The Impact of Financial Services in EU Free Trade and Association Agreements on Money Laundering, Tax Evasion and Elusion

Study by
the **T.M.C. Asser Instituut**
and the **University of Groningen**

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Preface

This report, entitled "The Impact of Financial Services in EU Free Trade and Association Agreements on Money Laundering, Tax Evasion and Elusion", analyses how the provisions on financial services that are included in EU trade and association agreements impact money laundering, tax evasion and tax elusion. It has been commissioned by the European Parliamentary Research Service (EPRS) for the Committee on International Trade (INTA) and was prepared by the T.M.C. Asser Instituut in cooperation with the Groningen Centre for European Financial Services Law (GCEFSL), University of Groningen.

The Hague, May 2016

Executive Summary

Topic and problem definition

The European Union has pursued deep and comprehensive free trade agreements since the *Global Europe Strategy* of 2006.[1] In 2009, the Treaty of Lisbon overhauled the EU's external action and increased the competences of the European Parliament. The Treaties now explicitly require that the Union's external action, including its trade partnerships, contribute to the goals of rule of law promotion, the sustainable development of the EU and its trading partners, and the eradication of poverty in developing countries. In October 2015, the European Commission proposed the updated EU's external trade and investment strategy, entitled *Trade for All*.[2]

As the world's largest services exporter, the EU emphasises the importance of liberalising trade in services as a means of stimulating economic growth and foreign direct investment, both within the EU and on a global scale. Financial services are a crucial income-generating activity. However, greater domestic market access for foreign financial services providers, and easier cross-border banking and insurance transactions, create opportunities not only for business and economic prosperity, but also for abuse through money laundering and tax fraud. In order to counter such undesired effects through EU free trade agreements and association agreements (both referred to as FTAs throughout this study), and operationalise EU Treaty provisions on achieving the above-mentioned wider societal goals, liberalisation of the provision of financial services should be accompanied by substantive and institutional safeguards aimed at reducing illicit financial flows. Yet, while the new *Trade for All* strategy acknowledges the necessity of tackling issues wider than purely trade-related matters, it only recognises the significance of addressing 'aggressive corporate profit shifting and tax avoidance strategies' and 'tax evasion' in general.[3] It makes no mention of action against money laundering.

The present study addresses this issue by analysing the impact of the inclusion of financial services provisions in EU FTAs with third countries on money laundering, tax evasion and tax elusion. The assessment focuses on FTAs with Mexico, South Africa, Serbia, the Republic of Korea and Colombia/Peru. These are selected to encompass countries where the conclusion of such agreements might pose an elevated risk of money laundering and tax evasion, to include countries with different levels of economic development, and to ensure a degree of geographical coverage.[4]

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[1] European Commission, *Global Europe: Competing with the World*, COM(2006) 567.

[2] European Commission, *Trade for All: Towards a More Responsible Trade and Investment Policy*, COM(2015) 497.

[3] *Ibid*., pp. 10 and 18.

[4] The EU-Central America Association Agreement, to which Panama is a party, is not included in this study. The FTAs were selected prior to the release of the 'Panama Papers'.

Objectives and methodology

The aim of this study, commissioned by the European Parliamentary Research Service (EPRS) for the Committee on International Trade (INTA) and carried out by the Asser Institute in cooperation with the University of Groningen, is threefold:

- To analyse the legal provisions of relevance to the supply of financial services that have been included in the selected EU FTAs and examine the implementation of these provisions in national legal orders of the selected EU partner countries;
- To assess the actual and potential impact of the liberalisation of trade in financial services between the EU and these partner countries in question on money laundering (primarily insofar as it is connected with the use of the international financial system to conceal the proceeds of crime) and tax evasion (notably insofar as it constitutes an aspect of money laundering);
- To provide policy recommendations to the INTA Committee for consideration in ongoing trade negotiations with third countries on how to improve the legal and institutional frameworks for the liberalisation of financial services with a view to combating money laundering, tax evasion and elusion.

In order to meet these objectives, the research team has carried out a comprehensive *comparative legal analysis* of the provisions of relevance to the supply of financial services in the selected EU FTAs (the texts of which are compiled in Annex 2) and the related implementing measures in the partner countries concerned. Building on the findings emerging from the comparative legal analysis, an *empirical analysis* has been conducted into whether the operation of EU FTAs has increased the threat of money laundering and tax evasion in these countries. For this purpose, publicly available information concerning illicit financial flows (defined as money illegally earned, transferred, or utilised) and their causes was gathered and analysed. In addition, important actors involved in combating money laundering and tax evasion at international, EU and national levels – such as financial supervisory authorities and financial intelligence units, governmental and non-governmental organisations, and academics – were consulted. The key findings from the legal and empirical parts have been *integrated* in order to provide policy recommendations. Both the findings and the recommendations are presented below.

Key findings

- EU FTAs generally cover a *broad* range of financial services, including banking and insurance.
- All EU FTAs contain *prudential carve-outs* in order to address important public policy concerns, such as resolving monetary and balance of payments difficulties.
- Most EU FTAs stipulate *vague commitments* of third countries with respect to combating money laundering and tax evasion, typically taking the form of 'best endeavour' clauses. Such provisions do not foster the national efforts aimed at combating these practices. With the exception of the EU-Colombia/Peru Agreement, the degree of sophistication of the analysed FTAs is inversely proportional to their lifespan: the older the FTA, the weaker the obligations of the partner countries.

- Provisions on *tax cooperation* as a rule fall outside the scope of EU FTAs.
- While all the partner countries concerned have committed themselves to *respecting international and European standards* on the combating of money laundering and tax evasion, the actual levels of their *implementation and enforcement vary*.
- While *precise* statistical data is lacking, there is a *general agreement that illicit financial flows originating from developing countries are substantial and on the rise*. In particular, according to the Global Financial Integrity, Mexico and South Africa are among the top 10 biggest exporters of illicit money. Thus, the developing countries concerned face *a significant threat* of money laundering.
- At present there is no conclusive *statistical* evidence to prove a causal link between the operation of EU FTAs and an increase in illicit financial flows. This was confirmed by all the respondents involved in the study. However, the available data does provide a *strong indication* that the liberalisation of trade between the EU and developing countries *increases the threat* of money laundering, given three key factors: (a) the significant degree of *trade openness* envisaged by EU FTAs, (b) the already *substantial and constantly rising illicit financial flows* from developing countries, and (c) the attractiveness of the EU as a destination for money launderers from such countries.
- An increase in illicit financial flows may not only (or even primarily) be attributable to the liberalisation of *financial* services. While traditionally, illicit money has been laundered through the international financial system, nowadays trade-based money laundering – through fraudulent manipulation of the price, quantity and quality of goods and services in general – has become increasingly important as a means for illicit transfers of funds out of developing countries.
- Illicit financial flows can have a *profoundly negative impact* on developing countries. Such an impact can be caused not only by outflows of illicit money from developing countries but also by inflows of illicit money into such countries. Substantial outflows of illicit funds severely undermine domestic resource mobilisation, imperilling sustainable development and economic growth. Significant inflows of illicit funds in turn strengthen crime and have major adverse socio-economic consequences.
- The key problem faced by developing countries in combating illicit financial flows is a *significant discrepancy between the law on the books and the law in action*. The effectiveness of anti-money laundering (AML) systems in such countries is undermined by two key factors: (a) *structural weaknesses* caused by poor implementation of good governance principles and deficiencies in the enforcement of the rule of law (e.g. corruption, large-scale organised crime, and substantial informal economy); and (b) major *functional weaknesses* related to the insufficient capacity of the authorities in fighting money laundering (e.g. shortage of financial and human resources, insufficient knowledge and experience, and a lack of coordination between the competent authorities). In addition, insufficiently strict anti-money laundering controls in the developed world, in particular the EU, have exacerbated the problem.
- The closer the ties between the EU and the partner country, the greater the *potential for the EU* to exercise direct or indirect influence on such a country.

Policy recommendations

- Given that the liberalisation of trade in goods and services, including financial services, between the EU and developing countries increases the risk of money laundering and tax evasion in these countries, the *extent of trade liberalisation* under EU FTAs should be made *conditional* on the partner country's respect for international and European standards in this area.
- Instead of producing 'Trade Sustainability Impact Assessments' just before the finalisation of negotiations or even afterwards, *these assessments should be finalised well in advance* of the end of the negotiations in order to enable the negotiators to take such recommendations into account.
- In view of the rise of trade-based money laundering, in future FTAs the EU should consider including provisions aimed at combating the *mispricing* of internationally traded goods and services, both between two different companies and companies of the same group or holding.
- In order to increase transparency and combat tax evasion, future EU FTAs should incorporate provisions on *cooperation in tax matters*. In particular, these provisions could address country-by-country reporting of payments made to governments by firms operating under the jurisdiction of one of the States Parties.
- In line with EU Treaty obligations and the new *Trade for All* strategy, future FTAs should include provisions on the establishment of mechanisms for monitoring the trading partner's *compliance* with the anti-money laundering and anti-tax evasion commitments that they undertook under these FTAs.
- The EU should also develop means to: *continuously monitor* the effects of the liberalisation of trade in goods and services, including financial services; carry out evaluations; and, where necessary, develop proposals to amend FTAs to address any concerns that may result from these evaluations.
- Efforts to foster international cooperation between EU partner countries and regional and global bodies in charge of developing international standards in the areas of banking, insurance, money laundering and tax evasion should be improved in order to provide for a greater *exchange of information* and *best practices*.
- Increasing the *effectiveness* of the law on the books in developing countries requires the EU to *widen* its approach to external trade by linking it to the overarching EU goals of international promotion of the rule of law and sustainable development, as well as the fight against poverty.
- The EU should invest *more resources* in studying and eliminating the *causes* of illicit financial flows from and into developing countries.
- In light of the post-Lisbon Treaty enhancement of the prerogatives of the European Parliament, the *European Parliament should have a stronger role* in EU trade negotiations to enable political contestation and debate on the choices to be made and directions to be followed in EU external trade, as well as to ensure a more effective monitoring of their implementation.

