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Driven Out of Paradise: Illicit Financial Flows and Offshore Leaks

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ABSTRACT

Illicit financial flows and recent offshore leaks constitute the topic of this article. As regards illicit financial flows, the focus is on two countries: Switzerland as an example of a country from the North, and South Africa as an example of a country from the South. The text is structured as follows. First, the concept and scale of illicit financial flows are discussed, as well as the problems related to them. Thereafter, illicit financial flows and their impact are examined from a North-South perspective. The next part looks at the responsibilities and strategies of countries of the North and of the South when it comes to tackling illicit financial flows. Finally, the role of offshore financial centres and selected issues arising from recent offshore leaks are addressed. The conclusion then tries to pull the threads of the discussion together.

1 WHAT ARE ILLICIT FINANCIAL FLOWS?

1.1 A definition?

The term illicit financial flows (IFFs) is used widely nowadays by analysts in the field of economic criminality. IFFs have become a key item on the international political agenda, as is evident from the statements and publications of various UN bodies,[1]

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1 See, for example, UN Department of Economic and Social Affairs (2018) *Financing for Development: Progress and Prospects, Report of the Inter-Agency Task Force on Financing for Development* at 52 *et seq*; UNODC/OECD (July 2016) *Coherent Policies for Combating Illicit Financial Flows*; UN General Assembly, Human Rights Council (15 January 2016) *Final Study on illicit Financial Flows* (A/HRC/31/61); UNDP (27 May 2014) *A Snapshot of Illicit Financial Flows from Eight Developing Countries: Results and Issues for Investigation*; United Nations Economic Commission for Africa (UNECA) (2015) *Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa* (Mbeki Report).

the OECD,[2] the G20,[3] the G7,[4] multilateral development banks (for example, the World Bank Group[5] and the African Development Bank),[6] non-governmental organisations (for example, Global Financial Integrity[7] and U4),[8] other civil society organisations (for example, Publish What You Pay),[9] and academic texts.[10]

Despite all this attention, there is little clarity about what IFFs are exactly. No single agreed definition of IFFs exists yet.[11] The World Bank describes IFFs as "money illegally earned, transferred, or used that crosses borders".[12] This definition is useful as it highlights three different reasons why financial flows are considered illicit:

- assets may originate from crime, for example, the proceeds of bribery, fraud, embezzlement or graft;
- assets may be transferred illicitly abroad to conceal them from the tax authorities (tax evasion, tax fraud) or to avoid taxes;
- assets may be used in an illicit manner, for example, to finance terrorism or human trafficking or as bribe payments.

These reasons may be combined. For instance, the proceeds of fraud may be used to finance human trafficking, or the proceeds of bribery may be transferred to offshore companies to evade taxes. An aspect that may be added to the World Bank definition is that the concept of IFFs is unlikely to be concerned with petty crime; rather, the focus is on large-scale economic transactions. Importantly, IFFs describe cross-border transactions, thereby excluding purely domestic transactions.

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2 OECD (2018) *Illicit Financial Flows: The Economy of Illicit Trade in West Africa*; OECD (2017) *Fighting Tax Crime: The Ten Global Principles*; OECD (2014) *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*.

3 G20 Germany (2017) *Annex to G20 Leaders Declaration, Hamburg Update: Taking Forward the G20 Action Plan on the 2030 Agenda for Sustainable Development* at 9.

4 G7 (13 May 2017) *Bari Declaration on Fighting Tax Crimes and Other Illicit Financial Flows*.

5 See http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs (visited 28 May 2018).

6 See http://www.afdb.org/en/illicit-financial-flows/ (visited 28 May 2018).

7 See http://www.gfintegrity.org/issue/illicit-financial-flows/ (visited 28 May 2018).

8 Le Billon P (November 2011) "Extractive Sectors and Illicit Financial Flows: What Role for Revenue Governance Initiatives?", U4 Issue No 13.

9 See http://www.publishwhatyoupay.org/using-illicit-financial-flows-to-increase-accountability/ (visited 28 May 2018).

10 For example, Herkenrath M (2014) "Illicit Financial Flows and Their Developmental Impacts: An Overview" 5(3) *International Development Policy*.

11 An overview of the different attempts to define IFFs can be found in Chowla P & Falcao T (5 December 2016) "Illicit Financial Flows: Concept and Scope (Draft)".

12 See http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs (visited 28 May 2018).

There may be situations in which it is not so easy to decide whether a cross-border financial flow is licit or illicit. Especially in the area of tax avoidance, it is difficult to answer the question as to whether certain practices are downright illegal or situated in a grey zone that, strictly speaking, still is considered to conform to the applicable international and domestic criminal and tax laws and regulations, but highly undesirable from a development perspective because socially harmful. The joint OECD and G20 project titled *Base Erosion and Profit Shifting* addresses this issue.

