the effect of making it more difficult for financial institutions, regulators, and law enforcement to obtain information that would allow for an accurate understanding of the ownership and control of the assets involved and the purposes for which specific financial transactions are conducted. Some vehicles are even designed to protect against asset confiscation; certain trusts, for example, require the trustee to transfer assets upon receiving notice of a law enforcement or regulatory inquiry.⁵⁰

51. The ease by which an individual can obtain a corporate vehicle is highlighted by J.C. Sharman’s recently-published foray into purchasing shell corporations. Sharman, a professor at Griffith University in Brisbane, Australia, noted that of 45 service providers he was able to contact, 17 of them were willing to form the company with only a credit card and mailing address (to receive the documents).⁵¹ Sharman acknowledged that the relatively small sample size of his study “necessitates a degree of modesty about the findings,” and that obtaining a bank account for the corporations without divulging an identity would be more difficult. Nevertheless, as he notes, “If one law-abiding individual with a modest budget can establish anonymous companies and bank accounts via the Internet using relatively high-profile corporate service providers, how much simpler is it likely to be for criminals, who are not bound by any of these restrictions, to replicate this feat?”

52. In the corruption context, it is easy to understand why a corrupt PEP may wish to use a corporate vehicle. In some jurisdictions, PEPs are subject to public asset disclosure requirements, rules regarding engaging in outside transactions to prevent self-dealing and conflicts of interest, and a

⁴⁸ FATF (2010b)

⁴⁹ See, e.g., United States Government Accountability Office (2006)

⁵⁰ Baker, R.W. (2005), p. 37.

⁵¹ Sharman, J.C. (2010)

host of other codes of conduct, and ethical prohibitions.⁵² Specific investigative bodies and watchdog groups may exist to guard against corruption, and in many countries a robust media is able to publicise missteps by public officials. Some countries have effectively implemented FATF Recommendation 6, and require financial institutions to conduct enhanced due diligence for those customers who are foreign PEPs. PEPs have their career and reputation at stake if found to be in possession of unexplained wealth. In this environment, corrupt PEPs have a greater need than others to ensure that specific criminal assets cannot be identified with or traced back to them. Corporate vehicles thus provide one of the most effective ways to separate the origin of the illegal funds from the fact that the PEP controls it.

53. One example of this comes from the case of Augusto Pinochet, the former President of Chile. Pinochet was assisted by his US-based bank (and its U.K. branch) in setting up corporate vehicles in order to both hide his assets and shield them from the reach of asset freezing and confiscation or civil recovery orders. Specifically, Pinochet was able to set up offshore shell corporations and a trust in 1996 and 1998, even after a Spanish magistrate had filed a detailed indictment against Pinochet for crimes against humanity and issued world-wide freezing orders.⁵³ 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). The bank has since been convicted of AML-related criminal charges.

54. According to the case study of Vladimiro Montesinos, Peruvian President Fujimori's security advisor, he used shell corporations very effectively to disguise and move money illegally obtained through defence contracts with the Peruvian government.⁵⁴ Such a scheme, involving several corporate vehicles in a number of jurisdictions with each vehicle holding bank accounts in yet other jurisdictions, is designed to frustrate any financial institution, regulator or government investigator attempting to unravel the scheme.

B. Use of Gatekeepers

55. Gatekeepers were significantly represented in the cases within the project team inventory. "Gatekeepers are, essentially, individuals that 'protect the gates to the financial system' through which potential users of the system, including launderers, must pass in order to be successful."⁵⁵ The issue of gatekeepers has been addressed by FATF on several occasions, including WGTYP's 2003-2004 Report, which concluded:

Increasingly, money launderers seek out the advice or services of specialised professionals to help facilitate their financial operations. This trend toward the involvement of various legal and financial experts, or gatekeepers, in money laundering schemes has been documented previously by the FATF and appears to continue today. The work undertaken during this year's exercise confirmed and expanded the FATF's understanding of specific characteristics of this sector and what

⁵² Many of these are obligations of member states under the UNCAC. A good description of the available legislative and regulatory schemes employed by some countries is described in the UNODC's *UN Anti-corruption Toolkit* (2004), found at www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf.

⁵³ Permanent Subcommittee on Investigations (2004)

⁵⁴ ADB/OECD (2007b); UNODC and World Bank (2007)

⁵⁵ FATF (2010c)

makes it vulnerable to money laundering. The most significant cases each involve schemes of notable sophistication, which were possible only as a result of the assistance of skilled professionals to set up corporate structures to disguise the source and ownership of the money.

56. In 2010, FATF published its *Global Money Laundering and Terrorist Financing Threat Assessment*, which described gatekeepers as a “common element” in complex money laundering schemes. The report noted that gatekeepers’ skills are important in creating legal structures that could be used to launder money and for their ability to manage and perform transactions efficiently and to avoid detection. Recommendation 12 acknowledges the role that such gatekeepers can play by recommending that such individuals engage in due diligence and record keeping when engaged in certain activities.

57. The review of the cases illustrates the variety of ways in which gatekeepers, in particular lawyers, are used to launder the proceeds of corruption. They have been used to create corporate vehicles, open bank accounts, transfer proceeds, purchase property, courier cash, and take other means to bypass AML controls. In addition, lawyers have subsequently used rules of attorney-client privilege to shield the identity of corrupt PEPs.

58. West African PEPs: In four separate case studies of West African PEPs and their families, the US Senate discovered that lawyers were used to create corporate vehicles, open bank accounts and purchase property with the express purpose of bypassing AML controls set up to screen for PEPs.⁵⁶ For example, the son of the President of one West African nation, who himself was a minister within the government, wished to purchase real estate and aircraft within the United States. To do so, a lawyer for the PEP opened bank accounts there. However, because of US banking rules requiring enhanced level of due diligence for funds moving through those accounts, several US banks closed the accounts on the belief that they were being used to conduct suspicious transactions. In response, the lawyers for the PEP would deposit incoming funds into attorney-client or law office accounts, and then transfer the money into newly-created accounts for the PEP. Due to the fact that the lawyer’s accounts were not subject to the same enhanced due diligence as the PEP, the lawyer was able to circumvent the enhanced AML/CFT measures. Ultimately, at least two banks were able to identify the fact that the attorney’s accounts were being utilised in this manner and closed the attorney accounts, but not before hundreds of thousands of dollars had passed through.

59. Duvalier case: Haitian government assets diverted by Jean-Claude Duvalier were likewise disguised by the use of lawyers as intermediaries, who would hold accounts for the Duvalier family. This, according to the UK court that examined the matter, had the added advantage of the use of professional secrecy to avoid identifying the client.⁵⁷ The court opinion identified numerous accounts held by law firms for Duvalier and his family, both in the UK and in Jersey. The use of professional secrecy was used to attempt to prevent an inquiry into the nature of the funds.

60. Chiluba case: Similarly, in a civil recovery suit instituted in the UK against the former President of Zambia, the court, in its factual findings, described in great detail the use of certain lawyers and law firms to distribute and disguise money embezzled from the coffers of the Zambian government.⁵⁸ Special corporate vehicles had been set up, purportedly for use by the country’s security services, and government funds were transferred to accounts held by those entities.

⁵⁶ Permanent Subcommittee on Investigations (2010)

⁵⁷ Republic of Haiti v. Duvalier, 1990 UK

⁵⁸ Attorney General of Zambia v. Meer Cares, *et al.*, UK court opinion (2007)

Thereafter, millions of dollars were transferred to the client accounts of certain law firms, from which the lawyers would then make certain disbursements upon instructions from complicit PEPs. These disbursements were to other accounts located both in Zambia and in other countries, as well as payments for personal expenses and asset acquisitions for the government officials and their families. As the Court noted in its opinion, “There is no reason for his client account to be used for any genuine currency transactions. This is . . . money which has been traced back to [the Zambian Ministry of Finance]. It is a classic example of washing money through [the attorney’s] client account to hide its origins and to clothe it with an aura of respectability.”