Acronyms

ACITA	Act for the Coordination of International Tax Affairs (Korea)
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering/Combatting the Financing of Terrorism
AMLD	Anti-Money Laundering Directive (European Union)
BCP	Banking Core Principles for Effective Banking Supervision
BIS	Bank for International Settlements
BOK	Bank of Korea
BSD	Banking Supervision Department (South Africa)
CATF	Chemical Action Task Force
CCP	Common Commercial Policy
CDD	Customer Due Diligence
CDR	Capital Requirements Directive (South Africa)
CETA	Comprehensive Economic and Trade Agreement
CFT	Combatting the Financing of Terrorism
CISCA	Collective Investment Schemes Control Act (South Africa)
CMLAC	Counter-Money Laundering Advisory Council (South Africa)
CNBV	Comisión Nacional Bancaria y de Valores (National Banking and Securities Commission) (Mexico)
CNSF	Comisión Nacional de Seguros y Fianzas (Mexico)
CONDUSEF	Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros
DCI	Development Cooperation Instrument
DNFBPs	Designated Non-Financial Business Professionals
DTA	Double Taxation Agreements
EBA	European Banking Authority
EDFTRUA	Enforcement Decree on Reporting and Use of Certain Financial Transaction Information (Korea)
EP	European Parliament
EPA	Economic Partnership Agreement
EPRS	European Parliamentary Research Service
ESAAMLG	Eastern and South Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FETA	Foreign Exchange Transactions Act (Korea)
FIC	Financial Intelligence Centre (South Africa)
FIU	Financial Intelligence Unit
FMA	Financial Markets Act (South Africa)
FSB	Financial Services Board (South Africa)
FSC	Financial Services Commission (Korea)
FSCA	Financial Sector Conduct Authority (South Africa)
FSR	Financial Sector Regulation (South Africa)
FSRBs	FATF-Style Regional Bodies
FSS	Financial Supervisory Service (Korea)
FTA	Free Trade Agreement and/or Association Agreement

FTRUA	Act on Reporting and Use of Certain Financial Transaction Information (Korea)
GAFILAT	Financial Action Task Force of Latin America
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Income
GFI	Global Financial Integrity
HMN	Hot Money Narrow
HR/VP	High Representative/Vice-President
ICP	International Core Principles of the International Association of Insurance Supervisors
IOSCO	International Organisation of Securities Commissions
IFFs	Illicit Financial Flows
IMF	International Monetary Fund
INTA	Committee on International Trade
INCSR	International Narcotics Control Strategy Report (Mexico)
IRD	International Relations Division (South Africa)
JSE	Johannesburg Stock Exchange (South Africa)
KNTS	Korean National Tax Service
LSE	London School of Economics and Political Science
MERCOSUR	Mercado Común del Sur
MLPA	Money Laundering Prevention Administration (Serbia)
MONEYVAL	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
NBS	National Bank of Serbia
NAFTA	North American Free Trade Agreement
NEDLAC	National Economic Development and Labour Council (South Africa)
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Cooperation and Development
RTAs	Regional Trade Agreements
SAA	Stabilisation and Association Agreement (Serbia)
SA Council	Stabilisation and Association Council SA
Committee	Stabilisation and Association Committee
SADC	Southern Africa Development Community
SARB	South African Reserve Bank
SARS	South African Revenue Service
SBS	Superintendent of Banks, Insurance and Pension Funds (Peru)
SHCP	Secretaría de Hacienda y Crédito Público (Mexico)
STRs	Suspicious Transaction Reports
SUNAT	Peruvian Customs and Tax Authority
TDCA	Trade, Development and Co-operation Agreement (South Africa)
TEU	Treaty on European Union
TPA	Trade Promotion Agreement
TPCA	Trust Property Control Act (South Africa)
Trade SIA	Trade Sustainability Impact Assessment (European Commission, DG Trade)

UAC/ECA	Joint African Union Commission/United Nations Economic Commission for Africa
UAIF	Unidad de Información y Análisis Financiero (Colombia)
UIF	Unidad de Inteligencia Financiera (Peru)
UNODC	United Nations Office on Drugs and Crime

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Part 1: Introduction

This study investigates the implementation and effects of the inclusion of provisions relevant to financial services in the selected EU free trade and association agreements[1] with third countries, with a particular focus on their propensity to facilitate money laundering, and to be misused for tax evasion and elusion reasons.

1.1 Definition of Concepts

For the purposes of this study, financial services are defined broadly as 'any service of a financial nature offered by a financial supplier of a party to the relevant agreement',[2] and cover banking and insurance. Following conventional wisdom, the study has also proceeded on the basis of the following general definitions of the three key concepts involved therein. 'Money laundering' is the term used for a number of acts involving processing the proceeds of crime with a view to concealing their illegal origin and bringing them back into the legal economy. It should be recalled in this context that the Financial Action Task Force (FATF) has recommended that countries criminalise money laundering and 'apply the crime of money laundering to all serious offences with a view to including the widest range of predicate offences'.[3] 'Tax evasion' has been defined as an illegal act of evading taxes by concealing income, earned either legally or illegally, from detection and collection by the tax authorities. Finally, 'tax elusion', also often referred to as 'tax avoidance', has been understood as a legal act of using the tax regimes to one's own advantage to reduce one's tax burden.

1.2 Context of the Study

The study is carried out in a period in which the EU – after already setting out such a course in the past – has committed itself in its Treaties to ensure that relations with third parties, including trade partnerships, contribute to the goals of promotion of the rule of law, sustainable development in the EU and in other countries around the world, and the fight against poverty in developing countries (notably in Articles 3(5) and 21(2)(d) TEU). Furthermore, the Union is to ensure consistency between the different areas of its external action and between these and its other policies (Article 21(3) TEU). Another important element of the post-Lisbon situation is the role that is assigned to the European Parliament in the context of the Common Commercial

[1] The authors recognise that the latter encompass more than the former, but for the sake of brevity the two types of agreements are together referred to as EU FTAs or FTAs.

[2] European Parliament, Directorate General for Internal Policies, *Financial Services in EU Trade Agreements: Study for the ECOM Committee*, EU 2014. Also see K. Sullivan, *Anti–Money Laundering in a Nutshell: Awareness and Compliance for Financial Personnel and Business*, Berkeley, CA: Apress, 2015; and L. Pantaleo, M. Andenas and C. Reul, *The European Union as a Global Model for Trade and Investment*, Research Paper No. 2016-02, University of Oslo, Faculty of Law, February 2016.

[3] FATF, *International Standards of Combating Money Laundering & the Financing of Terrorism & Proliferation: The FATF Recommendations*, February 2012 (as updated in October 2015), para. B.3.

Policy (CCP). Notably, the European Parliament now has to give its consent to trade, association and other agreements, and is to be immediately and fully informed at all stages of the negotiations procedure.[4]

Elements of the approach regarding such 'non-trade concerns' date back several decades. The integration of human rights,[5] labour rights[6] and protection of the environment has been on the EU agenda since the end of the 1980s,[7] as provisions on these topics included in recent EU trade agreements show. Inserting such commitments in the trade agreements does not necessarily mean that 'non-trade concerns' are effectively tackled in practice. The path from the adoption of law to its application in legal practice can take time. A proper policy process demands that after new standards are introduced, their implementation and effectiveness in realising the intended outcomes are assessed. In that respect, it is to be welcomed that monitoring implementation efforts is stressed explicitly in the new EU trade and investment strategy, entitled *Trade for All*, which was published by the European Commission in October 2015.[8] The document also sets out that European values, such as sustainable development, human rights, transparency, fair and ethical trade and the fight against corruption are to be promoted around the world, and that this means to include anti-corruption rules in the EU FTAs. Though countering tax evasion is mentioned as well, neither illicit money streams nor anti-money laundering (AML) are referred to.

In this study, five agreements concluded by the European Union with third countries or groups of countries were scrutinised as far as their provisions on financial services, money laundering, tax evasion and tax elusion are concerned. Three of the five agreements are with developing countries (South Africa, Mexico, and Colombia/Peru), one is with a country in transition that is striving to become an EU Member State (Serbia), and one with a developed country (Republic

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[4] See M. Armanoviča and R. Bendini, *The Role of the European Parliament in Shaping the European Union's Trade Policy after the Entry into Force of the Treaty of Lisbon*, In-Depth Analysis for Policy Department, DG External Policies, Brussels, 2014.

[5] Since the early 1990s, see L. Bartels, (2013) Human rights and Sustainable Development Obligations in EU Free Trade Agreements, in: D. Kleimann (ed.), *EU Preferential Trade Agreements: Commerce, Foreign Policy, and Development Aspects*, European University Institute, 2013, pp. 127-139.

[6] See, for instance, the European Commission Communication *Promoting Core Labour Standards And Improving Governance In The Context Of Globalisation*, COM(2001)416.

[7] The 1987 Single European Act had already introduced the duty to integrate environmental concerns in all other policy areas, and the goal of promoting sustainable development was added in 1997 by the Treaty of Amsterdam (nowadays art. 11 TFEU). The 1998 Cardiff process stimulated giving effect to the integration clause in EU trade relations. See W.Th. Douma, The Promotion of Sustainable Development through EU Trade Instruments, in: L. Pantaleo and M. Andenas (eds.), *The European Union as a Global Model for Trade and Investment*, University of Oslo Faculty of Law Research Paper No. 2016-02, pp. 86-103.

[8] European Commission, *Trade for All: Towards a More Responsible Trade and Investment Policy*, COM(2015)497.

of Korea). For the purposes of the study, we will refer to Serbia as a developing country given that, according to the International Monetary Fund (IMF), it currently belongs to the group of emerging and developing economies (which also includes South Africa, Mexico, Colombia and Peru)[9] and that, in many respects, countries in this group face similar development problems.

The number of initiatives relevant to this study is considerable. In particular, note was taken of the experience and outputs of the 'Cocaine Route Programme', a cooperation in the field of money laundering between the EU and GAFILAT, the Financial Action Task Force for Latin America which has some of the target countries of this study as members. The findings of several relevant studies of the European Parliament were also used as a basis. In particular, note was taken of the In-Depth Analysis conducted for the TAXE Special Committee of the EP concerning 'Selected International Third-Country Tax-Governance Issues' of October 2015, with emphasis on the part concerning the relationship between tax issues and illicit financial flows,[10] the examination carried out in 'Tax Transparency – Openness, Disclosure and Exchange of Information', inasmuch as it pointed out the direct link between lack of transparency in tax matters and money laundering and terrorism financing,[11] and finally, the study concerning 'Financial Services in EU Trade Agreements' carried out in November 2014 for the ECON Committee.[12]

1.3 Objectives of the Study

The overall purpose of the study is to contribute to the improvement of the EU's international action against illicit activities such as money laundering and tax frauds. EU institutions are strongly committed to streamlining their effort both domestically and internationally in the fight against illicit financial flows, whatever origin they have and no matter what form they take.

More specifically, the aim of the study is threefold:

- To analyse the legal provisions of relevance to the supply of financial services that have been included in the selected EU FTAs and examine the implementation of these provisions in national legal orders of the selected EU partner countries;
- To assess the actual and potential impact of the liberalisation of trade in financial services between the EU and these partner countries in question on money laundering (primarily insofar as it is connected with the use of the international financial system to

[9] International Monetary Fund, Country Composition of WEO Groups. In May 2013, the OECD initiated accession negotiations with Colombia. While the IMF was followed in this respect, it can be noted that the EU defines the countries analysed in this study as middle-income countries.

[10] J. Owens, Selected International Third-Country Tax-Governance Issues, at 17 ff.

[11] C. Remeur, Tax Transparency – Openness, Disclosure and Exchange of Information, In-Depth Analysis of the European Parliament Research Service (EPRS), at 9 ff.

[12] A. Lang and C. Conyers, Financial Services in EU Trade Agreements, Study for the ECON Committee.

conceal the proceeds of crime) and tax evasion (notably insofar as it constitutes an aspect of money laundering);

- To provide policy recommendations to the INTA Committee for consideration in ongoing trade negotiations with third countries on how to improve the legal and institutional frameworks for the liberalisation of financial services with a view to combating money laundering, tax evasion and elusion.