1.2 *Base Erosion and Profit Shifting*

The OECD and the G20 deal with the issue of tax avoidance in their joint project styled *Base Erosion and Profit Shifting* (BEPS). BEPS and its consequences may be summarised as follows:

> BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. Although some of the schemes used are illegal, most are not. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.[13]

The BEPS package contains 15 concrete actions that should equip governments with domestic and international instruments to address tax avoidance. The aim of these actions is to ensure that profits are taxed where the economic activities generating the profits are performed, and where value is created.[14] Action No 13 contains the Country-by-Country Reporting, in terms of which multinational enterprises (MNEs) are to report annually and for each tax jurisdiction in which they do business on revenues, profits, taxes paid and certain measures of economic activity.[15]

In June 2016, the so-called Inclusive Framework on BEPS was inaugurated. The idea of the Inclusive Framework is to monitor the implementation of the BEPS project globally and to provide a framework in terms of which all interested

13 See http://www.oecd.org/tax/beps/beps-about.htm (visited 28 May 2018).
14 See http://www.oecd.org/tax/beps/beps-actions.htm (visited 28 May 2018).
15 See http://www.oecd.org/tax/beps/country-by-country-reporting.htm (visited 28 May 2018).

countries which commit to implement the BEPS project, including non-G20 countries and developing economies, can become involved on an equal footing.[16]

The BEPS project is evolving and occupies some common ground with the global efforts to tackle IFFs and, at least when it comes to illegal practices to circumvent taxes, the two agendas overlap. The question as to whether illicit practices to evade taxes that are undesirable, but not downright illegal, also are covered by the definition of IFFs, is subject to debate.[17]

1.3 Scale of IFFs

The exact scale of IFFs is unknown, which is not surprising given the difficulties of defining them and the fact that they very often are concealed and sometimes connected to economic crime or criminal organisations. Most publications refer to the estimates of Global Financial Integrity (GFI), a non-governmental organisation (NGO), to obtain an idea of their size. While there has been some criticism of the methodology applied by GFI,[18] their numbers do reflect the most in-depth quantitative analysis of IFFs to date.

GFI defines IFFs as "illegal movements of money or capital from one country to another" and "classifies this movement as an illicit flow when the funds are illegally earned, transferred, and/or utilised".[19] For 2013, GFI estimates that US$ 1.1 trillion of illicit financial outflows left developing countries. GFI's figures are calculated from two sources: trade misinvoicing[20] and leakages in the balances of payments.[21]

1.4 The Problem with IFFs

The negative impact of IFFs on sustainable development is recognised widely by the international community, as illustrated by Article 23 of the Addis Ababa Action Agenda of the Third UN International Conference on Financing for Development, adopted in July 2015:

16 OECD *Inclusive Framework on BEPS, Progress Report July 2016-June 2017* at 4.

17 See Chowla & Falcao (2016) at 12 *et seq*.

18 See, for example, OECD (2014) at 20; UN General Assembly, Human Rights Council (10 February 2015) *Illicit Financial Flows, Human Rights and the Post-2015 Development Agenda* (A/HRC/28/60) at 4 *et seq*.

19 See http://www.gfintegrity.org/issue/illicit-financial-flows/ (visited 28 May 2018).

20 The UN Department of Economic and Social Affairs (2018) at 53 defines trade misinvoicing as involving "transactions being manipulated for the purposes of evading tariffs, circumventing capital account rules or financial regulations, or other illicit motives".

21 Global Financial Integrity (April 2017) *Illicit Financial Flows to and from Developing Countries: 2005-2014* at vii.

> We will redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. We will also reduce opportunities for tax avoidance, and consider inserting anti-abuse clauses in all tax treaties. We will enhance disclosure practices and transparency in both source and destination countries, including by seeking to ensure transparency in all financial transactions between Governments and companies to relevant tax authorities. We will make sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies.

The UN Sustainable Development Goals (SDGs)[22] also make explicit reference to IFFs in Target 16.4: "By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organised crime."

Tackling IFFs is not a task that can be accomplished by a single country. Cross-border transactions by definition involve at least two countries, and sometimes a multiplicity of jurisdictions. The Mbeki Report already pointed out that, with regard to IFFs, all countries should be aware of their responsibilities:

> [I]llicit financial outflows whose source is Africa end up somewhere in the rest of the world. Countries that are destinations for these outflows also have a role in preventing them and in helping Africa to repatriate illicit funds and prosecute perpetrators. Thus, even though these financial outflows present themselves to us Africans as our problem, united global action is necessary to end them.[23]

IFFs drain the resources of states, decrease people's trust in public institutions, increase social disparity and instability and foster crime – in short, they have a detrimental impact, in particular on emerging economies and developing countries.[24] While IFFs also negatively affect industrialised states in various ways – corruption, tax avoidance and the like are issues for those states as well – their impact generally is far less destructive. What industrialised states need to be very careful of is not to support the flows of illicit funds by under-regulating their financial and commercial centres.

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22 The 17 SDGs were adopted by countries on 25 September 2015 and have been in effect since January 2016. They build on and replace the Millennium Development Goals (MDGs) and aim to be implemented by 2030.

23 Mbeki Report (2015) at 4.

24 For a qualitative analysis of the interaction between illicit or criminal activities and the economy, security and development in West Africa, see OECD (2018).

The table overleaf has been constructed to illustrate different manifestations of IFFs from the point of view of an industrialised (Switzerland), an emerging state (South Africa) and developing states. The focus is on illicit inflows (money flowing into a country in a cross-border transaction), illicit outflows (money transferred out of a country in a cross-border transaction), and the services facilitating those in- and outflows. The table is not exhaustive, highlighting typical scenarios in the areas of corruption, money laundering and tax crimes.