61. The court also noted an instance in which the PEP’s lawyer withdrew GBP 30 000 – an amount that vastly exceeded the President’s annual salary -- and delivered it personally to the President. Moving the money through the lawyer’s accounts disguised the fact that the money originated from government accounts, and further hampered the ability to trace the proceeds. The court noted that the lawyers involved did not make any efforts to determine the source or the purpose of the money: “Yet [the lawyer] made no enquiry as to how the President could simply take such a large amount of money. An honest solicitor would not participate in such a transaction without a full understanding of its nature so that he could be satisfied it was lawful. [The lawyer] did not so satisfy himself because he was unwilling to ask the question because he was afraid of the answer.” Additionally, the lawyers involved formed foreign shell corporations, which were then used to purchase properties with government money for the benefit of corrupt officials.

C. Use of Domestic Financial Institutions

62. Much of the focus on PEPs to date has been to ensure that foreign PEPs are subject to enhanced due diligence regarding the source of funds deposited into financial institutions – in other words, measures to prevent corrupt PEPs from laundering their proceeds in foreign bank accounts. For example, the Third EU Directive requires enhanced due diligence only for foreign PEPs. The UNCAC, however, does not distinguish between foreign PEPs and those prominent political figures within the institution’s own country. The World Bank policy paper on PEPs notes that many financial institutions do not distinguish between foreign and domestic PEPs.⁵⁹

63. The Interpretive Note to Recommendation 6 encourages jurisdictions to extend its EDD requirements to domestic PEPs as well. Recently the FATF has discussed the degree to which domestic PEPs should be subject to enhanced due diligence, and in addressing the issue, has recommended that domestic PEPs continue to be considered on a risk-based approach, and that foreign PEPs continue to receive enhanced due diligence.⁶⁰

64. Some typology exercises the project team reviewed have concluded that domestic PEPs may present a significant risk for corruption-related money laundering. Professor Jason Sharman, in summarizing the ADB/OECD paper on PEPs, characterised the notion that domestic PEPs do not present a threat of money laundering as a “myth.”⁶¹ The project team’s analysis of the case study inventory found that PEPs are not only using foreign financial institutions to transfer and hide the proceeds of corruption. PEPs are also using domestic financial institutions to launder funds.

65. Perhaps the most obvious example of this involves President Joseph Estrada of the Philippines, who was convicted in his country of the crime of plunder. The court’s ruling in that case

⁵⁹ Greenberg, T.S. *et al.* (2009)

⁶⁰ This is the situation as at the publication of this report (July 2011).

⁶¹ Sharman, J.C., (2009)

noted that a significant portion of the money that Estrada collected as a result of kickbacks from illegal gambling and tobacco excise taxes ultimately ended up at a bank account in the Philippines in the name of an alias, Jose Velarde. The court noted that Estrada used the account and would simply sign Velarde's name to deposit slips, oftentimes in the presence of bank personnel. Money that went through that account was used for various asset purchases, including real estate for the benefit of Estrada.⁶²

66. The US Senate, in its 2010 investigation of the use of US banks to launder corruption proceeds, described in two different reports the banking and asset purchase activities of the President of a West African oil producing country as well as that of his son, who was also a high-level government official. The son, for example, in purchasing in cash a house in the United States for USD 30 million, wire transferred money, in six different USD 6 million tranches, from a personal bank account he held in his own country, through an account in France and then to the United States. The son had an official government monthly salary of approximately USD 6 000.

67. The case involving assets stolen by Joshua Chibi Dariye also highlight the use of domestic accounts in at least the initial stages of a more complex scheme. Dariye, the Governor of Plateau State in the Federal Republic of Nigeria from May 1999 through May 2007, embezzled money belonging to the state in several ways. Checks issued from the central bank of Nigeria to Plateau State for ecological works were received by Dariye and, rather than being deposited into a government account, were instead diverted to an account in Nigeria Dariye had established using an alias. The money was then transferred to accounts held in Dariye's own name in the UK. Likewise, Dariye purchased real estate by diverting money destined for a Plateau State account into an account in Nigeria in the name of a corporation he controlled. That corporation, in turn, transferred money to UK accounts in the corporation's name to effectuate the real estate purchase.⁶³

68. Raul Salinas, the brother of the President of Mexico, likewise was able to move money out of his home country by using the Mexican branch of a US-based international bank. 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 checks to the branch, where they were converted to dollars and wired to US accounts.⁶⁴

69. PEPs need accounts in their own country in which to fund their lifestyles, and there have been examples in which the PEP, after secreting money overseas, then moved the money back to his home country. The US Senate, in its 2004 investigation of corruption-related money laundering, provided one such example. Augusto Pinochet of Chile, notwithstanding a modest official government salary, was able to secret millions of dollars in UK and US accounts, often through the use of aliases and family members. In 1998 a Spanish investigating magistrate instituted worldwide asset freeze orders as a result of an investigation into Pinochet's role in human rights abuses and other crimes and was subsequently facing charges in Spain and Chile. Pinochet was able however, to purchase USD 1.9 million in cashier's checks (in USD 50 000 increments) from his account in the US, which he was thus able to cash using banks in Chile.⁶⁵

⁶² People of the Philippines v. Joseph Estrada court opinion

⁶³ Federal Republic of Nigeria v. Joshua Chibi Dariye (2007) (UK)

⁶⁴ Permanent Subcommittee on Investigations (1999)

⁶⁵ Permanent Subcommittee on Investigations (2004)

D. Use of Offshore/Foreign Jurisdictions

70. That corrupt PEPs would seek to move money outside of their home jurisdiction is at the root of Recommendation 6, requiring enhanced due diligence for foreign PEPs. An examination of the corruption case studies revealed that in nearly every case foreign bank accounts were being used in part of the scheme. Beginning with one of the earliest cases, Marcos of the Philippines, through the significant and egregious activity of Sani Abacha and a number of Nigerian governors, and most recently with the US Senate's study of three West African heads of state, corrupt PEPs nearly universally attempt to move their money outside of their home country. This money is typically moved from developing countries to financial institutions in developed countries or those with a stable climate for investment.

71. Of course, corruption not is restricted to developing countries. The project team analyzed the Nino Rovelli judicial corruption matter, for example.⁶⁶ There, approximately USD 575 million was paid out to individuals as a result of bribes paid to judicial officials in Italy. The money ultimately was moved and disguised in a series of financial transactions involving accounts and corporate vehicles in the United States, British Virgin Islands, Singapore, Cook Islands and Costa Rica. Likewise, the developing world's financial systems may well be used to hide money. In the Titan Corporation bribery case for example, bribes from a US corporation to the President of Benin, intended to secure government contracts in telecommunications, was moved, in cash, directly to Benin.⁶⁷

72. The reason for this preference is obvious. Foreign accounts hold the advantage of being harder to investigate for the victim country, are perceived of as more stable and safer, and are more easily accessed than accounts held in the PEPs home country. Moreover, a PEP can "stack" foreign jurisdictions: a bank account in one country could be owned by a corporation in another jurisdiction, which is in turn owned by a trust in a third jurisdiction. Each additional country multiplies the complexity of the investigation, reduces the chances of a successful result, and extends the time needed to complete the investigation.

E. Use of Nominees

73. The use of associates or nominees --- trusted associates or family members, but not necessarily the lawyers and accountants described in the gatekeepers section --- to assist the PEP in disguising and moving the proceeds of corruption was common in the inventory of cases. FATF has documented the use of such nominees previously. The WGTYP annual report for 2003 - 2004 noted at paragraph 78:

PEPs, given the often high visibility of their office both inside and outside their country, very frequently use middlemen or other intermediaries to conduct financial business on their behalf. It is not unusual therefore for close associates, friends and family of a PEP to conduct individual transactions or else hold or move assets in their own name on behalf the PEP. This use of middlemen is not necessarily an indicator by itself of illegal activity, as frequently such intermediaries are also used when the business or proceeds of the PEP are entirely legitimate. In any case, however, the use of middlemen to shelter or insulate the PEP from unwanted attention can also serve as an obstacle to customer due diligence that should be performed for every

⁶⁶ United States v. Proceeds of Crime Transferred to Certain Domestic Financial Accounts (2007), court filings

⁶⁷ United States v. Titan Corporation (US) (2005), court filings

customer. A further obstacle may be involved when the person acting on behalf of the PEP or the PEP him or herself has some sort of special status such as, for example, diplomatic immunity.