1.4 Structure and Methodology of the Study

The study is divided into two main parts. The first part (Chapter 2) focuses on a comparative legal analysis of, on the one hand, the provisions relevant to financial services included in the aforementioned five EU FTAs, and, on the other, the relevant domestic legislation of the six partner countries involved. The purpose of this part is to evaluate the legal frameworks governing illicit financial flows between the EU and the selected third countries. The trade agreements are discussed following the order of the date on which their negotiations were concluded: EU-Mexico (1997), EU-South-Africa (1999), Serbia (2008), EU-Korea (2009) and EU-Colombia/Peru (2010). For each of these agreements and legal frameworks of the partner countries concerned the study notably examines:

- the extent of coverage of financial services provisions and those related to this sector, and as far as possible the corollary effect(s) in terms of curbing or fostering money laundering, tax evasion and elusion practices;
- the effectiveness, achievements and deficiencies of any safeguards accompanying the inclusion of provisions related to financial services in terms of curbing – in relation to the originally intended results – money laundering, tax evasion and elusion;
- the extent to which better drafting of provisions related to financial services and the implementation of the existing financial services provisions could contribute to achieving the originally intended results;
- whether the rules are fit-for-purpose in today's environment in relation to money laundering, tax evasion and elusion practices, as well as the effectiveness of the existing mechanisms for monitoring and compliance.

The analysis consists of five sections, each of which covers one FTA.[13] Each of these sections starts with a short sketch of the context of the trade relationship between the country in question and the EU, and the institutional framework of the agreement. Subsequently, the regulatory framework for supplying financial services and combating illicit financial flows in the agreement is examined. This is followed by an assessment of the national legislation dealing with financial services, money laundering, tax evasion and tax elusion, where possible in light of the provisions of the agreement, other relevant international standards, guidelines, etc., and relevant developments. At the end of each section, some preliminary conclusions focused on the country analysed are presented. At the end of Chapter 2, some common key findings are outlined in order to identify the current state of affairs from a purely legal viewpoint. The preliminary conclusions and the key findings serve as a basis for the empirical part, in which the practical effects of the liberalisation of financial services between the EU and the third countries concerned are examined in further detail.

[13] To this end, Colombia and Peru are discussed in a one single report.

The original plan to also describe in detail a number of EU legal systems was abandoned when it became apparent that this was not conducive to answering the main questions of this study. Since the study was about FTAs with non-EU countries and their effect on illicit financial flows, it was decided that the focus should be on the FTAs, the rules on the liberalisation of financial services contained in these FTAs and on the corresponding legislation and legal practice of the EU's trading partners. Instead of also describing the legal systems of some of the EU member states, it was decided to make use of the information gathered on some of these countries where this was conducive to other findings throughout the study.

The second part of the study (Chapter 3) carries out an empirical examination of the practical effects of the liberalisation of financial services between the EU and the concerned third countries on money laundering, tax evasion and elusion. Given that financial services are the focus of this study, the empirical investigation is centred on money laundering because it is closely linked to the use of the international financial system in order to conceal the proceeds of crime. Tax-related illegal practices have been considered inasmuch as they constitute an aspect of money laundering. The main findings of the empirical investigation are presented at the end of the chapter.

For the purposes of the study, the research team has gathered and analysed information concerning the illicit financial flows affecting the selected third countries in general. More specifically, the team searched for evidence of (an increase in) such flows after the EU FTAs came into effect. To begin with, an analysis was carried out of the publicly available studies produced, *inter alia*, by the United Nations Office on Drugs and Crime (UNODC), the Joint African Union Commission/United Nations Economic Commission for Africa (AUC/ECA), the Organisation for Economic Cooperation and Development (OECD), the World Bank, non-governmental organisations, such as Global Financial Integrity (GFI), financial intelligence units, as well as academics.

In addition, the research team contacted key actors involved in combating money-laundering at international, EU and national level, with a view to: (a) receiving further data; and (b) verifying the information that it had gathered itself. To that effect, we prepared a questionnaire (see Annex 4). This questionnaire was directed to:

- the financial supervisory authorities and/or financial intelligence units, both those operating in the EU (in particular major financial centres generally viewed to be vulnerable to illicit financial flows, such as the United Kingdom, Germany, the Netherlands, Italy, and Spain) and those operating in the third countries in question;
- relevant international and national governmental and non-governmental organisations (in particular, the World Bank, FATF, United Nations Economic Commission for Africa, Global Financial Integrity, Transparency International, and Global Witness); and
- leading academics specialising in the field of the study.

Based on the responses to the questionnaire, the team also conducted semi-structured interviews with a number of respondents representing the three above-mentioned groups of actors. Most actors approached by the research team expressed their willingness to cooperate in the study. No (positive) response, however, was obtained from the representatives of relevant authorities in Germany and Colombia, as well as a number of international organisations and

academics. A complete list of all persons who have cooperated with the research team is included in Annex 5.

Finally, Chapter 4 presents conclusions in the form of policy recommendations addressed to the Committee on International Trade (INTA), for whom the European Parliamentary Research Service (EPRS) commissioned this study. These recommendations build on the main deficiencies and challenges identified in the two previous parts of the study. The aim is to formulate suggestions for improving the way in which EU FTAs deal with the problem of illicit financial flows. Such recommendations can be implemented under existing trade deals, though that might require amending the agreements in question. Most importantly, they can be inserted in the trade agreements that the EU will conclude in the future, some of which are being negotiated at the time of writing.

Part 2: Comparative Legal Analysis – Evaluating EU Trade Agreements with Third Countries

2.1 EU–Mexico Economic Partnership, Political Coordination and Cooperation Agreement

2.1.1 Trade context

2.1.1.1 Bilateral trade relations between the EU and Mexico

The EU and United Mexican States (Mexico) are important trade partners. Only the USA receives more exports from Mexico than the EU does, and the latter represents the third largest importer to Mexico after the USA and China, counting both trade in goods and trade in services. The flow of foreign investment between the parties is also quite significant. In 2013 it generated a total capital flow of approximately €125 billion, €100 billion of which were EU outward stocks entering into the Mexican economy.[14] The economic relations between the parties are governed by the EU-Mexico Economic Partnership, Political Coordination and Cooperation Agreement (hereinafter: the Global Agreement), signed on 8 December 1997 between the EU and its Member States of the one part, and Mexico of the other part. Article 2 of the Global Agreement states that this agreement aims to strengthen existing relations between the parties by means of, among other things, creating stronger commercial and economic relations. The Global Agreement laid down general principles and procedures on the basis of which a number of implementing decisions were adopted after its coming into force, as it will be explained below. To this end, Article 45 established a Joint Council vested with the power to supervise the implementation of this agreement. In addition, in accordance with Article 47, the Joint Council has also the power to make binding decisions in those cases stipulated in the Global Agreement.

On the basis of these provisions the Joint Council has adopted Decision 2/2000,[15] and Decision 2/2001 (hereinafter: the Decision),[16] concerning trade in goods and trade in services respectively.[17] When read together, these decisions are essentially equivalent to a comprehensive free trade agreement that also covers foreign investment. Given the research question of the present study, the decision related to trade in goods will not be comprehensively analysed. The focus will be on the decision concerning trade in services, and in particular on the provisions relating to financial services. To this end, the governance framework laid down

[14] For more information, see the link provided below, note 19.

[15] 'Decision (2000/415/EC) no. 2/2000 of the EC-Mexico Joint Council of 23 March 2000', *OJ* L157/10.

[16] 'Decision (2001/152/EC) no. 2/2001 of the EU-Mexico Joint Council of 27 February 2001', *OJ* L70/7.

[17] The decision on trade in goods entered into force in the year 2000, while the decision on trade in services entered into force in 2001. Further information can be found at:

http://ec.europa.eu/trade/policy/countries-and-regions/countries/mexico/ last visited 18 November 2015.

in the Global Agreement, the relevant provisions of the Decision and the relevant Mexican legislation adopted or adapted to implement the Global Agreement are examined. Some preliminary conclusions will be presented at the end under the heading 'Assessment' (2.1.4).

2.1.1.2 Institutional framework of the Global Agreement

The Global Agreement established two governing bodies responsible of its implementation. First of all, the previously mentioned Joint Council, which consists of members of the Council of the European Union and of the European Commission in one part, and members of the Mexican government, in the other. It is presided over by a member of the Council – on a rotating basis – and a member of the government of Mexico. It meets at regular intervals and whenever the circumstances require (Article 45). It examines any major issues arising within the framework of the Agreement and any other bilateral or international issues of mutual interest. However, the most remarkable function of the Joint Council is the power to issue binding decisions in the cases provided for in the Global Agreement, and in any other case as agreed by the Parties. It is on the basis of such power that the Joint Council has adopted the Decision that will constitute the primary focus of this section. In addition, the Joint Council is also vested with the power to establish special arrangements in case of trade related disputes arising out of the Global Agreement, provided that such arrangements are compatible with the rules of the WTO (Article 50). The rules concerning the settlement of disputes are laid down in Annex XVI to Decision 2/2000.

The Joint Council is assisted by a Joint Committee, which is composed of representatives of both parties at the level of senior civil servant. The Joint Committee meets once a year and whenever else agreed by the parties (Article 48). The functioning of both bodies is regulated by Decision 1/2001.[18] According to this Decision, their meetings are not public. It is not mandatory that their decisions be published but the Parties can decide to publish them in their respective official publications.[19] It is therefore difficult to know when the meetings have been held, and the agenda of those meetings. It is only possible to indirectly infer what was discussed in the meetings when the decisions made therein are published. The EU has published these decisions in the Official Journal on several occasions.[20]

In addition to the two general governing bodies, the Decision has also established a Special Committee on Financial Services (Article 23). It is composed of representatives of each Party's authority responsible for financial services as set out in Annex II of the Decision. For the EU, it is a representative of the DG Internal Market while the Member States have appointed a representative of their Ministry of Finance or equivalent. Mexico is represented by a member of the *Secretaría de Hacienda y Crédito Público* (see below). The functions of the Committee include the general supervision of the implementation of the Chapter concerning financial services, and

[18] 'Decision (2001/152/EC) no. 1/2001 of the EU-Mexico Joint Council of 27 February 2001', *OJ* L70/1.

[19] Article 11 and Article 5 of the respective rules of procedure.

[20] For example, from the adoption of the 'Decision (2004/805/EC) no. 2/2004 of the EU-Mexico Joint Council of 28 April 2004', *OJ* L356/8, one can indirectly infer that the Joint Council has met to discuss preferential tariffs concerning certain products.

any issues regarding financial services that are referred to it by a Party. The Special Committee is meant to meet once a year and to report to the Joint Committee. No rules concerning the functioning of this body are available, nor are any documents produced by it available. Therefore, it can be assumed that the activity of this body is subject to the same publicity regime applicable to the Joint Council and the Joint Committee. The fact that the activity carried out by the implementing bodies is not publicly available is regrettable as it would be useful to know if and how the implementation of the agreement is carried out and monitored in practice. Similarly, it is regrettable that no annual reports from the European Commission to the European Parliament and the Council are provided for where the EU-Mexico Agreements is concerned.