2 ILLICIT IN- AND OUTFLOWS FROM A NORTH-SOUTH PERSPECTIVE

The table shows that the ways in which states are exposed to IFFs vary. One reason for this is their different economic structure – the impact of IFFs in the services sector, for example, is different from their impact in the extractive sector. Another reason is the strength of state institutions: in countries with weak institutions where it is difficult to enforce the law, many people may generate income for themselves by participating in informal or even criminal economies.[25] This section considers two concrete examples: how are Switzerland and South Africa exposed to IFFs?

2.1 North: The Swiss Example

Switzerland is a country with a very stable and diversified economy that is highly competitive. Many multinational enterprises (MNEs), spanning, *inter alia*, the banking, insurance, extractive, pharmaceutical and engineering industries, have their headquarters in the country. Still, the vast majority of Swiss companies are small- and medium-sized enterprises. The Swiss economy is export-oriented.[26]

Switzerland is a leader in international wealth management. In January 2018, the total assets managed by Swiss banks amounted to CHF 6 650.8 billion, of which 48 per cent belonged to foreign customers. Swiss banks manage about 25 per cent of all assets that are invested cross-border worldwide.[27] The country also is a hub for traders in commodities and the extractive sector. In terms of market share, Switzerland holds 35% of the global trade in crude oil; 60% of the trade in metals; 35% of the trade in grains; 50% of the trade in sugar; and 60% of the trade

25 See OECD (2018) at 57 *et seq*.

26 See https://www.eda.admin.ch/aboutswitzerland/en/home/wirtschaft/uebersicht/wirtschaft---fakten-und-zahlen.html (visited 28 May 2018).

27 Swiss Bankers Association (January 2018) "The Swiss Bankers Association and the Swiss Financial Centre", available at www.swissbanking.org/en/financial-centre/20130715-fp_motor_der_schweizer_wirtschaft_en.pdf (visited 28 May 2018).

	Illicit Inflows	Illicit Outflows	Services Facilitating IFFs
Switzerland	**money laundering:** bribe payments or proceeds of bribery/fraud or funds originating from graft/embezzlement or funds originating from drug or human trafficking (organised crime), etc transferred to Swiss accounts **tax:** BEPS; inflowing assets with the purpose of illegal tax evasion or tax avoidance/tax fraud	**foreign bribery (public/private):** bribes paid by Swiss corporations abroad, or by foreign corporations through Swiss accounts	**financial services providers:** illicit in- and outflows channelled through Swiss financial operators **legal services providers/lawyers:** under the guise of professional secrecy, some may assist to set up offshore structures that enable money laundering/tax crimes
South Africa	**money laundering:** bribe payments or proceeds of bribery or fraud or funds originating from graft or embezzlement or funds originating from drug or human trafficking (organised crime), etc transferred to South African accounts **foreign bribery (public/private):** bribe payments to South African officials/employees by foreign corporations	**foreign bribery (public/private):** bribes paid by South African corporations abroad, or by foreign corporations through South African accounts **draining of state resources:** money originating from corruption, graft, embezzlement transferred to offshore accounts **tax:** BEPS; tax evasion through offshore accounts/illegal tax avoidance through transfer pricing/tax fraud	**financial services providers:** illicit in- and outflows channelled through South African financial operators **legal services providers/lawyers:** under the guise of professional secrecy, some may assist to set up offshore structures that enable money laundering/tax crimes
Developing economies	**foreign bribery (public/private):** bribe payments to domestic officials/employees by foreign corporations	**draining of state resources:** money originating from corruption, graft, embezzlement transferred to offshore accounts **tax:** BEPS; tax evasion through offshore accounts/illegal tax avoidance through transfer pricing/tax fraud	

in coffee.[28]

Switzerland's focus on services and exports, the popularity of its finance sector, and its appeal as a home country for MNEs make it rather susceptible to IFFs. On the inflows side, the Swiss economy is exposed heavily to the risks of money laundering, illegal tax avoidance and tax evasion. On the outflows side, the risks include bribe payments to foreign officials. What is more, lawyers and other legal service providers in Switzerland might facilitate IFFs by setting up offshore structures to disguise such flows, abusing their professional privilege to do so.

2.2 South: The South African Example

South Africa is, after Nigeria and Egypt, the third largest economy on the African continent.[29] Key sectors include finance and mining, where multinational businesses operate. Exports to Sub-Saharan Africa and to Europe are an important part of the country's economy. South African mines extract gold, platinum and other natural resources.[30] South Africa is – together with Brazil, Russia, India, and China – one of the five major emerging economies comprising the BRICS group of countries.

As regards illicit inflows, South Africa, given its focus on services, mining and exports, is exposed to the risk of money laundering through banks and other financial operators. For example, in the defence or construction sectors, there might be a risk of bribe payments to public officials by foreign companies. On the illicit outflows side, the country, because of its wealth in natural resources and its important extractive sector, is exposed to the hazard of illegal tax avoidance through transfer pricing and similar practices. The situation regarding legal services is the same as in Switzerland: lawyers and other legal service providers in South Africa, by abuse of their professional privilege, might facilitate IFFs by setting up offshore structures to disguise such transactions.

