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JUSTICE INITIATIVE

Corruption as a threat to the rule of law:
Abuse of the corporate entity, secrecy jurisdiction arbitrage and under-regulated financial services

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before the Parliamentary Assembly of the Council of Europe

March 19, 2013

Good morning honorable members of the Assembly. Thank you for your attention to this important issue, and the invitation to speak before you.

The Open Society Foundations is concerned by the role of Council of Europe companies and other intermediaries in assisting or colluding the perpetration of acts of grand corruption – particularly in cases resulting in massive draining of national treasuries and natural resource wealth of politically and economically vulnerable states.

The cases we develop and learn about through close monitoring and investigation illustrate in real terms the concepts you are grappling with - inequality before the law, arbitrariness and discrimination.

When left unaddressed, large-scale money laundering and related corrupt acts through pristine appearing financial instruments and institutions undermine the rule of law and respect for human rights, by allowing certain wealthy and politically powerful elites to take and self-deal amongst themselves – to the detriment of the people – at will and often with impunity.

Certain causes make this exploitation possible: (i) permitting abuse of the corporate entity to mask illicit transfers of wealth and frustrate law enforcement, (ii) failing to adequately oversee the provision of financial services and (iii) maintaining opportunity for secrecy jurisdiction arbitrage.

To date, enforcement of anti-money laundering law and standards across the Council of Europe has left much to be desired. A seeming non-stop stream of cases over the last several years have uncovered billions in illicit flows. What's more, layers of built-in secrecy and protection to the perpetrators means the cases we know about are likely only the tip of the iceberg.

Even so, they show that, while the Transparency International Corruption Perceptions Index names several Council of Europe member states amongst its "cleanest," some of these states – like the United Kingdom and Switzerland - are laundering the proceeds of criminal and corrupt acts on a vast scale.

The second evaluation round of the Group of States against Corruption (GRECO) included focus on misuse of legal persons and corporations to mask corrupt acts. While a positive step, the compliance

reports reveal that recommendations were often considered "implemented" even when it was noted how a member state's acts and justifications failed to address the need behind the recommendation.

A higher bar must be set. A review of current situations across the Council's boundaries elucidate the scope and nature of the problem. Given time constraints, I will discuss only three examples here. The Justice Initiative welcomes the opportunity to submit a fuller background brief in the coming weeks, and supports comprehensive monitoring and reporting to this body from across the Council of Europe.

Ukraine

Ukraine's proven reserves of natural gas are amongst the largest in the world. Tapping into the Black Sea's reserves, given the politically delicate region, vast sums of money involved and insatiable global thirst for energy create opportunities for grand corruption.

According to reporting and documents published by Ukranian NGO Anticorruption Action Centre, in March 2011, a subsidiary of the state owned Naftogaz bought an oil rig from a U.K.-registered company for $400 million, a 60% increase over the then market value of $250 million.

More than a year after the equipment should have been delivered, it has not. In questioning the cause for the $150 million premium, and failure to deliver the equipment, journalists and civil society investigators have uncovered a network of shell companies that obscured a purportedly competitive procurement process and masked a multi-million dollar assault on the Ukrainian Treasury allegedly perpetrated by a small group of individuals with close ties to high ranking public officials.

The Anticorruption Action Centre reports that the two "competing" companies for the equipment sale share a common director. The same name appears as the director of the winning company and as the director of the parent company of the losing company. It appears as though there was no true competition at all.

But even if the procurement process had been open and competitive, it is unclear what the Ukrainian government is getting for its money. Apparently, the rig has not yet been delivered. Ukrainian online newspaper Ukrayinska Pravda uncovered that an 80% down payment on the rig was paid and deposited into the winning U.K.-registered company's account at a small Latvian bank.

The site's investigative reporting also revealed a set of close relationships that raise serious questions about how the transaction came about, including the commonality between management of Ukrainian state-owned natural resource companies, the involved banks, the winning-bidding company, Russian criminal organizations and Ukrainian public officials.

What has been uncovered in this and other transactions in Ukraine rig sales reeks of insider dealing at the expense of citizens who cannot afford the bleeding of their national wealth. It appears that Latvia has and the U.K. may have initiated criminal investigations into this matter.

Ukraine has been evaluated three times by the Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL). In 2003 MONEYVAL concluded that most of Ukraine's issues were remedied, stemming from the country's 2002 passage of its anti-money laundering law. Without monitoring and enforcement, however, the progress is hollow.

Switzerland

Swiss banking secrecy, and its use as a vehicle for tax evasion, is well-known. Recent cases with the U.S. cement the reputation. In 2009, Swiss bank UBS paid $780 million in penalties, interest and restitution for conspiracy to defraud the United States by impeding tax collection from Americans' foreign bank accounts. The case allowed the U.S. to recover $5 billion in unpaid taxes and penalties from Americans. Last month, Switzerland's oldest bank, Wegelin, admitted that it helped American clients hide more than $1.2 billion from U.S. tax authorities, a plea which has contributed to the recovery of $74 million in fees earned by the bank.