2.1.2 Assessment of the Regulatory Framework for Financial Services Provision and Combating Illicit Capital Flows

Box 1 The EU-Mexico Agreement in a nutshell

- The provisions of the Agreement provide for a sound legal framework that seems able to guarantee a great deal of liberalisation of financial services between the two Parties.
- However, the impact of such provisions is limited considering the far-reaching exceptions listed in Annex I to Decision 2/2001.
- The Agreement contains only vague commitments when it comes to transparency of financial services. It only lays down a *best endeavours* obligation.
- The same holds true in respect of combatting money laundering and drug trafficking. Only elusive forms of voluntary cooperation and liaison are envisaged.
- Taxation is only addressed in a general manner. The Agreement contains a clause safeguarding the power of the Parties to implement measures aimed at preventing the avoidance or evasion of taxes. The clause is however standard practice in free trade agreements and does not imply that Parties have adopted a common strategy to fight tax misconduct.
- The governance structure of the Agreement appears flawed. The works and activities of monitoring bodies set up by the Agreement are not publicly available, and no annual reports to the European Parliament and the Council on the implementation of the Agreement are provided by the European Commission.

As already pointed out above, the Global Agreement itself does not contain any provisions relating specifically to financial services. Such provisions are included in the Decision. Article 12(1) of the Decision lays down a general clause granting the right to financial service suppliers of each party to *establish a commercial presence* in the territory of the other Party (Mode 3 under GATS). Article 12(2) safeguards the power of the Parties to require the suppliers to incorporate under each Party’s own law, or to impose specific terms and conditions provided that they are in line with the Decision. Article 12(3), however, imposes on the Party what could be labelled a ‘standstill obligation’ to the extent that it prevents the parties from enacting pejorative measures

than those already existing at the time the Decision came into force.[21] Article 12(4) provides quite a far-reaching list of measures limiting the supply of financial services which are expressly prohibited under the Decision. It includes some typical 'protectionist' measures such as limitations on the number of suppliers (i.e. quotas), limitations on the total value of financial transactions, and limitations on the participation of foreign capital in terms of maximum shareholding percentage, etc.

Article 13(1) replicates its predecessor in laying down a general clause granting to the suppliers of financial services of each Party the right to provide such services on a *cross-border* basis, namely in the territory of the other Party, without establishing a commercial presence (Mode 1 under GATS). Article 13(2) contains a standstill obligation identical to that of Article 12. However, Article 13(4) provides a limited carve-out allowing the Parties to exercise their regulatory powers in respect of related activities such as advertisement and market solicitation.

Article 14 grants *national treatment* to the suppliers of financial services operating in both modes identified above – those operating through commercial presence abroad and those supplying the services on a cross-border basis. The provision in question refers to several types of activities – such as establishment and sale or disposition – admittedly extending national treatment to both the pre-establishment and the post-establishment phases. Article 15 grants *most favoured nation treatment* (MFN) to suppliers of the other party, with the only limitation of special treatments accorded on the basis of regional trade agreements (RTAs) notified under Article V GATS.

When it comes to *transparency*, the Decision contains only one article devoted to this aspect of financial services. It lays down no effective legal obligations, and more closely resembles a declaration of intent stating the good willingness of the Parties to cooperate to enhance transparency. Article 20(4) states that the Parties shall make their 'best endeavours' to ensure that international standards – such as the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions - are implemented and applied in their territories. Article 20(5) stipulates that the Parties 'take note' of the 'Ten Key Principles for Information Exchange' adopted by the Finance Ministers of the G7.

The Decision also lays down rules concerning *investment and related payments*. To begin with, it provides a broad definition of covered investments (Article 28) which admittedly includes foreign direct and partly indirect investment. Article 29 contains a standstill obligation not to introduce new restrictions on payments related to investments, and a best effort obligation towards the gradual elimination of all restrictions between the Parties. The Decision also contains *ad hoc* carve-outs applicable only to certain situations, such as in case of monetary or balance of payments difficulties (Articles 30 and 31 respectively).

[21] Standstill obligations are traditionally a common feature of free trade agreements, and have recently started to make their way into investment and tax agreements. See, among other examples, Article 2 of Chapter 2 of the text of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

A provision devoted entirely to *combating drug trafficking and money laundering* is instead included in the Global Agreement (Article 28). However, the legal obligations in this provision are rather lax. In particular, it requires the Parties to take appropriate measures for cooperation and liaison with a view to preventing and reducing the production and distribution of drugs, and related activities. Where money laundering is concerned, such cooperation consists of exchange of information regarding legislative and administrative treatment, and of the adoption of appropriate measures including measures adopted by the Union and international bodies active in this field. In other words, the provision in question contains – once again – a declaration of intent pointing to the adoption of international best practices, of which rules approved by the EU are considered part. Neither in the Global Agreement nor in the implementing Decisions, additional or more specific references to international instruments, such as the FATF standards, are made.

The horizontal part of the Global Agreement, which is also applicable to financial services, contains another provision relevant for the sake of this study. Article 54 lays down a standard clause concerning tax evasion and avoidance. More specifically, with this provision the Parties confirm that nothing in the Agreement, or in any arrangements adopted under it, may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation.

2.1.2.1 Mexico's specific list of commitments applicable to financial services: Annex I to Decision 2/2001

Article 17 of the Decision lays down a general exception to the rules of the Chapter concerning financial services. According to this exception, the Parties are authorised to apply the limitations listed on Annex I to the Decision. Article 17(2) states that the latter shall be reviewed by the Special Committee on Financial Services to 'propose to the Joint Council [its] modification, suspension or elimination'. The Joint Council, no later than three years after the coming into force of the Decision, ''shall adopt a decision providing for the elimination of substantially all remaining discrimination', including those listed in Annex I. The research carried out in the context of this study, however, found no evidence of the adoption of this decision. This means that either the Joint Council has never adopted it, or that it has been adopted but not published in accordance with the rules concerning the functioning of this body already referred to above. It seems unlikely that such an important decision, if adopted, would not be made publicly available, if only because of the impact that it may have on the business community of the two Parties to the Agreement. As a result, the analysis of Annex I is based on the assumption that the limitations to market access therein provided are still in force. The examination will concentrate exclusively on the limitations applied by Mexico.

The list contained in Annex I is divided by sectors and subsectors. However, some exceptions are applicable to all financial services, or at least to the bulk of them. First and foremost, foreign investors can hold up to 49% of the paid up capital of an established financial institution. This requirement applies almost invariably to all financial services with some limited exclusions, such as commercial banks. The other side of the coin of this rule is that effective control by the Mexican shareholders is mandatory. Investments by foreign governments and their official agencies are not allowed. As far as insurance services are concerned, foreign insurance

companies are requested to register with the *Secretaría de Hacienda y Crédito Público* (SHCP, see below). A number of services auxiliary to insurance are generally excluded from the scope of application of Decision 2/2001. These include personal insurance of Mexican residents, insurance against civil liability for events occurring in Mexico, and other classes of insurance against risks occurring in Mexican territory. As far as banking is concerned, roughly the same general limitations apply, with the notable exception of commercial banks. Foreign investment in development banks and credit unions is not allowed.

2.1.3 Assessment of Mexican Legislation on Financial Services, Money Laundering, and Tax Evasion and Elusion

2.1.3.1 Financial services

Over the last few years Mexico's financial sector has undergone a series of major reforms aimed at increasing competition and transparency in the sector, in order to enhance its solidity and boost economic growth.[22] In particular, Mexico was one of the first countries in the world to implement Basel III standards in 2013.[23]

2.1.3.2 The National Banking and Securities Commission

As a general, preliminary assessment, it should be noted that Mexico's legal framework applicable to its financial system has been constantly updated and improved in recent years. Mexican authorities have made a considerable effort towards bringing the system in line with the most advanced international regulatory standards. The country's relevant authorities participate in all the main international institutions and bodies relevant to this field, such as IOSCO (International Organisation of Securities Commissions), the so-called Basel Committee, and the Financial Stability Board. No major specific challenge can be identified in this field.

More specifically, the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission, hereinafter: CNBV), an independent agency of the Secretariat of Finance and Public Credit, is the technical, autonomous body vested with executive powers over the Mexican financial system. Its main role is to supervise and regulate the entities that make up the Mexican financial system, in order to ensure its stability and proper operation, and to maintain and promote the healthy and balanced development of the financial system as a whole, while protecting the interests of the public.[24] CNBV is part and parcel of Mexico's strategy to conform to the best international standards and practices available in relation to regulation and supervision of financial markets. In a report published by the already mentioned FSB in 2010, it was acknowledged that the country has made significant progress in this

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[22] *Mexico's President Signs New Banking Reforms into Law*, 9 January 2014.

[23] U.S. State Department of State, *2015 Investment Climate Statement - Mexico*, p. 13.

[24] See the presentation of CNBV, available at:

http://www.cnbv.gob.mx/CNBV/Paginas/Misi%C3%B3n-y-Visi%C3%B3n.aspx,

last visited 19 November 2015.

direction.[25] As far as CNBV is concerned, the report recognised that its supervisory powers have been consolidated, and generally improved compared to a previous assessment carried out only a few years earlier.[26]

With regard to the supply of financial services by foreign banks, it is worth noting that foreign subsidiaries are incorporated under local laws, and they are regarded by Mexican authorities as standalone entities, even if they are supervised on a consolidated basis by a home supervisor. In addition, they have to be licensed in order to provide banking services. The requirements to obtain a license are numerous, detailed, and sufficiently transparent. Operating without a license is considered a criminal offence.[27]

2.1.3.3 Insurance services

Mexican legislation concerning insurance services does not seem to present specific challenges or weaknesses. No evidence was found of international monitoring bodies specifically singling out this sector.

Insurance business regulation and supervision is carried out by two separate entities, namely the already mentioned SHCP, and the *Comisión Nacional de Seguros y Fianzas* (CNSF). The SHCP is in charge of setting the insurance policy and introducing primary regulation, always with strong input from the CNSF that issues the secondary legislation and conducts its supervision. The *Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros* (CONDUSEF) is entrusted with consumer protection in the financial sector, including the insurance sector.

A foreign insurer applying for a license to operate through a subsidiary in Mexico must provide, among other information, a confirmation from the home supervisory authority to the CNSF stating that the insurer is authorised to carry out the business proposed. A foreign insurer also has to provide evidence that it is solvent, and it meets all the regulatory requirements in the home jurisdiction, and the information and documentation required to be licensed. Insurance legislation states that the same institution cannot acquire a license to perform both life and non-life business lines.[28]

The law lays down the requirements and procedures that must be met to properly establish an insurance institution.[29] However, SHCP can impose additional requirements, conditions, or restrictions whenever it is deemed appropriate. These might include restrictions on non-insurance activities, or permission to make, in the terms set forth by the SHCP, analogous and related authorised transactions according to Articles 34 and 81 of the law in question.[30]

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[25] See FSB, *Country Review of Mexico*, published on 23 September 2010.

[26] *Ibid.*, pp. 23-24.

[27] IMF, *Mexico: Financial System Stability Assessment*, 2012, at p. 34 et seq.

[28] Article 8 of Ley General de Instituciones y Sociedades Mutualistas de Seguros.

[29] Articles 16 and 29 of Ley General de Instituciones y Sociedades Mutualistas de Seguros.

[30] Articles 34 and 81 of Ley General de Instituciones y Sociedades Mutualistas de Seguros.

The CNSF's supervision process verifies that these requirements are maintained on a continuous basis. If this is no longer the case, the authorisation may be revoked. The requirement to be licensed to operate in insurance and surety is established in the law. The license requirement is a sensitive issue, as operating without a license is considered a criminal offence. In addition, the license process seems to be transparent and sufficiently publicised through the CNSF website.

The minimum capital requirements are at the current level of the Latin American region, but are low compared to the OECD countries.