3 TACKLING ILLICIT FINANCIAL FLOWS

As explained above, IFFs typically entail cross-border transactions. Therefore, they can (and must) be tackled not only at their source, but also at their destination. The responsibilities of countries vary, depending on whether they are affected by illicit in- or outflows.

28 Lannen A *et al* (2016) "Switzerland and the Commodities Trade: Taking Stock and Looking Ahead" 11(1) *Swiss Academies Factsheets* 1-8.

29 International Monetary Fund (October 2016) *World Economic Outlook Database*.

30 See https://www.heritage.org/index/country/southafrica (visited 28 May 2018).

3.1 The Responsibilities of Switzerland

Owing to its economic structure, Switzerland is exposed strongly to the perils of IFFs, in particular to the risk of illicit inflows, and needs strategies to address them effectively.

3.1.1 Measures Taken by Switzerland to Tackle IFFs

Switzerland has ratified a number of international treaties to combat IFFs, including the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention) and UN Convention against Corruption (UNCAC) of 2003.

In the area of anti-money laundering and organised crime, Switzerland has ratified the 1988 Vienna Convention[31] and the 2000 Palermo Convention.[32] It has been a member of the Financial Action Task Force (FATF)[33] since 1990. Over the past 25 years, Switzerland has sought to implement international standards, in particular the Recommendations of the FATF,[34] and continuously has adapted its domestic criminal and administrative laws to prevent, detect and sanction money laundering. For example, at the beginning of 2016, the Swiss Criminal Code was amended to include certain qualified tax offences as possible predicate offences for money laundering.[35]

As regards tax, Switzerland is a member of the BEPS Inclusive Framework and has committed to the global standard for the automatic exchange of financial account information (AEOI).[36] The relevant legal framework to combat BEPS entered into force in Switzerland on 1 December 2017. From the 2018 tax year, MNEs in Switzerland are obliged to draw up country-by-country reports. Switzerland will exchange a country-by-country report with South Africa from 2020 (at the latest) onwards. Furthermore, Switzerland can transmit country-by-country reports voluntarily submitted by MNEs for the tax periods 2016 and 2017 to South Africa.[37]

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31 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988.

32 UN Convention against Transnational Organised Crime of 2000.

33 The FATF is an inter-governmental body aiming to set standards and promote implementation of measures to combat money laundering and terrorist financing. See http://www.fatf-gafi.org/about/ (visited 28 May 2018).

34 FATF (February 2012) *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations*.

35 Article 305bis (1bis) of the Swiss Criminal Code.

36 See http://www.oecd.org/tax/beps/beps-about.htm (visited 28 May 2018).

37 For more details, see https://www.sif.admin.ch/sif/en/home/themen/informationsaustausch/automatischer-informationsaustausch/cbcr.html (visited 28 May 2018).

The legal basis for introducing the AEOI system into Switzerland commenced on 1 January 2017 when AEOI was activated, initially with 38 states and territories. AEOI with South Africa was launched on 1 January 2018, from which date Swiss financial institutions subject to the reporting requirement have collected account information concerning persons resident for tax purposes in South Africa. The information collected in 2018 will be exchanged between the competent Swiss and South African authorities for the first time in the autumn of 2019.[38]

3.1.2 Action Points and Open Issues for Switzerland to Address

In its Phase 4 evaluation of Switzerland in 2018, the OECD Working Group on Bribery (WGB)[39] commended the country for its active enforcement of the OECD Anti-Bribery Convention. Since the entry into force of the Convention, Switzerland has convicted nine natural persons and six legal persons of foreign bribery, and numerous investigations are ongoing. Nevertheless, the WGB found that, due to the size and export orientation of the Swiss economy and the risks inherent in some of its business sectors, the number of concluded cases should have been higher.[40] The WGB also complained that the sanctions imposed by Switzerland in concluded foreign bribery cases were not effective, proportionate and dissuasive, and that the cases should be published and their content disclosed as far as possible. Furthermore, it was suggested that Switzerland implement reforms to protect whistleblowers in the private sector.[41]

As to anti-money laundering, the 2016 FATF evaluation of Switzerland noted that in the area of customer due diligence, Swiss financial institutions and designated non-financial businesses and professions do not always implement due diligence measures satisfactorily for existing customers, in particular longstanding customers. The FATF also found that the sanction policy of the Swiss Financial Market Supervisory Authority (FINMA) and of self-regulatory bodies for serious

38 For more details, see https://www.sif.admin.ch/sif/en/home/themen/informationsaustausch/automatischer-informationsaustausch/automatischer-informationsaustausch1.html (visited 28 May 2018).

39 The OECD Working Group on Bribery in International Business Transactions was established in 1994 and is made up of representatives of the States Parties to the OECD Anti-Bribery Convention. The Working Group is responsible for monitoring the implementation and enforcement of the Convention. See http://www.oecd.org/corruption/anti-bribery/anti-briberyconvention/oecdworkinggrouponbriberyininternationalbusinesstransactions.htm (visited 28 May 2018).