74. A typical use of nominees can be found in the case of Arnoldo Aleman. Aleman was able to siphon government funds through a non-profit institution known as the Nicaraguan Democratic Foundation (FDN), an entity incorporated by Aleman's wife in Panama. In addition, Aleman and his wife set up both front companies and non-profit organisations to funnel money through. Lastly, Aleman was able to defraud the government in the sale of telecommunications frequency to a private entity, using companies set up by advisors to Aleman. Aleman was also assisted in his efforts to steal and subsequently move money through the active participation of Byron Jerez, the country's tax commissioner at the time.⁶⁸

75. The scheme set up by a high level PEP in a Central American country likewise depended on the assistance of both family members as well as other associates to succeed. The PEP would divert money that was intended to be paid to the country's treasury through a series of financial transactions, which would then ultimately end up in foreign bank accounts in the name of the PEP's former wife and daughter.⁶⁹

F. Use of cash

76. The use of cash, and its placement into the financial system, has long been identified as a method for the laundering of proceeds of crime. Indeed, when the FATF 40 Recommendations were first issued in 1990, the focus of many of its preventative measures was on detecting money laundering at the cash proceeds stage. The anonymous nature of cash, with its lack of paper trail, is attractive and may outweigh other negatives. Some of the predicate crimes, such as drug trafficking, are historically cash businesses. Indeed, even for crimes that do not generate cash requiring placement into the financial system, WGTYP has noted (Report on Money Laundering Typologies, 2000-2001), some laundering schemes in which the proceeds are converted back to cash in order to break the paper trail.

77. While smaller-scale, endemic corruption (in which money is provided to lower- or mid-level government officials in order to act or refrain from acting in their official capacity), would be expected to generate cash in need of placement, the grand corruption cases would not be expected to have significant amounts of cash. A cash payment to a PEP would break the chain of bank records, of course, but it would require the PEP to run the gauntlet of AML/CFT controls designed to combat placement of illegally-derived cash into the system. This would include the possibility that the PEP's transactions (as well as those for his family and close associates) are subject to enhanced due diligence in accordance with Recommendation 6. In each case in which the PEP receives the cash, he must engage in a calculus to determine whether the risks associated with placement – including the possibility of EDD as a result of his PEP status -- outweigh the benefits of having broken the chain. It appears that in a significant number of cases, the corrupt PEP wants the cash and, moreover is able to place the cash without attracting undue attention.

78. The US Senate's investigation of corruption-related money laundering identified the President of one oil rich West African country, for which a US bank accepted nearly USD 13 million in cash deposits over a three-year period into accounts controlled by the President or his wife. The

⁶⁸ United States v. \$125,938 (US) (2008) court filings

⁶⁹ United States v. Alfonso Portillo (US) (2009) court documents

report noted that some of these deposits were for a million dollars at a time, and the currency was in shrink-wrap packaging. The report could identify no legitimate source for such currency. This same bank also provided USD 1.9 million in cashier checks to a PEP from a South American country, using the maiden name of the wife of the PEP as the payee. These cashiers' checks were ultimately cashed in the PEP's home country. The bank involved was fined and criminally prosecuted for these violations and ultimately was closed as a result.⁷⁰

79. The Zambian asset recovery lawsuit, noted above, also highlights the use of cash. As part of the scheme, the president of Zambia directed his UK-based lawyer to withdraw GBP 30 000 in cash from accounts containing diverted government money and deliver it to him personally. There were also other significant cash payments, including a USD 250 000 payment made from a diverted account to the Zambian Ambassador to the United States, which he then took in a suitcase to Switzerland and gave to the head of the Zambian security service, and hundreds of thousands of dollars in cash used to purchase property in the UK and elsewhere. The court found that there was no legitimate purpose for the large cash withdrawals.⁷¹

80. Other case studies have shown the presence of significant amounts of unexplained cash. Diepreye Alamiyeseigha, for example, was found to have over GBP 1 000 000 in his apartment in the UK at the time of his arrest, notwithstanding the fact that as governor of Bayelsa State in Nigeria, his salary was a fraction of that. Another governor of a Nigerian state around that time, Joshua Chibi Dariye, previously discussed, was found to have deposited into his UK accounts in excess of GBP 480 000 during a four and a half year period. According to a US Senate report on the matter, immediately after Sani Abacha's death in 1998, his wife was stopped at a Lagos airport with 38 suitcases full of cash, and his son was found with USD 100 million in cash. According to the World Bank study he was able to place significant amounts of cash in the financial system by using associates. Lastly, Montesinos used cash couriers to transfer funds from Switzerland to Mexico and Bolivia.

81. PEPs have an advantage not usually available to the general public: the use (and abuse) of the so-called "diplomatic pouch." Intended to protect free communication between diplomats and their foreign missions, a diplomatic bag is protected from search or seizure by the *1961 Convention on Diplomatic Relations*.⁷² A diplomatic bag may only be used for official materials and, while the Convention protects it from search, it does not relieve the carrier of adherence to the laws of the host nation, including cross-border currency reporting requirements.

82. Such was the situation that the US Senate uncovered in its report on the financial affairs of one West African PEP. His daughter, who was in graduate school in the United States, asked her US bank to count certain cash she had stored in her safe deposit box. The bank found USD 1 million in cash, in USD 100 bills, wrapped in plastic. When asked about the source of the money, the daughter replied that her father, the PEP, provided her the cash when he came into the United States, and that he often brought cash into the United States. The PEP had never declared his transport of the cash, as he was required to do by US law.⁷³

⁷⁰ Permanent Subcommittee on Investigations (2004)

⁷¹ Attorney General of Zambia v. Meer Cares, *et al.*, (UK)(2007) court opinion

⁷² http://untreaty.un.org/ilc/texts/instruments/english/conventions/9_1_1961.pdf

⁷³ Permanent Subcommittee on Investigations (2010)

4. VULNERABILITIES LEADING TO AN INCREASED RISK OF THE LAUNDERING OF THE PROCEEDS OF CORRUPTION

A. Control over the State

83. A central challenge faced by those attempting to prevent and investigate corruption offenses – and this may be unique to grand corruption -- are situations in which PEPs involved have sufficient control over the State both to allow money to be embezzled (or bribes and kickbacks to be demanded and received) and, because their power over the State was so great, to be able to use that same power to launder the money with impunity. 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. The project team noted a number of instances where the corrupt PEP created or used systems within his own government to be able to disguise or move the money.

84. Indeed, in 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.

85. One example of such control over a corrupt network was found in Peru during the term of Alberto Fujimori, as described in Guillermo Jorge's case study at the ADB/OECD report of its 2007 regional anti-corruption seminar. Through a series of dismissals and patronage appointments, extortions, bribes, and the corruption of the electoral process, Montesinos and Fujimori took control of the police, military and judiciary and, in effect, the country.

86. As the Peruvian Special Prosecutor, Luis Vargas Valdivia, noted in the ADB/OECD case study:

When exercising control of almost all state organs -- the executive, legislative, and judicial branches; Public Ministry; National Elections Jury; Constitutional Tribunal; Comptrollership; and the army, among others -- Fujimori and Montesinos notably weakened, and in some cases eliminated, these organ's role to control the exercise of government.⁷⁴

87. Money embezzled from the state was moved through a variety of schemes to Switzerland, the United States and the Cayman Islands. Montesinos used his influence to cultivate a corrupt relationship with a Cayman-based bank, which he had allowed to operate in Peru without authorisation. The Peruvian authorities later concluded that this bank had at least the tacit approval of the banking authorities. Montesinos used similar influence with a second Cayman-based bank through bribery and exchanges of favours. The relationship with the CEO of that bank was such that the CEO would give him advice on the best way to hide his money offshore. Such was Montesinos' power that no police agency, money

⁷⁴ ADB/OECD (2007b), p. 223.

laundering control organisation, or banking regulator would be able to detect, much less stop, this illegal behaviour. It is telling that Montesinos' schemes came to light only after one of his bribes to a politician, which Montesinos had recorded as insurance, was broadcast on an independent Peruvian cable television station.