2.1.3.4 Money laundering

In recent years, the situation concerning money laundering in Mexico seems to have largely improved, at least in theory. In particular, the country has enacted several reforms aimed at fighting against money laundering and has substantially improved its toolbox against money laundering. This was confirmed by a 2014 FATF Report, which acknowledged that the country has built a comprehensive and solid legal and institutional framework, which has efficiently addressed the deficiencies identified in previous reports.[31] As a result, Mexico has been removed from the list of countries placed under a follow-up process. In addition, money laundering is now criminalised by the Federal Criminal Code, which has also been amended in recent years. In particular, and based on recommendations issued by the FATF, in 2014 Mexico reformed Article 400bis of the Criminal Code so as to criminalise concealment – namely, the use or disposition of property or goods resulting from criminal proceedings. Another step taken by Mexico in the direction of fighting money laundering was the 2013 amendment to Article 421 of the National Code of Criminal Procedure, which introduced criminal liability of legal persons.

As is well-known, money laundering was, and to a large extent still is, traditionally a significant problem in Mexico. The country is a major hub for drug-producing and transit, which makes it naturally vulnerable to activities associated with money laundering. For this reason drug proceeds are the main source of money laundering in Mexico,[32] and they often involve actors from the U.S. and Europe, which are Mexico's two major drug markets.[33] The International Monetary Fund (IMF) has brought into the open the attempt to launder some €236 million in drug proceeds from Spain to Mexico through the export of precious metals involving an international network of individuals. The same report also mentioned an attempt to launder US-sourced drug proceeds in Mexico through a highly sophisticated network of legal entities.[34]

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[31] FATF, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – Mexico*, 2008, pp. 6-7.

[32] Other significant sources of laundered funds include notably corruption, kidnapping, extortion, intellectual property rights violations, human trafficking, and trafficking in firearms.

[33] FATF, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – Mexico*, 2008, p. 16.

[34] IMF, *Mexico: Detailed Assessment Report on Anti-Money Laundering and Combating the Financing of Terrorism*, 2009, p. 15.

These cases 'illustrate the magnitude of illicit resources controlled by Mexican criminal organisations, as well as the complexity of their international operations'.[35] In recent times, and more precisely in 2014, U.S. authorities unveiled a large trade-based money laundering operation involving the Los Angeles-based garment district. In this case, it was found that Mexican drug cartels not only laundered money through legitimate businesses, but also perpetrated tax frauds through the tax exemption granted to imported goods under the NAFTA.[36]

As already mentioned, Mexico has long been a country under the strict surveillance of international bodies dealing with money laundering. In particular, the FATF, of which Mexico is a member,[37] had placed Mexico under observation, and issued throughout the years a number of recommended measures that the country was meant to implement to bring its legal framework into compliance with internationally agreed standards. It is worth mentioning that Mexico became a FATF observer state in September 1999 and a full member in June 2000. Although Mexico's accession to FATF was not specifically occasioned by the conclusion of the Agreement with the EU, it seems safe to affirm that such accession was part and parcel of the country's strategy to improve its international credibility *vis-à-vis* its trade partners.

More specifically, in 2010 a U.S. dollar cash deposit limit was imposed in an effort to prevent money-laundering transactions. The regulations stipulated that natural persons could only deposit up to $4,000 a month, while legal persons could deposit up to $14,000. However, this regulation has recently been softened. In order to boost economic growth a reform adopted in 2014 allowed border and tourist areas businesses to exceed the limit under certain conditions, among which importantly is the obligation to provide more detailed and transparent information concerning financial and tax statements to Mexican authorities in exchange for the waiver of the cash deposit limit.[38] Mexico has also recently enacted a major, comprehensive law on money laundering that was approved on 17 October 2012 and came into force nine months later in accordance with the Second transitory provision of the law in question.[39] The law is now fully operational. Among other things, the law greatly expands the number of financial and designated non-financial entities required to submit reporting on financial transactions and suspicious operations, and to apply know-your-customer programmes. The law also 'requires

[35] FATF, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – Mexico*, 2008, p. 19, p. 18.

[36] For information see U.S. Department of State, *International Narcotics Control Strategy Report (INCSR)*, March 2015, pp. 235-259.

[37] Mexico is also a member of the sister organisations Financial Action Task Force in Latin America (GAFILAT) and the Financial Action Task Force on Money laundering in South America (GAFISUD), despite not being located in South America. However, the last report concerning Mexico issued by these organisations dates back to 2008. See GAFILAT, *Informe de Evaluación Mutua - Anti Lavado de Activos y contra el Financiamiento del Terrorismo – Mexico*, 17 October 2008.

[38] U.S. State Department of State, *2015 Investment Climate Statement - Mexico*, June 2015, p. 25.

[39] See *Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita*.

cash intensive businesses to apply restrictions to cash transactions and bans the use of cash for transactions over set amounts'.[40]

2.1.3.5 Tax evasion legislation

The tax administration is traditionally an inefficient branch of the Mexican state. In recent times, companies have identified Mexican complex tax regulations as the second most problematic barrier to business, after corruption.[41] The most recent OECD Report available reveals that Mexico has the lowest tax revenue to GDP among the 34 OECD Member States, way below OECD average.[42] Mexico's poor tax performance can partly be explained by high level of tax evasion and avoidance. For this reason, Mexico is struggling in an effort to increase the country's tax base. A package of tax reforms has been approved in 2013 for this purpose. The measures include a raised VAT applicable to certain products and regions, an increased income tax for individuals earning more than 3 million pesos a year, and decreased deductions for companies for expenses related to employee benefits. The impact of such measures on the country's overall tax base remains to be assessed.

Tax-related crimes are duly criminalised by Title IV of the Mexican Federal Criminal Code (Articles 92-115bis), titled 'Of tax-related infringements and felonies'. The perpetration of such crimes is also punishable in the form of the attempt, provided that the conduct undertaken by the perpetrators leads to at least the commencement of the crime itself (*principio de ejecución*). Aggravated penalties are applicable to civil servants (*funcionario o empleado público*) who commit or participate in the perpetration of tax-related crimes. However, it is worth noting that Mexican legislation suffers from an endemic lack of enforcement. This seems to be particularly true when it comes to the liability of civil servants for the acts committed in the exercise of their function. Cases in which public officials are actually held liable for illegal acts are extremely rare.[43]

2.1.4 Concluding remarks

As a general point, the EU-Mexico Agreement does not lay down any substantial obligations in the field of preventing and fighting illicit capital flows. Provisions devoted to these issues are scarce, often vague and indefinite.[44]

At the same time, the analysis of the Mexican legal order carried out above has shown that there are no (or no longer) major gaps, deficiencies or challenges identifiable in the relevant legislation. As we have seen, after the signature of the Agreement, Mexico has committed itself to implement major reforms of its legislation in an attempt to bring it into harmony with the

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[40] *Ibid*.

[41] World Economic Forum, *The Global Competitiveness Report 2014/2015*, p. 286.

[42] OECD, *Revenue Statistics 2014 - Mexico*. It can be noted that Korea is also low on the OECD list.

[43] Business Anti-Corruption, *Mexico Country Profile*.

[44] See, among many examples, *Commissioner Jourová Welcomes Progress towards a Stronger EU Framework to Combat Money Laundering*.

highest international standards available. So far, these attempts seem to have been successful, as confirmed by the positive evaluations issued by the relevant international bodies, such as FATF.

As already observed, although there is no evidence of a direct connection between the signature of the Global Agreement and such reform efforts, it seems safe to assume that Mexico has been motivated to take concrete steps in this direction, among other things, by the willingness to improve its modest international reputation in the matter, thus attracting more foreign capital and investment.

Box 2 The structural deficiencies of the Mexican system

- Mexico's legal framework has constantly been updated and reformed in recent years in an attempt to improve the international credibility of the country, and the perceived safety and profitability of investing in Mexico. Reform efforts are partly still ongoing.
- The improvement of Mexico's legal framework has been certified by relevant international bodies such as FATF.
- Despite this fact, Mexico's ability to successfully tackle illicit capital flows is still regarded as partly unsatisfactory. This is mainly due to general deficiencies in the enforcement of Mexican legislation and endemic levels of corruption.

However, the significant improvement of Mexican legislation in many fields does not mean that illicit capital flows to and from Mexico have decreased, and that the related problems have been resolved – quite the contrary. One major obstacle in this direction certainly has to do with the general lack of enforcement of Mexican legislation. To name but one example, only 14 convictions for money laundering were reported nationwide in 2013, with little increase of the reported convictions in the following years.[45] Second, endemic levels of corruption also play a major role. As a matter of fact, and despite corruption being a veritable national emergency, Mexico only equipped itself with a comprehensive anti-corruption law in 2015. The ambitious project had been awaiting the Senate's approval for quite some time and only regained momentum in the wake of the tragic events that led to the 2014 Iguala Mass Kidnapping.[46] This law has created the National Anti-Corruption System but the bulk of the reform will be substantiated by secondary legislation to be approved by the Congress.[47] The process is still largely ongoing. As a consequence, at this stage it is difficult to assess the effectiveness of the new legal framework.

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[45] FATF, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – Mexico*, 2008, p. 19.

[46] J.C. Perez, *Mexico Missing Students: Looking for Iguala Mass Graves*, 8 December 2014, BBC News.

[47] See for further detail J. Benejam, *Mexico's new National Anticorruption System: 7 Key Points*, 20 July 2015, DLA Piper.

2.2 EU-South Africa Trade, Development and Cooperation Agreement

2.2.1 Trade context

2.2.1.1 Bilateral trade relations and the nature of the Agreement

Signed on 11 October 1999 in Pretoria, the 'EU – South Africa Trade, Development and Cooperation Agreement' (TDCA) entered into force on 1 May 2004.[48] The TDCA created a comprehensive political and development partnership between the EU and South Africa, and provided for the introduction of a free trade area with preferential trade arrangements. The EU is South Africa's main trading and investment partner. The FTA aims to ensure better access to the EU market for South Africa and access to the South African market for the EU. As a result, it plays an important role in South Africa's integration into the world economy. The Agreement covers around 90% of bilateral trade between the two parties. The EU offered to remove 95% of its duties on South African originating products by 2010. In turn, South Africa offered to remove 86% of its duties on EU originating products by 2012.[49]

Box 3 Impact of the TDCA

- The strength of the wording of the relevant provisions in the TDCA can be considered 'weak';
- Nevertheless, South Africa's overall implementation of international standards can be considered 'advanced';
- In terms of implementation of international standards in national law, no causal link was detected between the TDCA and South Africa's performance; and
- In practice, the TDCA focuses on promoting free trade and investment rather than on promoting the implementation of international standards.

Following the review procedure as envisaged in articles 18 and 103 TDCA, South Africa and the EU negotiated new provisions in 2007 under Titles I (Political Dialogue), IV (Economic Cooperation), V (Development Cooperation), VI (Other areas of cooperation), and VII (Financial aspects of cooperation) of the Agreement. As regards the revision of the trade chapters (Title II – Trade, and Title III – Trade related issues), it was decided in March 2007 to unlink them from the broader TDCA revision and to integrate this part in the SADC EPA negotiating

[48] The TDCA has been implemented in the European legal order by 'Council Decision of 26 April 2004 (2004/441/EC)', *OJ* L127/109.