40 Implementing the OECD Anti-Bribery Convention, Phase 4 Report: Switzerland (15 March 2018) at 10-12.

41 Implementing the OECD Anti-Bribery Convention, Phase 4 Report: Switzerland (15 March 2018) at 4.

violations of anti-money laundering obligations remains inadequate.[42] Regarding the investigation and prosecution of money laundering cases, the FATF observed that Switzerland runs large-scale complex investigations, using high-quality intelligence provided by MROS, the Swiss financial intelligence unit. Convictions were obtained for all types of money laundering, especially in cases involving predicate offences committed abroad. However, the FATF concluded that Switzerland still needs to make progress in imposing proportionate and sufficiently dissuasive sanctions.[43]

In its assessment of the transparency of legal persons and in particular the issue of bearer shares, the FATF commented that purchasers of bearer shares in Switzerland now are required to declare and identify themselves to the company or to a financial intermediary and, under certain circumstances, they have to identify the beneficial owner behind share transactions. Companies must keep a register of the holders of bearer shares and of beneficial owners.[44] The FATF concluded, however, that sanctions for violations of this requirement do not seem to be adequately dissuasive.[45]

Besides these action points raised through the monitoring processes by international bodies, there are other open issues that Switzerland needs to address to deal with IFFs convincingly. These include effective corporate criminal liability legislation directed not only at a limited number of economic crimes, but at all crimes for which companies might be held responsible.[46] In the IFF context, this is relevant because IFFs connected to human rights violations or environmental damage abroad may not always be covered by the current Swiss anti-money laundering legislation. In a wider context, this boils down to the question of how MNEs with their seats in Switzerland can be held responsible criminally (and civilly)

42 In the BSI Bank case, however, where FINMA found that the bank had seriously violated Swiss anti-money laundering law in the context of the 1MDB (the Malaysian sovereign wealth fund) corruption case, the FINMA enforcement proceedings eventually led to the dissolution of BSI Bank. See FINMA Press Release (24 May 2016) "BSI in Serious Breach of Money Laundering Regulations".

43 FATF (December 2016) *Anti-Money Laundering and Counter-Terrorist Financing Measures, Switzerland, Mutual Evaluation Report* at 3-4.

44 See Articles 697*i*-697*m* of the Swiss Code of Obligations (SR 220).

45 FATF (December 2016) at 9.

46 Betz K & Pieth M (2016) "Globale Finanzflüsse und Nachhaltige Entwicklung, Handlungsmöglichkeiten der Schweiz aus Sicht der Entwicklungspolitik" Basel Institute on Governance, Working Paper Series 21, at 27-33.

for the conduct of their subsidiaries in foreign countries.[47] Article 102(1) of the Swiss Criminal Code as it stands is insufficient in this regard.[48]

An interesting development is the growing number of newly established "crypto trusts" in Switzerland, which deal with blockchain technology. Since 2014, 40 such crypto trusts have been founded in the Canton of Zug, and the crypto currency "Ether" of the Ethereum trust enjoys the largest capitalisation after Bitcoin.[49] The Swiss anti-money laundering legislation applies to crypto currencies since 2016.[50] However, as crypto currencies offering maximum anonymity are on the rise,[51] the risk that they will be abused for money laundering purposes is ever growing. Switzerland will have to take additional measures to regulate crypto currencies.[52]

Another open issue for Switzerland, as a hub for commodity traders, is transparency in payments by such traders to officials in foreign countries. The current reform proposal for the Swiss stock corporation legislation foresees a duty on companies extracting raw materials to report publicly all payments to government agencies that exceed the amount of CHF 100 000 per year.[53] The reform proposal, however, omits commodity traders with their headquarters in Switzerland. This deficiency seriously reduces the likely effectiveness of the reform proposals. Switzerland should move forward in this area and require transparency in payments to government authorities not only from extracting companies but

47 See the "Responsible Business Initiative" of the Swiss Coalition for Corporate Justice, available at http://konzern-initiative.ch (visited 28 May 2018).

48 Pieth M (2015) "Anwendungsprobleme des Verbandsstrafrechts in Theorie und Praxis, Erfahrungen aus der Schweiz" 3 *Kölner Schrift zum Wirtschaftsrecht (KSzW)* at 229.

49 *Neue Zürcher Zeitung Online* (22 May 2018) "Das Schweizer Stiftungsvermögen ist auf fast 100 Milliarden Franken gestiegen"; *Cash Online* (12 July 2017) "Das nervenaufreibende Auf und Ab bei Ether".

50 Article 2(c) of the FINMA Anti-Money Laundering Ordinance (*Verordnung der Eidgenössischen Finanzmarktaufsicht über die Bekämpfung von Geldwäscherei und Terrorismusfinanzierung im Finanzsektor* (GwV-FINMA, SR 955.033.0).

51 *Bloomberg* (2 January 2018) "The Criminal Underworld Is Dropping Bitcoin for another Currency".

52 See *Cash Online* (30 January 2018) "Mark Pieth im Cash-Interview 'Die Schweiz schadet Leuten weltweit in verschiedenen Bereichen'".