88. Likewise, Abacha controlled the government of Nigeria, which allowed him both the opportunity to embezzle government funds, but also to ensure that it was safely laundered. Enrico Monfrini, in his case study of Abacha, described the corruption within the country as “blatant and systematic.” Money was embezzled through a variety of means, one of which was Abacha directing his national security advisor to create and present false funding requests, which Abacha authorised. Cash was taken out of the central bank, given to the national security advisor, and then laundered through domestic banks or by Nigerian and foreign businessmen to offshore accounts held in the name of family members. Because Abacha had control over all aspects of the Nigerian government, there was no opportunity for any domestic regulator, law enforcement or financial institution to prevent the theft of the money.⁷⁵

89. Lazarenko had sufficient control over the Ukrainian apparatus of governance that he was able to require businesses operating in the country to give him half of their profits. He could also divert for his own use money designated to purchase the country's wheat supplies, and could direct funds derived from customers paying for natural gas be transferred to the accounts of offshore shell companies controlled by Lazarenko. Lazarenko, as noted previously, utilised financial institutions under his control to be able to move his stolen money to a variety of foreign accounts. Because Lazarenko's control over the country was so pervasive, he was able to scheme without worry that a regulator or domestic law enforcement agency would be able to either prevent or detect his crimes.

90. What is the net effect, for AML/CFT purposes, of a corrupt PEP's control over his country? Financial institutions and countries confront a unique set of challenges, to say the least. Consider for example the situation in which the PEP claims that he is entitled by law (or decree) to the proceeds of the country's treasury. The US Senate's 1999 investigation of money laundering in private banking highlighted one example. A US bank held an account with an individual they understood to be an undisputed West African PEP. The bank's customer profile noted that the source of the PEP's funds was government funds, and that the President had “carte blanche authority of his government's funds.”⁷⁶ Global Witness likewise noted the instance of another West African PEP claiming his entitlement to engage in self-dealing with its own government – essentially, that the PEP can do business with the state such that he would be entitled to the proceeds of government contracts. This PEP owned natural resource extraction companies which had been given extraction rights by the government. In a defence of a lawsuit, the PEP claimed:

“Cabinet Ministers and public servants . . . are by law allowed to own companies that, in consortium with a foreign company, can bid for government contracts and should the company be successful, then what percentage of the total cost of the contract the company gets will depend on the terms negotiated between the parties. *But, in any event, it means that a cabinet minister ends up with a sizable part of the contract price in his bank account.*⁷⁷

91. The stated lack of any prohibition against conflict of interest and self-dealing, even if actually consistent with the PEP's domestic law, appear to violate Articles 7 and 8 of the UNCAC's prohibition against conflict of interest, and functionally constitutes a license to steal.

⁷⁵ Monfrini (2008)

⁷⁶ Permanent Subcommittee on Investigations (1999), pp 14-15.

⁷⁷ Global Witness (2009a), p. 12.

92. Because there is no domestic control or supervision of the corrupt PEP's transactions, the PEP has functionally "rigged the game" in his own country. This increases the pressure on, and difficulty for, foreign financial institutions to understand the source and nature of the money entering its institution. Unfortunately, the source of information available to the financial institution may be restricted. Guillermo Jorge, in his analysis while discussing the Montesinos matter, poses the fundamental problem that foreign jurisdictions and financial institutions have in dealing with such regimes:

[W]hat would have happened if Swiss banks reported Montesinos as early as 1998? For the sake of this exercise, one can speculate that, on the Swiss part, an investigation on money laundering would be opened and a request for assistance to Peru forwarded to determine the origins of the assets. However, in 1997, with Montesinos in power, one can be almost sure that Peru would not have been able to provide accurate information on the origins of the assets.⁷⁸

93. The PEP's control allows him to create corporate structures and to prevent reasonable inquiry by financial institutions or regulators as to the beneficial ownership of those companies. This problem was highlighted in the US Senate's 2004 investigation of corruption-related money laundering. There, in the course of investigating the financial transactions of a West African PEP, a US financial institution discovered a series of wire transfers totalling USD 34 million out of the country's oil revenue account to accounts held in a third country by two corporations incorporated in the PEP's home country. The PEP refused to disclose the beneficial owners of those accounts and, because of the PEP's control over the government, neither the bank, the regulators, nor law enforcement outside of the PEP's country had the ability to determine the identity of the recipient of the money, or the purpose of the payments.⁷⁹

B. Financial Institution Capture

94. That a financial institution may be compromised by criminal elements, which then may launder funds with impunity, is a concern. As early as WGTYP's 1996-97 Report, FATF has been concerned with the risks associated with such financial institution "capture." FATF, in its Recommendations 23 and 24, require that regulators take steps to ensure that banks and casinos remain free of criminal influence, particularly in regard to ownership and management. These recommendations do not cover PEPs, however, and there is no standard that would prohibit a PEP, directly or beneficially, from owning a financial institution.

95. The project team found such financial institution capture to place the entire system of global AML/CFT at risk. According to the case study of Vladimiro Montesinos contained in the ADB/OECD report of its 2007 regional anti-corruption seminar, Montesinos was able to orchestrate with his associates the use of pension fund money and their own money to buy a majority interest in a Peruvian banking institution, Financiera del Sur (FinSur). The use of such an institution gave Montesinos and Fujimori an unprecedented ability to move and disguise funds. Due to the fact that the bank involved was in the PEP's own jurisdiction, it appeared that the Montesinos' status as a PEP contributed to his ability to control the bank.

96. Indeed, a PEP may have the wherewithal, due to his connections and sophistication, to be able to capture a bank outside his own jurisdiction. This was demonstrated in the actions of the former Prime Minister of Ukraine, Pavel Lazarenko. As noted in the US criminal court opinion affirming his conviction, he and his associates were able to control two banks, the European Federal Credit Bank ("Eurofed") and

⁷⁸ ADB/OECD (2007b), p. 211.

⁷⁹ Permanent Subcommittee on Investigations (2004), pp. 54-55.

Postabank, both established in foreign jurisdictions. Those banks, in turn, had correspondent and other accounts at scores of banks worldwide, and Lazarenko was able to use these accounts to move millions unimpeded through the worldwide financial system.

C. Ineffective Enhanced Due Diligence

97. Recommendation 5 and its interpretive note set forth the nature of the due diligence that should be applied at account opening and in reviewing transactions for ordinary account holders. With Recommendation 6, FATF has recognised that foreign PEPs pose significantly greater risks than do ordinary customers, and that financial institutions should take steps to understand and more closely monitor the financial transactions of PEPs as well as their families and associates. The Recommendation requires systems to determine whether a customer is a PEP, to reasonably determine the source of the funds, and to engage in enhanced ongoing monitoring of the relationship.

98. Others have recognised the necessity of an EDD process for PEPs as well. The Wolfsberg Group, an organisation of large money-centre banks, has issued guidance that discusses the rationale behind this rule:

Relationships with PEPs may 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 or resulting from bribery and corruption. In addition, they may also seek to use their power and influence to gain representation and/or access to, or control of legal entities for similar purposes.⁸⁰

99. The project team found in many cases that the financial institutions involved failed to conduct any due diligence to determine that they were dealing with a PEP, and thereby failed to determine the source of the funds or engage in relationship monitoring. In other instances, they understood that they were dealing with a political official, but nevertheless failed to understand the source of the wealth. Either because the facts themselves revealed it or as a result of a government inquiry, we were able to conclude that, had a reasonable level of inquiry been conducted concerning the PEP or the transactions involved, the financial institution would have been able to detect and prevent the laundering of the proceeds of corruption. Moreover, in at least one case, the bank took steps to hide the fact that the PEP involved had an account at its institution, and took further steps to disguise certain financial transactions. In other circumstances, the institutions involved readily acceded to the PEP's demand for secrecy.