[49] Republic of South Africa, Department of Trade and Industry, available at: http://www.thedti.gov.za/trade_investment/ited_trade_agreement.jsp.

process.[50] The negotiations on an EU-Southern Africa Development Community Economic Partnership Agreement (EU-SADC EPA) were concluded on 15 July 2014.[51] For services, it is envisaged that all four traditional GATS-modes will be covered by the EU-SADC EPA (i.e. cross-border supply; consumption abroad; commercial presence; temporary presence). However, the EPA shall be based on asymmetry and gradual market opening,[52] since some SADC States felt the need to have prior regional integration, while there are only limited interests in exporting services to the EU.

2.2.1.2 Institutional framework of the Agreement

The TDCA established a Cooperation Council to ensure the smooth operation of the Agreement.[53] The Joint Cooperation Council is the body that oversees the overall implementation of the TDCA. It meets on an annual basis, in order to take stock of progress in implementing the TDCA and to discuss the way forward on a wide range of issues where policy dialogues and cooperation have been established in the context of the EU-South Africa Strategic Partnership. The latest 'Progress Report', published in 2013, did not mention cooperation between the EU, the EU Member States and South Africa on the area of financial services, the implementation of international standards related to the provision of financial services or cooperation in tax matters. Furthermore, the implementation of the TDCA is facilitated by the EU-South Africa 'Dialogue Facility'.[54] Among the 'Dialogue Areas' listed on the website of the Facility, 'financial services' does not appear as a separate issue.[55]

For the years 2014 and 2015, no press communiqués or joint statements of the Joint Cooperation Council were released. For those years for which joint statements were released (2008-2013), the topics of combating money laundering, fighting IFFs, and tax evasion and avoidance do not appear to be addressed to the extent that this deserved mentioning in the final texts released. Only the communiqués of 2009 and 2010 mentioned the strengthening of the supervisory and regulatory framework for the financial sector in the context of countering the 2008 financial crisis and the stimulation of sustainable economic growth.[56]

In 2015, an inter-ministerial meeting took place within the framework of the newly concluded EU-SADC EPA. During this meeting, preparations were discussed for the implementation of

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[50] Republic of South Africa, Department of International Relations and Cooperation, available at: http://www.dfa.gov.za/foreign/saeubilateral/tdca.html.

[51] European Commission, DG Trade, Southern African Development Community.

[52] Article 73(2)(e) EU-SADC EPA.

[53] Article 97 TDCA.

[54] SA-EU Strategic Partnership Dialogue Facility, *About*.

[55] SA-EU Strategic Partnership, Dialogue Facility, *Dialogue Areas*.

[56] See for example: *Joint Communiqué, Second South Africa-European Union Summit*, Kleinmond, Doc. no. 13231/09 (Presse 266), 11 September 2009, p. 2.

this agreement. In addition, the Parties agreed to consolidate efforts in supporting frameworks for better economic governance in order to better prevent 'financial leakages'.[57]

Last but not least, the move by the EU and South Africa to negotiate a separate FTA outside the framework of the SADC has been criticised for creating negative economic effects for the other Southern African countries and for frustrating the process of further regional integration, because the SADC's desire to eventually conclude a regional trade agreement was already known at the time of the conclusion of the TDCA.[58] Furthermore, the EU was criticised for splitting the Southern African Customs Union through the EU-SADC EPA negotiations and, accordingly, to have contributed to the fragmentation of the region rather than its further integration.[59]

2.2.2 Assessment of the Regulatory Framework for the provision of Financial Services and Combating Illicit Financial Flows

2.2.2.1 Financial services

Right to establishment and supply of services

The TDCA is less ambitious than most other FTAs concluded between the EU and its trading partners. For example, this is exemplified by the use of the terminology 'endeavour' in article 30 TDCA. With regard to the right to establishment and the supply of services, the TDCA refers to the obligations of the Parties under the GATS, and in particular to the Most-favoured-nation principle, including the protocol and annexes.[60] The Parties reaffirm their respective commitments as annexed to the fifth Protocol to the GATS concerning financial services.[61] The parties pledge to endeavour to go beyond the GATS requirements by aiming for a further liberalisation of the supply of services in order to eliminate all discrimination between the Parties in the services sector. This shall include the supply of services: (a) from the territory of one Party into the territory of the other; (b) in the territory of one Party to the service consumer of the other; (c) by a service supplier of one Party, through commercial presence in the territory of the other; and (d) by a service supplier of one Party, through presence of natural persons of that Party in the territory of the other.[62]

[57] *Joint Communiqué EU-SADC Political Dialogue Meeting at Ministerial Level*, Luxembourg, 27 October 2015.

[58] G. Wellmer, Join My Value Chain, South Africa's Regional Trade Policy, in: J. Becker and W. Blaas, *Strategic Arena Switching in International Trade Negotiations*, Ashgate Publishing lt., 2007.

[59] A. Adebajo, *The EU and Africa: From Eurafrique to Afro-Europa*, C. Hurst & Co. London, 2012, pp. 128-129.

[60] Article 29 TDCA.

[61] Article 29(3) TDCA.

[62] Article 30 TDCA.

Similarly, the terminology chosen, i.e. 'to foster cooperation' and to 'encourage', does not evince any strong ambitions of the Parties in this context. Under the TDCA, the Parties committed to 'foster' the cooperation in the services sector in general and in the areas of banking, insurance and other financial services in particular.[63] This is to be performed by, *inter alia*: (a) encouraging trade in services; (b) exchanging, where appropriate, information on rules, laws and regulations governing the services sector in the Parties; and (c) improving accounting, auditing, supervision and regulation of financial services and financial monitoring, for example through the facilitation of training schemes.[64]

In the 2013 Progress Report on cooperation between the EU, the Member States and South Africa under the TDCA,[65] no reference is made to cooperation in the area of financial services. However, in the section covering the bilateral relations between the EU Member States and South Africa, one notion deserves attention. It is explicitly mentioned that South African investment in the financial services sector of Ireland is 'significant', stating that 'South African investment in Ireland has mainly focussed on financial services companies, many of which now have a significant presence in Ireland'.[66] It can be deduced from this that the TDCA is facilitating money flows between these two countries, and, from the South African perspective, specifically to the financial services sector in Ireland. A strong argument can be made with regard to the reasons behind the choice for Ireland as destination for South African investments in the financial services sector, since Ireland is often reported as having one of the lowest corporate tax rates in the developed world.[67] More specifically, Irish corporate tax is currently set at 12.5% for trading income (and 25% for non-trading income such as investments made), whereas the EU average is currently 22.25%.[68] As such, Ireland is considered a relatively advantageous destination to conduct business compared to other EU countries (Germany: 29.65%; The Netherlands: 25%; France: 33.33%; Belgium: 33.99%).[69] Especially for non-EU trading partners, such as South Africa, this factor will weigh in significantly in deciding where to establish their EU-based operations.

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[63] Article 63 TDCA.

[64] Article 63(b) TDCA.

[65] Delegation of the European Union to the Republic of South Africa, *The EU and South Africa: Development Partners, Progress Report 2013*. It can be noted that the report is not the same type of report as the European Commission's annual reports to the European Parliament and the Council as presented under the trade agreements with Colombia/Peru and with Korea.

[66] *Ibid.*, p. 16.

[67] See for example: *State Aid: European Commission Press Release, Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg)*, Brussels, 11 June 2014; Andersen, J., *FDI in Ireland: A Reason for Optimism?*, The World Bank, Private Sector Development: News and Views on a Competitive Private Sector and a Resilient Financial Sector, 19 March 2012.

[68] KPMG, *Corporate Tax Rate Table*, 18 March 2016.

[69] *Ibid.*

Current payments and capital movements

With regard to the facilitation of current payments, the wording chosen can be considered to allow for significant room for manoeuvring by the States Parties. Under the TDCA, the Parties 'undertake to allow' all payments for current transactions between residents of the Community and of South Africa to be made in a freely convertible currency.[70] To compare, the EU-Colombia/Peru Trade Agreement uses the wording 'shall' (see Annex 1).[71] Apparently, the negotiators of the TDCA deemed it necessary to refrain from mandatory liberalisation in this particular area. Furthermore, South Africa may take additional measures to ensure that this provision is not used by its residents to make unauthorised capital outflows.[72] During and after the 2008 financial crisis, South African banks introduced restrictions aimed at preventing an outflow of private capital.[73]

The TDCA stipulates that the Parties shall ensure that direct investments in South Africa in companies formed in accordance with current laws can move freely, and that such investment and any profit stemming therefrom can be liquidated and repatriated.[74] With regard to investment promotion and protection, the Parties shall aim to establish a climate which favours and promotes mutually beneficial investment, both domestic and foreign, especially through improved conditions for investment protection, investment promotion, the transfer of capital and the exchange of information on investment opportunities.[75] The TDCA promotes the conclusion of agreements between South Africa and the EU Member States in the area of investment promotion and protection, the avoidance of double taxation and the exchange of information on investment opportunities.[76]

Transparency aspects of financial services/Data protection

The TDCA contains few provisions covering transparency aspects of financial services as such, but does contain a general provision on data protection. The TDCA creates an explicit obligation for the Parties to cooperate to improve the level of protection for the processing of personal data, taking into account international standards.[77] Cooperation may include technical

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[70] Article 32(1) TDCA.

[71] Article 168 EU- Colombia/Peru Trade Agreement: "The Parties shall authorise, in freely convertible currency and in accordance with the provisions of Article VIII of the Articles of Agreement of the International Monetary Fund, any payments and transfers on the current account of balance of payments between the Parties."

[72] Article 32(2) TDCA.

[73] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision*, IMF Country Report No. 15/55, March 2015, p. 12.

[74] Article 33(1) TDCA.

[75] Article 52(1) TDCA.

[76] Article 52(2) TDCA.

[77] Article 91(1) TDCA.

assistance in the form of exchanges of information, exchange of experts and the establishment of joint programmes and projects.[78] As such, this provision contains relatively strong language compared to the other provisions discussed here, committing the Parties to undertake action in this area.

2.2.2.2 Money laundering and fight against drugs

Considering the fact that it is well known that both Parties face significant challenges in the fight against money laundering, the commitments made under the TDCA are rather minimal. Furthermore, a comparison of provisions on money laundering among EU FTAs leads to the conclusion that stricter formulations are used in other FTAs. In the EU-Korea FTA for instance, it is stated that '[e]ach party shall, to the extent practicable, ensure that internationally agreed standards (…) are implemented and applied in its territory,'[79] thus explicitly committing the Parties to cooperate (see Annex 1).

The TDCA contains a general provision on money laundering in which explicit reference is made to the FATF standards. The Parties undertake to cooperate in the fight against money laundering by preventing the use of their financial institutions to launder capital arising from criminal activities in general on the basis of standards equivalent to those adopted by international bodies, in particular the FATF.[80] Furthermore, South Africa can take measures to prevent abuse of the liberalisation of current payments, in order to prevent unauthorised capital outflows.[81] As such, the TDCA does not provide for an explicit obligation for the Parties to combat money laundering, but rather encourages them to take action.

2.2.2.3 Tax evasion and avoidance

The TDCA does not contain an explicit obligation for the Parties to combat tax elusion and evasion. What is more, the TDCA does not address cooperation in international tax matters. Rather, the TDCA safeguards the rights of the Parties to take autonomous measures in this context and preserves the functioning of existing or future bilateral tax arrangements between South Africa and an EU Member State.