53 *Botschaft zur Änderung des Obligationenrechts (Aktienrecht) vom 23 November 2016* (16.077) at 466-468. See also *Unlautere und unrechtmässige Finanzflüsse aus Entwicklungsländern, Bericht des Bundesrates in Erfüllung des Postulats 13.3848 (Ingold) vom 26 September 2013 und des Postulats 15.3920 (Maury Pasquier) vom 23 September 2015* at 25.

also from traders.[54]

3.2 The Responsibilities of South Africa

South Africa has different risks and responsibilities regarding IFFs from Switzerland due to its different economic structure. Particularly in the extractive sector, resource-rich South Africa has a number of responsibilities.

3.2.1 Measures Taken by South Africa to Tackle IFFs

South Africa has taken a number of important measures against illicit in- and outflows. To begin with, it has ratified a number of international treaties to combat IFFs, including the OECD Anti-Bribery Convention and UNCAC. As regards anti-money laundering and organised crime, South Africa has acceded to the Vienna Convention and ratified the Palermo Convention. The country has been a member of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) since 2002 and of the FATF since 2003. The FATF/ESAAMLG Mutual Evaluation Report of 2009 described South Africa's banking sector as "characterised by well-established infrastructure and technology, but limited participation (over 60% of the adult population was excluded from any formal financial services in 1994), and a growing demand for financial services".[55]

In the tax arena, South Africa is a member of the BEPS Inclusive Framework and has adopted the new international standards for the automatic exchange of information (AEOI). It has committed to the common reporting standard (CRS) and South African financial institutions have to comply with these standards when reporting to tax authorities.[56] As far as BEPS is concerned, the domestic legal framework for country-by-country reporting is in place and the information exchange network has been activated.[57]

3.2.2 Action Points for South Africa to Address

In its Phase 3 evaluation of March 2014, the OECD WGB noted a serious lack of foreign bribery enforcement actions by South Africa. Since 2007, when South Africa became a party to the OECD Anti-Bribery Convention, only ten foreign bribery

54 Betz & Pieth (2016) at 31 -32, with further references. See also Interdepartementale Koordinationsgruppe zur Bekämpfung der Geldwäscherei und der Terrorismusfinanzierung (KGGT) (June 2015) *Bericht über die nationale Beurteilung der Geldwäscherei- und Terrorismusfinanzierungsrisiken in der Schweiz* at 120-121.

55 FATF/ESAAMLG (26 February 2009) *Mutual Evaluation Report – Executive Summary, Anti-Money Laundering and Combating the Financing of Terrorism, South Africa* at 3.

56 See http://www.sars.gov.za/clientsegments/businesses/mod3rdparty/aeoi/Pages/default.aspx (visited 28 May 2018).

57 See http://www.oecd.org/tax/beps/beps-about.htm (visited 28 May 2018).

allegations had surfaced and none of them resulted in a prosecution, although South Africa has links to a number of countries with corruption risks. While the South African foreign bribery legislation, including corporate criminal liability, is strong, the lack of enforcement concerned the WGB because political and economic considerations might influence South Africa's ability to investigate and prosecute foreign bribery.[58] Further, in the OECD WGB Phase 2 and Phase 3 evaluations, it was noted that, for domestic bribery and the prosecution of legal persons, South Africa cited only one case in which a company was convicted (for passive corruption).[59]

In this regard, the State of Capture Report released in October 2016 by the former Public Protector, Thuli Madonsela, is an important step forward. The Report:

> relates to an investigation into complaints of alleged improper and unethical conduct by the president and other state functionaries relating to alleged improper relationships and involvement of the Gupta family in the removal and appointment of ministers and directors of State Owned Entities (SOEs) resulting in improper and possibly corrupt award of state contracts and benefits to the Gupta family's businesses.[60]

The remedial action decided upon by the then Public Protector included the establishment of a properly funded commission of inquiry to investigate the alleged misconduct.[61] In March 2018, the six members of the commission of inquiry were named and the investigation was to start within the ensuing months.[62]

In the area of anti-money laundering, the FATF/ESAAMLG Mutual Evaluation Report of 2009 found that in South Africa:

> Major profit-generating crimes include fraud, theft, corruption, racketeering, precious metals smuggling, abalone poaching, "419" Nigerian-type economic/investment frauds and pyramid schemes, with increasing numbers of sophisticated and large-scale economic crimes and crimes through criminal syndicates. South Africa remains a

58 Phase 3 Report on Implementing the OECD Anti-Bribery Convention in South Africa (13 March 2014) at 5-6.

59 Phase 3 Report on Implementing the OECD Anti-Bribery Convention in South Africa (13 March 2014) at 18; Phase 2 Report on Implementing the OECD Anti-Bribery Convention in South Africa (17 June 2010) at 63-64.

60 *State of Capture: A Report of the Public Protector* (14 October 2016) at 4.

61 *State of Capture: A Report of the Public Protector* (14 October 2016) at 353-354.

62 See https://www.bloomberg.com/news/articles/2018-03-07/s-africa-names-6-members-of-commission-to-probe-state-capture (visited 28 May 2018). The commission commenced its inquiry on 20 August 2018.