100. To be sure, the project team encountered other cases, such as Pavel Lazarenko, where an interlocking web of corporate vehicles and captured financial institutions across the globe would have challenged even the most diligent of compliance investigators. Finally, in some instances, there was not enough data to conclude whether the due diligence conducted allowed the PEP to move stolen money into the financial system.

101. Guidance for due diligence for a PEP is readily available. As the Stolen Asset Recovery (StAR) group noted in its report, *Politically Exposed Persons*:

The identification of a PEP customer usually results from a bank's normal CDD processes. Depending on the type of product or service sought, geographic area of business, or source of

⁸⁰ Wolfsberg Group (2008)

funds, CDD could also include questioning the customer on whether he or she is a PEP. Certain answers would normally trigger further research.

102. The Abacha case stands as perhaps the most visible example of the consequences of the lack of a financial institution's due diligence in allowing suspect money to flow freely through accounts. The story of the crimes of the former Nigerian President Sani Abacha are well described in the case study conducted in the ADB/OECD report of their 2007 proceedings, as well in an unpublished World Bank case study.⁸¹ Abacha is safely estimated to have embezzled between USD 2-4 billion during his four and a half year rule.

103. The governments of at least three of the countries involved in receiving suspect Abacha funds – the US, UK, and Switzerland -- have concluded that their financial institutions conducted inadequate due diligence in their handling of those accounts. A 2000 report of the Swiss Federal Banking Commission, for example, reviewed the actions of Swiss banks “to ascertain whether [the banks] had fully adhered to due diligence requirements . . . as set out in banking law and other applicable legislation in accepting and handling funds from the entourage of the former President of Nigeria, Sani Abacha.” Its review identified five banks with “shortcomings” and six banks in which there were “instances of serious omissions and serious individual failure or misconduct.” This included ignoring indications of the possible suspicious origin of the funds, not passing relevant information to high levels in the bank and misjudging the customer relationship. The Commission did note that none of the accounts except one were in Abacha's name, and that none of the account holders identified themselves as prominent political figures, but that the banks nevertheless should have been more cautious, particularly in dealing with regions which have a history of corruption.⁸²

104. The UK likewise conducted an investigation in 2001 of Abacha money that passed through UK financial institutions. Of the twenty-three UK banks investigated because of possible links with Abacha accounts, fifteen were found to have “significant money laundering control weaknesses.” Within those banks, the FSA found forty-two personal and corporate account relationships that were linked to the Abacha family and close associates. It estimated that those accounts were responsible for a total turnover between 1996 and 2000 of USD 1.3 billion in Abacha money.⁸³

105. The US Senate likewise found a US-based bank (with branches in the UK) to have failed to engage in an appropriate level of due diligence with regard to money funnelled through accounts of two sons of Sani Abacha. The Senate noted that no client profiles existed for the accounts for a time period in which USD 47 million passed through the accounts, and when profiles were created, they repeatedly failed the bank's own internal quality review. The bank acknowledged that the KYC documentation on those accounts were below that required under bank policy.⁸⁴

106. Another case involved former Chilean president Augusto Pinochet. There, a US-based bank that maintained accounts for Pinochet understood that Pinochet was in fact a PEP. The bank's KYC client profiles compiled from the late 1990's to 2002 noted that Pinochet was a political figure, that his estimated net worth was approximately USD 50-100 million, and that he had as much as USD 6.3 million on deposit with the bank. Other than to state that the wealth came from his government salary and “family wealth,” there was no effort to determine the actual source of the wealth. In another instance, as we noted in the section on corporate vehicles, the bank actually set up a shell corporation in an offshore jurisdiction with weak money laundering controls to be the nominal owner of the accounts. The KYC profile for those

⁸¹ Okonjo-Iweala, *The Nigerian Experience* (2007) unpublished World Bank case study

⁸² Swiss Federal Banking Commission (2000)

⁸³ Financial Services Authority (2001)

⁸⁴ Permanent Subcommittee on Investigations (1999)

accounts simply listed the corporations, not Pinochet, as the owners, notwithstanding the fact that the bank itself knew that a PEP was the beneficial owner. During part of this time, the bank had been required to engage in EDD for PEPs; during the earlier years it was required, in any event, to engage in due diligence to ensure that the money that was placed into its institution was not derived from illegal activity.⁸⁵

107. As with Pinochet, Raul Salinas' bank gave him active assistance. 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 accounts that Salinas had established at the bank. 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 to own the shell corporation, with Salinas as the secret beneficiary.⁸⁶

108. The bank, according to a US Senate investigation, accepted Salinas as a client without any specific review of his background and without determining the source of funds that would be deposited into his account. Indeed, a review of Salinas' client profile after his arrest showed that it was blank. The structure the bank set up for Salinas allowed him to move USD 67 million in two years from Mexico to accounts in Switzerland, the UK and the US.⁸⁷

109. Other cases show that the banks fully understood that the money that was passing through PEPs' accounts was money from the national treasury. One US bank, for example, listed as the source of wealth for the President of an oil-rich African nation "the result of position," and candidly acknowledged that the source of the money was the President's personal access to those funds. The bank's own 1997 analysis of the KYC for the account noted significant deficiencies, and the bank acknowledged that the KYC profile was "wholly inadequate." At the time this was occurring, the media reported that the French government had opened an investigation related to bribes being paid by a French oil company to this country's officials, including the president.⁸⁸

110. Notwithstanding the publication of this report in 1999, US banks continued to cater to this President's family members. For example, a different US bank allowed the President's daughter, a foreign national, to deposit in excess of a million dollars of cash into her account notwithstanding her status as an unemployed graduate student. When some transactions were ultimately flagged, the branch manager told the AML personnel that she is "the princess of [] African royalty." Further due diligence by the bank's AML department resulted in a telephone call to the daughter, who readily acknowledged receiving the cash from her father, who would give it to her on his trips to the United States. Further review revealed that the daughter's name was not on the list of PEPs a vendor provided to the bank. The bank then engaged in enhanced transaction monitoring on the account. The account was ultimately closed two years later when the daughter, whose father was still under French investigation for bribery, attempted to purchase a USD 1 million cashier's check using cash she had previously placed in two safe deposit boxes at the bank.⁸⁹

111. Other cases showed the result of a lack of due diligence in identifying customers and monitoring accounts. Philippine President Joseph Estrada, for example, maintained an account through which he funnelled bribe and payoff cash in the name of a pseudonym. In one instance, a bank employee saw Estrada sign the false name on various bank documents; on other occasions, the president's personal

⁸⁵ Permanent Subcommittee on Investigations (2004); United States v. Riggs Bank, (US)(2005) court documents

⁸⁶ Permanent Subcommittee on Investigations (1999)

⁸⁷ Permanent Subcommittee on Investigations (1999)

⁸⁸ Permanent Subcommittee on Investigations (1999)

⁸⁹ Permanent Subcommittee on Investigations (2010)

secretary made cash deposits. In such circumstances, it is hard to imagine any legitimate reason for the president of a country to legitimately engage in such transactions.

112. There were other instances in which the project team noted that the ease by which money was subsequently frozen indicated that the identity of the beneficial owners was readily apparent. For example, the Montesinos case was broken when videotaped recordings of Montesinos bribing a congressman was aired on local television. That and subsequent videos created a scandal both in Peru and around the world. Banks in money-centre countries then almost immediately froze and reported the existence of accounts; this money was ultimately confiscated and repatriated to Peru. As was noted in the ADB/OECD report of proceedings regarding the Montesinos case, “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.”⁹⁰ More recently, as noted previously, banks around the world identified and froze suspected assets related to the recently deposed leaders in several Middle Eastern countries. This poses the obvious question: How were the banks able to identify such accounts so readily and quickly? The inference from these facts suggests that the information concerning Montesinos’ PEP status was either in the possession of the banks or readily available.