[78] Article 91(2) TDCA.

[79] Article 7.24 EU-Korea FTA.

[80] Article 90 TDCA.

[81] Article 32(2) TDCA.

Box 4 South Africa's capacity to combat illicit financial flows (IFFs) and tax evasion

- As the largest financial centre of the region, South Africa is an important hub for IFFs;
- While the legal frameworks to combat IFFs and tax evasion are generally in place, lack of enforcement capacity frustrates the fight against these illegal practices;
- Without mutual commitment from both the EU and its Member States and South Africa, tax evasion and elusion will continue to take place; and
- In this regard, the EU, as developed partner, has an enhanced responsibility to address tax evasive practices, also outside the OECD frameworks and especially vis-à-vis EU companies.

On a more general note, as mentioned earlier, the Parties have 'pledged' to further cooperate in the services sector through, *inter alia*, exchanging, 'where appropriate', information on rules, laws and regulations governing the services sector.[82] This provision can imply cooperation and exchange of information on tax matters. Nevertheless, phrased like this, it can hardly be concluded that a serious commitment to ensure the exchange of tax information between the Parties has been created.

Tax carve-out clause

The Parties confirm that nothing in the TDCA, or in any arrangements adopted under this Agreement, may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation.[83] South Africa concluded numerous 'Double Taxation Agreements' (DTAs), the purpose of which is to enable the administrations of the States Parties to eliminate double taxation. South Africa has concluded DTAs with all EU Member States, except Slovenia, Estonia, Latvia and Lithuania.[84] Thus, these DTAs are not affected in any way by the provisions of the TDCA.

[82] Article 63(b) TDCA.

[83] Article 98(2) TDCA.

[84] South African Revenue Service, available at: http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx.

2.2.3 Assessment of South African Legislation on Financial Services, Money Laundering and Tax Evasion and Elusion

2.2.3.1 Financial services

A. Banking sector

South Africa has a large and sophisticated banking sector based on a well-developed financial infrastructure.[85] It is highly concentrated, with approximately 90% of total assets being controlled by four banks, the 'Big Four' (First Rand, Standard Bank, ABSA, Nedbank), and an investment firm (Investec). Since the end of Apartheid, major efforts have been directed at opening up access to banking services for low-income South Africans to counter the exclusionary effects of the former regime. Three key trends can be identified which shaped the current state of the banking sector: (I) a strong emphasis on international compliance; (II) international ambitions for South African financial institutions; and (III) state-driven financial inclusion attempts to rectify inequality.[86]

During the 2008 financial crisis, the South African banking sector remained financially sound, maintaining good asset quality and solvency ratios. Nevertheless, the banks have to operate in an economically challenging environment with stagnating economic growth, high unemployment, and a recently downgraded credit rating, warranting exchange controls on capital transactions by residents.[87] Despite these challenges, it can be concluded that, overall, the South African banking sector is functioning well.

All banks and branches of foreign banks operating in South Africa are governed by the Bank Act, 1990 (Act No. 94, 1990). Apart from rules on establishment, shareholding, functioning and solvency standards, the Bank Act contains detailed provisions on behaviour of directors and officers of a bank or controlling company. For example, each director, chief executive officer and executive officer of a bank owes a duty towards the bank to act *bona fide* for the benefit of the bank and to avoid any conflict between the bank's interests.[88]

The 'Registrar of Banks' is concerned with the registration of banks or public companies who desire to perform banking services.[89] This person may implement such international regulatory

[85] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision*, IMF Country Report No. 15/55, March 2015, p. 10.

[86] Global Partnership for Financial Inclusion, *South Africa's Engagement with the Standard Setting Bodies and the Implications for Financial Institutions*, 2011, p. 1.

[87] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision*, IMF Country Report No. 15/55, March 2015, pp. 11-12.

[88] Article 60(1)(a) Bank Act.

[89] Article 4(1) Bank Act.

or supervisory standards and practices as he or she deems appropriate after consultation with banks.[90] All banks must establish an independent compliance function as part of the risk management framework of the bank, headed by a compliance officer.[91] Foreign banks who wish to operate in South Africa may do so with the prior written authorisation of the Registrar and subject to other prescribed conditions.[92] For example, the Registrar may request the foreign branch to supply specific information or documents.[93] If foreign branches fail to ascertain the Registrar that proper supervision is ensured in the 'home jurisdiction', the Registrar can decide to refuse the operating licence.[94] Failure of the foreign institution to comply with a prescribed condition may result in revocation or suspension of the licence by the Registrar, upon consent by the Minister and by notice in writing to the foreign institution concerned.[95] Formulated as such, the Registrar is allowed a significant amount of discretion in deciding whether or not to issue operating licences to foreign branches.

The Financial Services Board

The securities regulatory and supervisory responsibilities in South Africa are divided among several public authorities: the Financial Services Board (FSB) and the Johannesburg Stock Exchange (JSE).[96] The FSB is an independent institution established by statute to oversee the South African Non-Banking Financial Services Industry in the public interest. The FSB oversees retirement funds, short-term and long-term insurance, companies, funeral insurance, schemes, collective investment schemes (unit trusts and stock market) and financial advisors and brokers. The functions and powers of the FSB are set out in the FSB Act and in various sectoral Acts, such as the Financial Markets Act (FMA) and the Collective Investment Schemes Control Act (CISCA).[97]

On 27 October 2015, the Minister of Finance tabled the Financial Sector Regulation (FSR) Bill in Parliament,[98] which contained a set of major reforms aimed at the supervisory system of the financial sector. The planned reforms are inspired by the 'Twin Peaks model' of financial sector regulation. Essentially, the Twin Peaks model contemplates that the financial services sector will have two primary regulators. The reforms will create a prudential regulator, the Prudential

[90] Article 4(6) Bank Act.

[91] Article 60A Bank Act.

[92] Article 18A Bank Act.

[93] Article 18A(3)(a) Bank Act.

[94] Article 18A(5) Bank Act.

[95] Article 18B(1) Bank Act.

[96] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Implementation on the IOSCO Objectives and Principles of Securities Regulation*, IMF Country Report No. 15/57, March 2015, p. 8.

[97] *Ibid.*, p. 7.

[98] South African Treasury, *Financial Sector Regulation Bill*, As introduced in the National Assembly (proposed section 75), explanatory summary of Bill published in Government Gazette No. 39127, 21 August 2015.

Authority, housed in the South African Reserve Bank (SARB), while the FSB will be transformed into a dedicated market conduct regulator, the Financial Sector Conduct Authority (FSCA). The implementation of the Twin Peaks model in South Africa has two fundamental objectives: to strengthen South Africa's approach to consumer protection and market conduct in financial services, and to create a more resilient and stable financial system. The Prudential Authority's objective will be to promote and enhance the safety and soundness of regulated financial institutions, while the Financial Sector Conduct Authority will be tasked with protecting financial customers through supervising market conduct. Structures will be in place to ensure proper co-ordination between the two authorities and other regulators.[99] The intention is for the FSR Bill to be enacted towards the end of 2016 or early 2017 to enable implementation soon thereafter.

The Basel Committee on Banking Supervision

Overall and despite certain pitfalls reflected below, the supervision over the South African banking sector can be considered (largely) compliant with the Basel framework. Through the South African Reserve Bank (SARB), South Africa has been a member of the Basel Committee on Banking Supervision (BCBS) since 2009.[100] Its Membership status came with the global expansion of the BCBS beyond the OECD countries after the 2008 financial crisis. Similarly, the SARB was invited to join the 'Committee on Payments and Market Infrastructures' (CPMI)[101] in 2009 when the G-7 Countries extended membership to the G-20 Countries. According to the IMF, South Africa was deemed to be either 'compliant' (22 of the 29 principles) or 'largely compliant' (6 of the 29 principles) with the Basel Core Principles on Effective Banking Supervision,[102] with only one instance of 'material non-compliance'. It pertained to Core Principle 11, which refers to the corrective and sanctioning powers of supervisors.[103] When a bank registered in South Africa does not comply with conditions attached to the registration, the Registrar can suspend or cancel that registration in accordance with South African law.
Similarly, the Registrar can restrict a bank's activities where: the bank does not satisfactorily carry out the business of a bank; the bank has failed to comply with a requirement of the Bank Act; or the bank continues to employ an undesirable practice. However, the Bank Act provides for a 30 day prior notice period and a subsequent possibility for banks to challenge decisions of the supervisor concerning corrective action. The IMF deemed this to be a material shortcoming

[99] Financial Services Board, '*Twin Peaks: What is Twin Peaks?*'.

[100] Basel Committee, Membership, available at: http://www.bis.org/bcbs/membership.htm.

[101] Since September 2013, the CPMI is the successor of the Committee on Payment and Settlement Systems (CPSS).

[102] The Basel Core Principles on Effective Banking Supervision are available at: http://www.bis.org/publ/bcbs230.pdf.

[103] Principle 11 (Corrective and sanctioning powers of supervisors): "The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation."

in South Africa's compliance with Principle 11 of the Basel Core Principles, which advocates action at an 'early stage' and an 'adequate range of supervisory tools'.[104]

International Organisation of Securities Commissions

South Africa is a member of the International Organisation of Securities Commissions (IOSCO) and as such it is required to implement the Objectives and Principles of Securities Regulation.[105] According to the IMF, South Africa was 'partly implementing' seven of the 38 IOSCO Objectives and Principles of Securities Regulation,[106] 15 were 'broadly implemented', 13 were 'fully implemented', and two were 'not implemented'.[107] The principles that have not been implemented are principles 26 and 27,[108] which deal with disclosure requirements related to asset valuation. This assessment leads to the conclusion that, although implementation of the IOSCO Principles is 'complete in several areas, there is room for enhancement'.[109]

B. Insurance sector

The insurance sector is an important pillar of the financial system in South Africa. In 2013, assets held by insurers accounted for nearly 23% of all financial sector assets in South Africa. The long-term insurance sector is highly concentrated with the top five conglomerates dominating the market with over 73% of total industry assets in 2013. In contrast, the short-term insurance industry is less concentrated.[110]
The insurance division of the FSB supervises and enforces insurers' compliance with the financial soundness, governance and conduct of business requirements of the Long-term

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[104] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision*, IMF Country Report No. 15/55, March 2015, pp. 75-76.

[105] For more information, see: https://www.iosco.org/about/?subsection=about_iosco.

[106] The IOSCO Objectives and Principles of Securities Regulation are available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf.

[107] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Implementation on the IOSCO Objectives and Principles of Securities Regulation*, IMF Country Report No. 15/57, March 2015, pp. 17-26. Note that the IMF assessment refers to 37 IOSCO principles, whereas there are 38.

[108] IOSCO Principle 26: "Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme (CIS) for a particular investor and the value of the investor's interest in the scheme;" and IOSCO Principle 27: "Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS".

[109] IMF, *South Africa Financial Sector Assessment Program Detailed Assessment of Implementation on the IOSCO Objectives and Principles of Securities Regulation*, IMF Country Report No. 15/57, March 2015, p. 6.

[110] IMF, *South Africa Financial Sector Assessment Program: Detailed Assessment of Observance on the Insurance Core Principles*, IMF Country Report No. 15/56, February 2015, p. 11.