> transport point for drug trafficking. Corruption also presents a problem.[63]

The FATF/ESAAMLG Report noted that, although South Africa did not criminalise self-laundering, its anti-money laundering legislation was largely consistent with the international standard set by the Vienna and Palermo Conventions.[64] However, South Africa was rated at the time as being non-compliant with the FATF Recommendations, especially in relation to enhanced due diligence for politically exposed persons (PEPs) and correspondent banking relationships; special attention for business relationships and transactions with persons from or in higher risk countries; information on the beneficial ownership and control of legal persons; and designated non-financial businesses and professions – for example, most precious metals and stones dealers were not subject to the customer due diligence and record keeping requirements of the Financial Intelligence Centre Act of 2001.[65] In November 2017, the FATF removed South Africa from its targeted follow-up process, noting that South Africa had addressed adequately the remaining deficiencies pertaining to customer due diligence and record-keeping.[66] The next FATF/ESAAMLG mutual evaluation of South Africa is scheduled provisionally for 2019/2020.[67]

4 PANAMA PAPERS AND PARADISE PAPERS: LESSONS FROM OFFSHORE LEAKS

When it comes to tackling IFFs in the countries directly affected by the illicit in- and outflows, offshore centres play a central role. Recent offshore leaks, such as the Panama Papers and the Paradise Papers, have shown the extent of the global offshore industry and have shed light on the problems linked to it. The Panama Papers comprise 11.5 million internal documents (2.6 terabytes) leaked by an unknown source from the Panamanian law firm Mossack Fonseca to journalists of the German newspaper *Süddeutsche Zeitung*. The data extend from the 1970s to 2016.[68] The Paradise Papers are a leak encompassing 13.4 million internal documents (1.4 terabytes) which were obtained by the same German newspaper. The majority of the documents originated with the law firm Appleby which has its head office on the Isle of Man. In addition, there were details from the company

63 FATF/ESAAMLG (26 February 2009) at 3.
64 FATF/ESAAMLG (26 February 2009) at 3-4.
65 FATF/ESAAMLG (26 February 2009) at 11-20.
66 Financial Intelligence Centre/National Treasury of South Africa (10 November 2017) "FATF Agrees to End South Africa's Mutual Evaluation Follow-Up Process".
67 See http://www.fatf-gafi.org/countries/#South Africa (visited 28 May 2018).
68 See http://panamapapers.sueddeutsche.de/ (visited 28 May 2018).

registers maintained by governments in 19 jurisdictions.[69] The data cover the period from 1950 to 2016.[70] The data from the offshore leaks were shared with the International Consortium of Investigative Journalists (ICIJ).[71] In May 2018, the ICIJ launched the "West Africa Leaks", investigating the consequences of the offshore industry and of tax avoidance for 15 West African countries.[72]

On a political level, the offshore leaks had a significant impact – for example, the Prime Ministers of Iceland[73] and Pakistan[74] stepped down in the wake of the Panama Papers scandal – and triggered a number of public and private initiatives and legislative changes on the domestic,[75] regional[76] and international[77] levels. In Switzerland, for example, the Paradise Papers leak triggered a criminal complaint by human rights campaigners, asking the Swiss attorney general to investigate how the commodities giant Glencore acquired the Katanga copper mine in the Democratic Republic of Congo.[78] In their report, *Overcoming the Shadow*

69 These jurisdictions are Antigua and Barbuda, Aruba, the Bahamas, Barbados, Bermuda, the Cayman Islands, the Cook Islands, Dominica, Grenada, Labuan, Lebanon, Malta, the Marshall Islands, St Kitts and Nevis, St Lucia, St Vincent, Samoa, Trinidad and Tobago, and Vanuatu.

70 See https://www.theguardian.com/news/series/paradise-papers (visited 28 May 2018).

71 See https://offshoreleaks.icij.org/ (visited 28 May 2018).

72 See https://www.icij.org/blog/2018/05/introducing-west-africa-leaks/ (visited 28 May 2018).

73 *The Guardian Online* (5 April 2016) "Iceland PM Steps Aside after Protests over Panama Papers Revelations".

74 *BBC Online* (28 July 2017) "Pakistan PM Nawaz Sharif Resigns after Panama Papers Verdict".

75 See, for example, *Financial Times Online* (2 May 2018) "Caymans, Bermuda and BVI Face New Corporate Transparency Laws".

76 See, for example, the work of the PANA Committee of the European Parliament which concluded its mandate in October 2017. The 206 political recommendations of the PANA Committee were adopted by the European Commission and Council on 13 December 2017. Details available at http://www.europarl.europa.eu/committees/de/pana/home.html (visited 28 May 2018).

77 For example, the 2018 World Economic Forum in Davos, Switzerland had a session devoted to the Paradise Papers and global tax avoidance.

78 See *The Guardian Online* (21 December 2017) "Paradise Papers Prompt Criminal Complaint against Glencore". In May 2018, the UK Serious Fraud Office was preparing to open a formal bribery investigation in the case. See *Bloomberg* (18 May 2018) "Glencore May Face UK Bribery Probe Over Congo Dealings". Furthermore, the US Department of Justice is conducting an investigation into bribery and money laundering. See *Financial Times Online* (3 July 2018) "Glencore Subpoenaed by US Justice Department".