113. Some of the case studies predate Recommendation 6 and any official or industry recognition that foreign PEPs pose an inherently greater risk of money laundering than ordinary customers, as well as the push by the OECD to curb foreign bribery. It can be argued that the older cases would not likely occur today. Such an argument is undercut, however, by the fact that only a fraction -- 7 of 34 -- of the FATF member jurisdictions received a Largely Compliant rating for Recommendation 6 in their last evaluation. No country was completely compliant. Indeed, the StAR paper ‘Stolen Asset Recovery’ (2009) found that 84 percent of the 124 countries assessed either by FATF or a FSRB rated as non compliant or only partially compliant. “The picture today is of an overall failure of effective implementation of international PEP standards.”⁹¹

114. Moreover, the project team found a significant number of cases – Abubakar, Chen Shui-Bien, some of the Pinochet transactions, the three West African PEPs, the Bangkok film festival case, to name a few -- in which accounts were held in countries that have imposed an EDD requirement for foreign PEPs. Nevertheless, significant amounts of corrupt funds were able to be laundered. Finally, a number of cases that predate an industry, government, or FATF recognition of PEP risks – Abacha, Pinochet, Estrada, and Salinas for example – involved instances of the bank conducting no due diligence or actively assisting in the laundering of money. That being said, a true global regime of enhanced due diligence will almost surely force corrupt PEPs to increase reliance on other means of disguising their ill-gotten wealth, such as the use of corporate vehicles, gatekeepers and associates. Moreover, as the report noted previously, when the PEP effectively controls the machinery of government, the PEP can readily access the international financial system to launder his proceeds.

D. Ineffective communication among States and financial institutions

115. Money laundering, regardless of the predicate offenses, is a global problem. Communication among states is a key element to enhanced effectiveness and maximizing the use of scarce resources. In many of the case studies, money was laundered using accounts in many jurisdictions being held by corporate entities registered in yet other jurisdictions. In the Abacha case, for example, the money involved at least twelve different jurisdictions. Such a tangled financial structure is intentional, as money launderers and corrupt PEPs perhaps count on the fact that each layer of the scheme involving another

⁹⁰ Valdivia (2008)

⁹¹ Greenberg T.S. *et al.* (2009), at xv.

country will reduce the chances of regulators, investigators, or the financial institutions – relying on information exchange procedures that are either cumbersome or not being utilised -- being able to understand and prevent the laundering of proceeds of corruption.

116. The project team did not find any instance of a foreign FIU, regulator, or law enforcement agency discovering evidence of corruption and proactively alerting the affected country. This may be the result of the nature of grand corruption; as noted previously, it is likely that notifying a country ruled by a corrupt PEP of suspicious transactions will serve only to alert them to their need to be better at hiding the money. This also may be the result of the nature of the materials the project team studied, as the method by which the relevant country was tipped off to the corruption is often not discussed.

117. That being said, however, it may simply be that a foreign competent authority simply does not look for such evidence or, upon finding it, does not pass it on to the affected country. While not the focus of this typology, it should be noted that in the asset recovery sphere, the communication and evidence sharing among competent authorities is often measured in months and years (and sometimes, literally, dozens of years). Since there is no reason to believe that the efforts in the detection and prevention sphere are any different, then the corrupt PEPs, who are able to move money with 21st century speed, will always have the upper hand.

118. Even within the same country, barriers exist to ensure effective AML controls. The US Senate's report on certain West African PEPs recounted a situation in which a PEP had, at various times, accounts at three different financial institutions either in his own name or in corporate vehicles in which he was a beneficial owner. Each financial institution ultimately decided to close the accounts because of suspicious financial transactions, yet none of the banks knew of the existence of, or the suspicious nature of, the accounts in the other financial institutions. In another instance, a US financial institution knew the daughter of the president of an African country to be a PEP, and had been subjecting the accounts to EDD. Because of AML concerns, it decided to close the accounts and provided the daughter with two cashier's checks reflecting account balances of over USD 800 000. The daughter merely opened an account at another institution in the same city, depositing the cashier's checks from the first bank. The second bank apparently never inquired of her former bank the circumstances surrounding the closing of the account and never knew she was a PEP until the legislative investigators asked about it.⁹²

⁹² Permanent Subcommittee on Investigations (2010)

5. CONCLUSION

119. Corruption-related money laundering shares many of the same traits as the laundering of proceeds of other types of crime, but there are important differences as well. Corrupt PEPs, like other criminals, have a need to disguise the proceeds of their crimes, and use a variety of methods ranging in sophistication, to do so. Corrupt PEPs may have certain natural advantages in laundering their funds not available to other criminals: they may control the machinery of the state, allowing them to co-opt those individuals and institutions that are supposed to prevent and detect such crimes; they can use the proceeds of corruption to finance political parties or organisations and, in turn, reinforce their control over government mechanisms; their political power gives them the ability to recruit skilled associates within their own country to engage in transactions to make the proceeds indistinguishable from legitimate money and provide a diplomatic cover; and they often have a veneer or respectability that deflects suspicion.

120. On the other hand, corrupt PEPs also face risks that other criminals do not: A PEP's mere association with large unexplained wealth can be enough to trigger inquiries. As we noted previously, greater information often exists as to the wealth and income of PEPs as a result of asset and income disclosure requirements, which would allow a more accurate assessment of the nature and source of specific transactions. Lastly, more attention being paid to this issue by multilateral bodies, NGOs and individual governments than ever before.

121. The cases in this study reveal that, similar to other sophisticated criminals, corrupt PEPs use a broad array of methods to hide their proceeds. Corrupt PEPs disguise their ownership through corporate vehicles and trust companies and use gatekeepers and nominees to launder proceeds through the domestic and foreign financial institutions. They have used their power to acquire state assets, control law enforcement, and capture banks. Finally, past cases demonstrate that AML standards are not always being implemented by financial institutions; nor are AML laws and regulations being enforced by regulatory authorities or supervisors. Case after case shows how financial institutions have failed to follow AML procedures – even where those procedures called for only an ordinary risk-based approach – and have thus given corrupt PEPs continued and unabated access to the global financial system.

122. Preventing and detecting the proceeds of corruption involve the array of FATF recommendations. While Recommendation 6, regarding EDD for PEPs, is obviously central to an effective AC regime, our survey indicates that corruption-based money laundering also requires jurisdictions to effectively implement the Recommendations on corporate vehicles and trusts (Recommendations 33 and 34); the power and authorities (including the independence) of the competent authorities (Recommendations 26, 27 and 28); the use of cash couriers (Special Recommendation IX); gatekeepers (Recommendation 12); and the need for integrity within financial institutions themselves (Recommendation 23). Moreover, as we note below, it may be useful to look again at some of these recommendations in light of this report's findings.

6. SUGGESTED FOLLOW-UP WORK

123. More work could be done. The issue of corruption-related money laundering is sufficiently unique, complex, and of public importance to merit further study. Because corrupt PEPs face risks in disguising and moving their money which may not be present in other types of crime, further study on the methods of money laundering and the vulnerabilities of the current system could lead to greater effectiveness to both the AML/CFT and AC efforts.

124. Specifically, the project team suggests that the FATF WGTYP may consider conducting research in the following areas, either in combination with each other or as stand-alone projects:

125. Red flag indicators: Given that the current project has given WGTYP an understanding of the manner in which corrupt PEPs may seek to move and disguise money, WGTYP may wish to understand the “red flags” that may be present in corruption-related financial transactions. Because FATF would benefit from the insight of the private sector in this area, this work should include consultation with the private sector, including financial institutions and NGOs.

126. Identification, prevention and enforcement, particularly as it relates to AML: Because the project focused exclusively on existing typologies, it did not study whether specific AML controls successfully prevented or detected the laundering of the proceeds of corruption. Surveying the law enforcement, regulators, and FIUs of FATF members for instances in which existing controls were successfully used (or, in the alternative, did not succeed) may be useful in determining whether changes are necessary.

127. Geographic and sector risk: This report has seen that the failure of some jurisdictions to adhere to basic AC principles, combined with other factors such as a poor history of effective governance or ready access to sources of state income, can create significant AML risks. FATF may wish to consider the appropriate response by financial institutions and AML/CFT authorities to financial transactions emanating from countries that do not comport with basic AC principles.