In the last few years, however, uprisings against corruption and dictatorship in Tunisia, Egypt, Libya and Syria have revealed more drastically the human rights impacts of secrecy jurisdictions. These movements show, in no uncertain terms, how such banking operations can be the partner of an oppression so intolerable to a people that the people, *en masse*, revolt.

Switzerland's anti-money laundering laws require reporting of suspicious transactions and strong rules on identification of customers. In October 2012, however, the lack of implementation and enforcement of these rules became clear. The mass revolutionary struggles in several countries forced Swiss authorities to investigate. In doing so, they found more than 140 accounts tied to the former Egyptian and Tunisian leaders and their associates, and traced tens of thousands of related financial transactions.

Over $1 billion has been frozen. Yet, it is not clear, still, that the full scope of banks or accounts involved have been identified, let alone investigated; nor has the public been advised of sanctioning of any of the involved banks.

It seems most of the frozen assets from the Middle East and North Africa should have been prevented from entering the country under existing law.

Nonetheless, Switzerland is now considering a stronger anti-money laundering law, which would helpfully introduce tax fraud as a predicate offense to money laundering. Legislation should also (i) ensure that natural resource extraction and trading companies, which effectively perform the functions of financial intermediaries, are covered, (ii) provide for clear, public announced sanctions for violations, and (iii) ensure sufficient resources for government investigation and prosecution of related crimes.

Beyond enhancing the law on the books, Switzerland must fundamentally improve enforcement.

United Kingdom

A similar pattern follows in the United Kingdom: reports of considerable money laundering, particularly via accounts of politically exposed persons, existing anti-money laundering legislation which has been progressed over time, and nonetheless, a failure to enforce the law.

A June 2011 report of the Financial Services Authority found that in high-risk situations, including correspondent banking relationships, wire transfer payments and politically exposed persons as customers, U.K. banks often failed in their duty to prevent money laundering. It concluded that around three quarters of the banks it sampled are not managing high-risk customer relationships effectively.

Indeed, reporting from U.K.-based NGO Global Witness revealed last year how U.K. shell companies responsible for laundering money through Kyrgyz banks were registered by a Russian who had already been dead for three years. Three companies profiled in the report transferred $1.2 billion through their accounts in Kyrgyzstan over the course of two-and-a-half years despite never filing any account information before dissolving.

Likewise, the FSA report admits that despite changes in the legal and regulatory framework, a number of the weaknesses identified are the same as, or similar to, those identified in their 2001 report on how banks in the U.K. handled accounts linked to the former Nigerian military leader, General Sani Abacha.

That banks won't turn away illicit dealings of the wealthy and political elite, and member states don't make banks follow their own laws, indicates that the corporate entity is a vehicle through which both states – the wealth source state and the laundering source state – agree to undermine the rule of law by permitting continuing thieving of the majority of populations for the benefit of a select few.

The Council of Europe should, especially given recent and expected legal developments in the U.S. and European Union, take all possible measures to establish a Council-wide disclosure regime and ensure legal requirements are effectively implemented and enforced, specifically:

- Addressing the problems posed by anonymous shell companies, foundations, and trusts by requiring disclosure of beneficial ownership in all banking and securities accounts, and requiring that information on the true, human owners of all corporations, trusts, and foundations be disclosed upon formation, maintained current and be readily available publicly or, at the very least, to law enforcement and banks and other institutions and professionals with legal obligations of financial due diligence;

- Requiring publicly available country-by-country reporting of sales, profits and taxes paid to governments by corporate entities domiciled in or transacting business within member states;

- Harmonizing anti-money laundering laws across all member states, including predicate offenses and covered entities, and implementing measures to facilitate cooperation and mutual legal assistance;

- Promoting strong enforcement of existing anti-money laundering laws and regulations, including by adopting any necessary amendments to ensure that financial transactions executed by companies not traditionally considered "financial services" – such as resource extraction and trading companies that effectively function in significant degree as financial intermediaries -- do not escape regulatory review.

- Pressing states to provide sufficient resources for law enforcement investigation and prosecution of financial corruption proportionate to the economic and social destruction created by such corruption.

Honorable Members of the Assembly, even perceived "clean" states within the Council can not any longer legally accept and economically depend on the fruits of crime, secrecy and swindle. Taking a strong stance now can restore faith in member states and support a trend of active resistance to theft masked as legitimate economic activity. Indeed, there are a lot of people living within and beyond the borders of the Council, whose lives are all affected by it, and they have their perceptions too.

Thank you for your attention.