Economy, Stiglitz & Pieth[79] remark that:

> There is a growing global consensus that the secrecy-havens – jurisdictions which undermine global standards for corporate and financial transparency – pose a global problem: they facilitate both money laundering and tax avoidance and evasion, contributing to crime and unacceptably high levels of global wealth inequality.[80]

The Panama Papers and Paradise Papers, as well as other offshore leaks, raised several concrete issues relevant to confronting IFFs, some of which are addressed below.

4.1 Nominee Directors and Bearer Shares

The Panama Papers expose the typical *modus operandi* used to conceal the true ownership of a company: a shell company is founded by an offshore provider, for example, by a law firm such as Mossack Fonseca, which then installs nominee directors who sign anything they are asked to sign on behalf of the company (sometimes even blank sheets of paper). To the outside world, the nominee directors officially represent the company and the identity of the true owner remains unknown. According to the Panama Papers, one such nominee director represented 25 000 existing and former shell companies! Three documents are needed to set up this system of concealment. Firstly, the nominee director signs a declaration undertaking to follow the orders of the true owner and not to bring any claims against the true owner or the company. Secondly, the true owner receives a power of attorney that makes him the *de facto* director of the company. And, finally, the nominee director signs an undated resignation letter, handing it over to the true owner who thus can dismiss the nominee director at any time.[81]

The shares of the shell company may be issued as bearer shares, which are not registered against the name of the shareholder in a share register. Whoever physically owns all of its shares owns the company. From the outside, it is impossible to determine the true beneficial owner behind the company. A further

79 Joseph Stiglitz and Mark Pieth had been members of the Committee of Independent Experts established by the President of Panama in the wake of the Panama Papers scandal of 2016. The Committee's task was to assess and recommend legal and institutional reforms for Panama. Stiglitz and Pieth left the Committee in August 2016. See http://time.com/4446733/joseph-stiglitz-panama-commission/ (visited 28 May 2018).

80 Stiglitz JE & Pieth M (November 2016) *Overcoming the Shadow Economy* at 1.

81 Obermayer B & Obermaier F (2016) *Panama Papers: Die Geschichte einer weltweiten Enthüllung* at 20-22 & 188-190.

method of disguising the true owner of a company is by way of nominee shareholders who hold the shares on a quasi-trust basis.[82]

The question of anonymous holders of bearer shares is not new. For example, in 2015 Switzerland, when implementing the Recommendations of the FATF,[83] introduced more strict regulation of bearer shares. However, further legislative amendments are probably necessary.[84]

4.2 Publicly Accessible Company Registers

Concealing beneficial ownership behind shell companies is a perfect way to evade taxes and launder ill-gotten gains. One way to resist this are publicly accessible company registers. Such registers should identify the directors, agents and beneficial owners of legal persons. They should be public because resources of government agencies are limited, and because public accessibility allows civil society and the media to take on a watchdog role.[85] Interestingly, the United Kingdom is about to amend its laws to introduce public ownership registers in Britain's overseas territories, including the British Virgin Islands and the Cayman Islands.[86]

4.3 The Role of Legal Services Providers

Another lesson from the Panama Papers concerns the role of legal services providers in the creation of offshore shell companies. It is usual lawyers' work to create legitimate companies for clients. However, some Swiss lawyers appear in the Panama Papers because they helped their clients to create offshore structures.[87] In 2016, the FATF noted that in Switzerland, the work of lawyers and notaries does not fall under the Swiss anti-money laundering legislation if this work is limited to the creation of companies, legal persons and legal arrangements, and does not involve preparing or executing the financial part of those transactions.[88] If lawyers help to create offshore shell companies, the important question is where to draw the line between financial intermediation that falls under the Swiss anti-money laundering legislation, and "traditional" lawyers' work that does not. In the wake of recent offshore leaks, it becomes more and more difficult for lawyers to

82 Obermayer & Obermaier (2016) at 22-23.
83 Recommendation 24 of the FATF Recommendations, 2012.
84 See §3.1.2 above.
85 Stiglitz & Pieth (November 2016) at 16.
86 *The Guardian Online* (1 May 2018) "'Dirty Money': U-turn as Tories Back Plans to Make Tax Havens Transparent".
87 *Tagesanzeiger Online* (6 April 2016) "Schweizer Anwälte helfen bei heiklen Schattengeschäften".
88 FATF (December 2016) at 95-96 & 197.

turn a blind eye to the question of why their clients actually set up their offshore companies.

5 CONCLUSION

IFFs know no borders. Confronted with illicit in- and outflows, countries of the North and South, such as Switzerland and South Africa respectively, need to be aware of their risks and responsibilities and should have strategies available to combat IFFs. Under-regulation of MNEs or financial and legal service providers and weak enforcement of laws in their territory often will have dire consequences, not only abroad – in particular for developing economies – but sometimes also at home. In resource-rich countries of the South, the state's assets need to be protected against possible corruption and graft, as well as the dangers of tax avoidance and evasion by MNEs. Attracting foreign investment is only one side of the coin – the flipside is to force foreign companies to respect laws and pay taxes. The recent offshore leaks have placed the spotlight on the scale of the global offshore industry that facilitates IFFs, and have raised concrete issues that need to be addressed by lawmakers and regulators worldwide. International co-operation between countries of the North and South is key to tackling IFFs effectively.