128. Original typologies and other methods of laundering not covered in the typology review: The project team merely surveyed typologies and case descriptions done by others. Insight may be gained by conducting specific, in depth, and original research on other cases of grand corruption. The survey revealed some use of other methods of money laundering, such as real estate, the purchase of luxury goods, misuse of diplomatic or sovereign privileges and immunities, and the cross-border movement of metals and stones. Further study in this area could yield some insights into the appropriate response to this type of money laundering.

129. Asset recovery: This typology has focused on the methods used by corrupt PEPs to move their money, but did not address whether assets were returned to the country harmed by corruption. Efforts by governments to recover stolen proceeds have received considerable study by governments, FSRBs, NGOs, and multilateral bodies.⁹³ Since AML tools are critical in asset recovery, there may be some benefit in

⁹³ See, e.g., The World Bank and UNODC Stolen Asset Recovery Initiative, www.worldbank.org/star; Basel Institution on Governance, International Centre for Asset Recovery, www.baselgovernance.org/icar/; U4 Anticorruption Resource Centre, www.u4.no/themes/uncac/asset-recovery.cfm.

studying this area to understand how the FATF recommendations, and the AML/CFT expertise that FATF members possess, could assist in this area.

130. Systemic or petty corruption: The project team limited itself, because of time and resource limitations, to grand corruption. Yet so-called “petty” corruption appears to be widespread and carries with it many of the economic and governance liabilities as grand corruption. Consideration should be given to studying the typologies of petty corruption in order to gain an understanding of the methods used to launder the proceeds of that type of corruption.

131. Additionally, WGTYP may wish to consider collaborating with other FATF working groups and outside agencies:

132. Assessment of the FATF Recommendations: Because, as noted above, this research identified deficiencies in either the effectiveness of or the compliance with a broad array of Recommendations, it may be useful to assess, in coordination with WGTM, whether specific changes need to be made in the Recommendations themselves.

133. Collaboration with anticorruption experts: Gaining a better understanding of the experiences of operational anticorruption experts may assist in developing a better understanding of the relationship between corruption and money laundering enforcement. The Experts Meeting on Corruption in February 2011, chaired by the President of the FATF, was a useful first start in exchanging information within the two communities, and FATF may wish to consider holding such future meetings.

134. Best practices: WGTM has committed to write a best practices paper on corruption, and insights gained from these typologies can assist in that effort. WGTYP should consider collaborating with WGTM on that issue.

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ANNEXES

ANNEX 1: GRAND CORRUPTION CASE INVENTORY

Identifier	dates	source country	destination country	approx. amount (US millions)	official	nature of the corruption	state capture	gatekeeper	FI capture	foreign accounts	domestic accounts	corporate vehicle	shell company	cash	family members/ associates?	false nominee/ name?
Frederick Titus Chiluba	1995-2001	Zambia	UK, Jersey, US	\$72 M	president	embezzlement	Y	Y	N	Y	Y	Y	Y	Y	Y	
Diepreye Alamiyeigha	1999-2005	Nigeria	UK, South Africa	\$17 M	State governor	embezzlement	Y		N	Y	N	Y		Y		
Joshua Dariye	1999-2006	Nigeria	UK, Nigeria	\$17 M	State governor	embezzlement	Y	Y	N	Y	Y	Y		Y	Y	Y
Pavel Lazarenko	1992-1997	Ukraine	US, Switzerland, Antigua, Poland, Bahamas	\$44 M	prime minister	embezzlement; extortion	Y	Y	Y	Y		Y			Y	
Vladimiro Montesinos/Alberto Fujimori	1990-2000	Peru	Switzerland, US, Cayman Islands	\$ 250 M	presidential advisor	bribery; self dealing	Y	Y	Y	Y	Y	Y			Y	
WGYP 2003-04 case 16	unknown	"former dictatorship"	domestic	\$ 6 M	petroleum minister	embezzlement	N		N		Y					Y
West African PEP #1	2005-2011	Equatorial Guinea	US	\$80 M	president's son	embezzlement; self dealing	Y	Y	N	Y	Y	Y				
West African PEP #2 (wife, adult children, daughter-in-law)	1985-2009	Gabon	US, Malta, Switzerland, France, UK	\$130 M	President (son)	embezzlement				Y	Y	Y		Y	Y	
Atiku Abubakar	2000-2008	Nigeria	US, Guernsey	\$40 M	vice president	self dealing	Y	Y		Y		Y			Y	

Identifier	dates	source country	destination country	approx. amount (US millions)	official	nature of the corruption	state capture	gatekeeper	FI capture	foreign accounts	domestic accounts	corporate vehicle	shell company	cash	family members/ associates?	nominee/ false name?
EAG #1 (p. 14)	2003-04	Russia	Russia	\$500,000	program administrator	embezzlement	N	N	N	N	Y	Y	Y			
EAG#2 (p. 15)		Ukraine	"abroad"	\$4 M	officials of a national enterprise	self dealing	N	N	N	Y	Y	Y	Y	N		
Sani Abacha (and sons)	1993-2000	Nigeria	UK, Switzerland, US, Jersey, Luxembourg, Lichtenstein, Austria, France, Lebanon, Kenya, Cayman Islands, Bahamas	\$3,000 - 5,000 M	president	embezzlement; extortion; self dealing	Y	Y	Y	Y	Y	Y	Y	Y	Y	
Ferdinand Marcos	1965-1986	Philippines	Singapore, Switzerland, US	\$5,000 - 10,000 M	President	embezzlement; bribery	Y			Y		Y	Y		Y	
Jean-Claude Duvalier	1971-1986	Haiti	UK, Switzerland	\$300 M	President	embezzlement	Y	Y		Y					Y	
Ao Man Long	1999-2006	Macau China	HK, Macau, UK	\$100 M	Secretary for Transport and Public Works	bribery	N		N	Y	Y	Y	Y	N	Y	N
Chen Shui-Bien	2000-2008	Taiwan	Switzerland, US	\$14 M	President (wife)	bribery	N	Y		Y	Y	Y	Y	Y	Y	
South Asian PEP (husband)	1995-1997	Pakistan	UK, Switzerland, British VI	\$40 M	Prime Minister (husband)	bribery		Y	N	Y		Y	Y		Y	
Augusto Pinochet	1973-2004	Chile	Chile, US, UK,	\$27 M	President	unknown	Y		Y	Y	Y	Y	Y	Y	Y	
West African PEP #3	2000-04	Equatorial Guinea	US, Bahamas		President	bribery, embezzlement, self dealing	Y			Y	Y	Y	Y	Y	Y	

Identifier	dates	source country	destination country	approx. amount (US millions)	official	nature of the corruption	state capture	gatekeeper	FI capture	foreign accounts	domestic accounts	corporate vehicle	shell company	cash	family members/ associates?	nominee/ false name?
Raul Salinas	1998	Mexico	US, Switzerland, UK, Cayman Islands	\$80-100 M	President (brother)	embezzlement	N		N	Y	Y	Y	Y		Y	
Arnoldo Aleman	1997-2002	Nicaragua	Nicaragua	\$100 M	President	embezzlement	Y		N	Y		Y	Y		Y	
Yevgeny Adamov	1993-2003	US, Russia	US, Monaco, France	\$15 M	Minister of Atomic Energy	embezzlement	N		N	Y	Y	Y	Y	Y	Y	
Xu Chaofan, Xu Guojun, and Yu Zhendong (Bank of China embezzlement)	1992-2001	China	US, Canada, HK China	\$485 M	bank officials	embezzlement	N			Y	Y	Y	Y		Y	
Joseph Estrada	1998-2001	Philippines	Philippines	\$11 M	President	bribery; embezzlement	N	Y	N	N	Y	Y			Y	Y
Denis Christel Sassou Nguesso	2004-2006	Congo	UK		President	embezzlement		Y		Y		Y	Y			
Central American PEP	2000-2004	Guatemala	US, France, Luxembourg, UK, Switzerland, Lichtenstein	\$15 M	President	embezzlement	N		N	Y		Y		Y	Y	N
Khaleda Zia/Arafat Rahman	1991-2001	Bangladesh	Singapore, Austria, Cyprus	\$3 M	Prime Minister (son)	bribery	N		N	Y		Y	Y		Y	
Carlos Garcia	1993-2004	Philippines	US	\$6.8 M	General (son)	bribery	N		N	Y	Y			Y	Y	
Juthamas Sriwan/Green (Bangkok film festival case)	2002-2007	Thailand	US, Jersey, Singapore, UK	\$1.8 M	Governor of Tourism	bribery	N		N	Y		Y		Y	Y	

Identifier	dates	source country	destination country	approx. amount (US millions)	official	nature of the corruption	state capture	gatekeeper	FI capture	foreign accounts	domestic accounts	corporate vehicle	shell company	cash	family members/ associates?	nominee/ false name?
Nino Rovelli	1990-1993	Italy	US, UK, Switzerland, Canada, Cayman Islands, Costa Rica	\$500 M	judges	bribery	N	Y	N	Y	N	Y	Y	N	Y	N
Titan bribery -- Benin	1999-2001	US	Benin	\$3.5 M	president	bribery			N	N	Y	N	N	Y	Y	
Randall Cunningham	2000-2005	US	US	\$2.4 M	senior legislator	bribery	N	N	N	N	Y	Y	N	Y		N

ANNEX 2 : OVERVIEW OF INTERNATIONAL ACTION TO FREEZE ASSETS BELONGING TO FORMER HEADS OF STATE, THEIR ENTOURAGE AND CERTAIN STATE ENTITIES UNDER THEIR CONTROL

- 6 January 2011: The United States froze the assets of Ivory Coast President Laurent Gbagbo, his wife and close associates after Gbagbo refused to step down following the country's presidential run-off election in November.
- 14 January 2011: The European Union's political and security committee froze the assets of Gbagbo, his family and associates.
- 17 January 2011: Three Civil Society Organisations (The Arab Commission for Human Rights, Transparency International and SHERPA) file a complaint with the French public prosecutor's office to freeze assets held in France by the Ben Ali and Trabelsi families. The objective of the complaint, according to Transparency International's press release, was to open an official judicial investigation and formally freeze the assets that could have come from embezzled public funds.
- 19 January 2011: The Swiss government froze assets of Ben Ali, his family and close associates. The freezing of the assets would apply for a period of three years. The Swiss government subsequently announced that it had received a request for mutual legal assistance from Tunisian authorities. Switzerland later announced that USD 69 million of Ben Ali, his family and close associates was frozen.
- 19 January 2011: The Swiss government froze the assets of Gbagbo, family and close associates. The assets remain frozen for a period of three years. Switzerland later announced that USD 81.5 million of assets of Mr. Gbagbo, his family and close associates were frozen.
- 20 January 2011: The US FIU issues an advisory to financial institutions to take reasonable steps to guard against the potential flow of illicit assets that may be related to the current political and social unrest in Tunisia and abrupt changes in the government in Tunisia.
- 24 January 2011: The French Government's l'Office central pour la repression de la grande delinquance financiere (OCRGDF, Central Office for the Repression of Great Financial Crime) opened an investigation into assets held by Ben Ali. Tracfin (Traitement du renseignement et action contre les circuits financiers clandestins) called the reporting entities to enhance due diligences concerning PEP's and to declare promptly any suspicion in order to allow the French FIU to postpone the suspicious transactions.
- 24 January 2011: Canada stated that it was prepared to work with the UN or Tunisia to freeze assets of Ben Ali's family held in Canada, including a CAD 2.8 million mansion in Westmount section of Montreal and bank accounts.

- 31 January 2011: The Council of the European Union froze the assets of Ben Ali, his wife and associates. The freeze was amended and updated on 5 February 2011.
- 6 February 2011: German authorities seized several bank accounts and property in Frankfurt belonging to Ben Ali, his wife and 46 family members. It was reported that the seizure took place after the EU took steps to freeze the assets.
- 9 February 2011: The FBI and the anti-kleptocracy unit of the United States Justice Department opened a preliminary probe into Ben Ali and his associates to determine whether they have any US assets.
- 11 February 2011: The Swiss Government froze any assets in Switzerland of the former President Mubarak and parties close to him. The assets remain frozen for three years. Switzerland later revealed that USD 474 million of assets of Mubarak, his family and close associates were frozen. The Swiss government subsequently announced that it had received a request for mutual legal assistance from Egyptian authorities.
- 16 February 2011: The US FIU issues an advisory to financial institutions with respect to a potential increased movement of assets that may be related to the situation in Egypt.
- 24 February 2011: The Swiss Government froze assets of Gaddafi, his family and close associates. The freeze remains valid for three years. On 30 March 2011, Switzerland adopted a new ordinance, which replaced the one adopted in February, thereby implementing the UN security council resolution and adopting the additional measures taken by the EU. Switzerland later announced that the total amount of assets linked to Gaddafi, his family and close associates that were frozen was USD 585 million.
- 24 February 2011: The US FIU issues an advisory to financial institutions to take reasonable risk-based steps with respect to the potential increased movement of assets that may be related to the situation in Libya.
- 25 February 2011: President Barack Obama issued an Executive Order entitled "Blocking Property and Prohibiting Certain Transactions Related to Libya" under the International Emergency Economic Powers Act and the National Emergencies Act. The Executive Order applied to Gaddafi, members of his government, members of his family and close associates. Three days after the Executive Orders, the New York Times (citing US Department of Treasury as source) reported that USD 30 billion in assets had been frozen in the United States.
- 26 February 2011: The United Nations Security Council agreed to freeze the assets of Gaddafi and four officials.
- 27 February 2011: The Government of United Kingdom froze the assets of Gaddafi, members of his family and associates. There had been press reports that Gaddafi's son had purchased a GBP 10 million mansion in Hampstead Gardens in 2009, with a British Virgin Islands registered company Capitana Seas Ltd. as its legal owner. As of 4 March 2011, the U.K. had frozen USD 3.2 billion of Gaddafi, his family and senior associates, including the assets of the Libyan Investment Authority, the country's sovereign wealth fund that officials estimate controls USD 60 billion in assets.

- 27 February 2011: Canadian Prime Minister Stephen Harper announced that Canada will freeze the assets of the Government of Libya and its agencies, including the Libyan Central Bank.
- 28 February 2011: The Egyptian Public Prosecutor issued an order freezing the assets of Mubarak and his family. BBC also reported that Mubarak's former ministers of interior Habib al-Adly, tourism Zuhair Garana, and housing Ahmed al-Maghrabi were charged with “corruption-related offences”.
- 28 February 2011: The European Union passed a resolution freezing the assets of Gaddafi and his family. The asset freeze was extended to additional persons and entities on 23 March 2011.
- 1 March 2011: CBC News (Canada) reported that the Canadian government had frozen more than USD 2 billion in Libyan assets, and will continue to target the assets of Gaddafi and his family.
- 1 March 2011: Austria's Oesterreichische Nationalbank (OeNB) announced a freeze of all assets of Gaddafi, his family and associates sanctioned by the EU. The OeNB said that "EUR 1.2 billion are invested Libyan deposits in Austrian financial institutions." It is still being determined whether, or what part of the deposits, correspond to the sanctions list.
- 2 March 2011: Dow Jones Newswires reported that Spain planned to freeze Libyan assets in the country. The assets included a 25-square-mile, property in Costa del Sol area of Andalusia, Spain. According to unconfirmed media reports, the assets owned by the Libyan government in Spain also include other Spanish properties and Aresbank, a small Spanish lender that underwent restructuring in recent years.
- 21 March 2011: The European Union froze the assets of Mubarak and 18 of his associates.
- 23 March 2011: Canada adopted the *Freezing Assets of Corrupt Foreign Officials Act* to enable the freezing of corrupt leaders' assets, such as those of former Tunisian president Ben Ali and his family. The law targets politically exposed persons (PEPs) and their family members and close associates in circumstances where the foreign nation is in a situation of “internal turmoil” and the freezing of assets is in the best interest of the “international community.”
- 30 March 2011: The United Nations Security Council froze the foreign assets of Gbagbo, his wife and three top aides.



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