Insurance Act (No. 52 of 1998) and Short-Term Insurance Act (No. 53 of 1998), and develops regulatory proposals on how these requirements may need to be adapted to best meet the objectives of insurance regulation and supervision.

South Africa, through the FSB, was one of the co-founders of the International Association of Insurance Supervisors (IAIS). The FSB is still an active member of the IAIS,[111] and consequently, South Africa implements the Insurance Core Principles, standards, guidance and assessment methodology. In 2015, the IMF concluded that South Africa 'observed' six of the 29 Insurance Core Principles, 'largely observed' eleven and 'partly observed' nine.[112] As such, there is still room for considerable improvement of South Africa's compliance to the IAIS Insurance Core Principles.

Ongoing legislative reforms are expected to enhance South Africa's ability to adhere to international standards related to the supervision of the insurance sector. The 'Insurance Bill', tabled in January 2016, was approved by the South African Government on 4 November 2015. The Bill forms part of the above-mentioned Twin Peaks reforms,[113] and provides a consolidated legal framework for the prudential supervision of the insurance sector that is consistent with international standards for insurance regulation and supervision. It also seeks to replace and consolidate substantial parts of the Long- and Short-term Insurance Act relating to prudential supervision.[114] As such, the Bill is expected to improve the maintenance of a fair, safe and stable insurance market by establishing a legal framework for insurers that: enhances financial soundness and oversight through higher prudential standards, insurance group supervision; increases access to insurance through a dedicated micro-insurance framework; strengthens the regulatory requirements in respect of governance, risk management and internal controls for insurers; and aligns with international standards.[115]

2.2.3.2 Money laundering

South Africa, being the largest regional economy, faces significant challenges concerning money laundering related activities, including the narcotics trade, smuggling, human trafficking, and diamond dealings. Similarly, South Africa's position as the major financial centre in the region,

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[111] GPFI, *South Africa's Engagement with the Standard Setting Bodies and the Implications for Financial Inclusion, Alliance for Financial Inclusion*, 2011, p.4.

[112] IMF, *South Africa Financial Sector Assessment Program: Detailed Assessment of Observance on the Insurance Core Principles*, IMF Country Report No. 15/56, February 2015, p. 29.

[113] The Twin Peaks model of financial sector regulation will see the creation of a prudential regulator – the Prudential Authority – housed in the South African Reserve Bank (SARB), while the FSB will be transformed into a dedicated market conduct regulator – the Financial Sector Conduct Authority.

[114] South Africa, National Treasury, *Media Statement on the Tabling of the Insurance Bill*, 1 February 2016.

[115] Ibid.

its relatively sophisticated banking and financial sectors, and its large cash-based market, render the country a very attractive target for transnational and domestic crime syndicates.

In April 2014, the South African Central Bank (SARB) fined four South African banks after it detected deficiencies in their control mechanisms to combat money laundering and terrorist financing (see Table 1 below).[116] The SARB emphasised that the banks did not engage in the active facilitation of transactions involving money laundering and terrorist financing. All four banks announced that remedial action would be taken. In January 2014, the London branch of one of the four banks was fined by the UK regulator for not having adequate policies or procedures in place to protect corporate customers connected to political figures in relation to the prevention of money laundering.[117]

Table 1 Overview of Sanctions issued against the 'Big Four'

Entity sanctioned	Non-compliance	Sanction
Standard Bank of South Africa	Client identification and verification in contravention of section 21 FIC Act	Directive
	Record-keeping in contravention of sections 22-24 FIC Act	R10 million
	Duty to report suspicious and unusual transactions in contravention of section 29 FIC Act	R20 million
	Duty to report cash threshold transactions in contravention of section 28 FIC Act	R20 million
	Reporting of property associated with terrorist and related activities in contravention of section 28A FIC Act	R10 million
FirstRand Bank Ltd	Client identification and verification in contravention of section 21 FIC Act	R5 million
	Record-keeping in contravention of sections 22-24 FIC Act	Directive
	Duty to report suspicious and unusual transactions in contravention of section 29 FIC Act	R25 million
Nedbank Group Ltd	Client identification and verification in contravention of section 21 FIC Act	R15 million
	Reporting of property associated with terrorist and related activities in contravention of section 28A FIC Act	R10 million
Barclays Africa Group Ltd	Client identification and verification in contravention of section 21 FIC Act	R10 million
	Record-keeping in contravention of sections 22-24 FIC Act	Directive
	Duty to report suspicious and unusual transactions in contravention of section 29 FIC Act	Reprimand

Source: FIC Annual Report 2014/2015, p 30.

[116] *FIC Annual Report 2014/2015*, p. 30.

[117] R. Bonorchis, '*South African Banks Fined After Money-Laundering Probe*', Bloomberg, 16 April 2014.

The South African Government estimates that between $2-8 billion are laundered each year through South African financial institutions. Money laundering investigations involved offences of fraud, theft, corruption, racketeering, and gambling. Major profit-generating crimes include precious metals smuggling, abalone poaching, and sophisticated investment scheme frauds. Other trends in money laundering are based on investment frauds through pyramid schemes and fraud cases through fake cheques. Funds are noted to have been laundered through lawyers or other service providers, purchase of properties, establishment of shell companies and home businesses. The authorities also pointed to an increase in the sophistication and scale of economic crime and crimes through criminal syndicates.[118] The scope of the challenges related to IFFs faced by South Africa is further highlighted in the empirical part of this study; see notably Box 15 in section 3.3.2.

South African AML legislation

According to the 2015 IMF assessment of South Africa's financial sector, the country has made significant progress in in improving its AML/CFT legal and institutional framework since it was last assessed against the AML/CFT standard in 2008. However, significant technical deficiencies remain, such as the absence of requirements to identify and verify the identity of beneficial owners of customers, and to apply enhanced due diligence to high risk situations.[119] As such, the process of implementation of AML/CFT standards in South Africa is on the right track, but has still to be considered 'work in progress'.

Since 1992, the laundering of drug-related money has been criminalised in South Africa. The Proceeds of Crime Act (No. 76 of 1996) criminalised money laundering for all serious crimes. This Act was supplemented by the Prevention of Organised Crime Act (No. 121 of 1998), which confirmed the criminal character of money laundering, mandates the reporting of suspicious transactions, and provides a 'safe harbour' for good faith compliance. Violation of this act entails a fine of up to 100 million Rand or imprisonment for up to 30 years. The AML framework was further complemented when South Africa criminalised terrorist financing in the Protection of Constitutional Democracy against Terrorist and Related Activities Act of 2004.[120]

The Financial Intelligence Centre (FIC), South Africa's central financial intelligence body, was established in 2001 under the FIC Act (No. 38 of 2001) to act as the primary authority over anti-money laundering efforts in South Africa. The FIC Act, together with the said Protection of Constitutional Democracy Act, is aimed at ensuring that South African law complies with the key FATF recommendations on terrorist financing and money laundering. The FIC Amendment Act (No. 11 of 2008), which took effect in 2010, sought to further clarify the roles and

[118] FATF/ESAAMLG, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism*, South Africa, 26 February 2009, p. 16.

[119] IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 4.

[120] GPFI, *South Africa's Engagement with the Standard Setting Bodies and the Implications for Financial Inclusion, Alliance for Financial Inclusion*, 2011, p. 3.

responsibilities of supervisory bodies. The FIC is responsible for establishing an AML regime and maintaining the integrity of the South African financial system by enforcing record-keeping and reporting procedures of financial institutions within the country. The FIC Act also sets up a regulatory AML regime which is intended to break the cycle used by organised criminal groups to benefit from illegal profits. By doing this, the Act aims to maintain the integrity of the financial system. The regulatory regime of the FIC Act imposes 'know your client-obligations' and record-keeping and reporting obligations on the responsible institutions. It also requires the responsible institutions to develop and implement internal rules to facilitate compliance with these obligations. The FIC Act complements and works with the Prevention of Organised Crime Act (No. 121 of 1998) which contains the substantive money laundering offences.[121]

Financial Action Task Force (FATF)

South Africa has been a member of the FATF since 2003 and as such is required to implement the FATF Recommendations.[122] In fact, South Africa was implementing the Recommendations even before its accession to FATF.[123] South Africa is an active participant in review groups and projects, most notably related to financial inclusion. As the only African member of FATF, South Africa represents the interests of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the regional body consisting of eastern and southern African countries, in the FATF.[124] The purpose of the ESAAMLG is to combat money laundering by implementing the FATF Recommendations. This effort includes coordinating with other international organisations concerned with combating money laundering, studying emerging regional typologies, developing institutional and human resource capacities to deal with these issues, and coordinating technical assistance where necessary. ESAAMLG enables regional factors to be taken into account in the implementation of AML measures.

FATF Mutual Evaluation (2008)

The most recent comprehensive assessment of South Africa's AML/CFT system based on the FATF Recommendations took place in 2008.[125] Although the Mutual Evaluation Report, published in early 2009, concluded that the South African government was strongly committed to the implementation of the Recommendations, the development of AML/CFT systems in

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[121] FIC, *Organisation profile*, https://www.fic.gov.za/SiteContent/ContentPage.aspx?id=1.

[122] See http://www.fatf-gafi.org/countries/#South Africa.

[123] GPFI, *South Africa's Engagement with the Standard Setting Bodies and the Implications for Financial Inclusion, Alliance for Financial Inclusion*, 2011, p. 6.

[124] *Ibid.*, p. 3.

[125] The next comprehensive assessment of South Africa's AML/CFT system, which will be based on the revised FATF standard and methodology, is expected to take place after 2017.See: IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 7.

South Africa was deemed to be a 'work in progress'.[126] Identified concerns were, amongst others, related to: monitoring of financial institutions on their compliance with the FATF Recommendations; requirements ensuring that accountable institutions apply enhanced due diligence for higher risk categories of customers, business relationships or transactions; requirements in law or regulation requiring accountable institutions to identify or verify the identity of beneficial owners; and to the prohibition on financial institutions from entering into, or continuing, correspondent banking relationships with shell banks. It was expected that many of the identified deficiencies would be addressed by the FIC Amendment Act 2008.[127]

As already mentioned, the Mutual Evaluation Report, published early 2009, exposed certain weaknesses in the South African AML/CFT system. The FATF Report differentiated between four levels of compliance. These are: compliant, largely compliant, partially compliant and non-compliant. Based on the, then, 40 FATF Recommendations and the nine Special Recommendations, South Africa was still found to be in non-compliance with regard to seven out of the 40 FATF Recommendations.[128] These seven cases are highlighted in Table 2.

Table 2 Overview of non-compliance with FATF Recommendations (2009)

FATF No.	Issue/Topic	Present status of compliance in South Africa
12	**Politically exposed persons**	The absence of a requirement for enhanced due diligence measures for politically exposed persons is addressed in 'Guidance Notes' drafted by the FIC.[129] However, these measures are not anchored in the current FIC Act and are not enforceable. As a consequence, there are no legal obligations to apply enhanced due diligence on politically exposed persons and other high risk customers or scenarios.
13	**Correspondent banking**	Some banks have developed frameworks to assess money laundering/financing terrorism risks and apply enhanced measures for cross-border correspondent banking relationships. However, no corresponding obligation for the responsible institutions to conduct enhanced due diligence on cross-border correspondent banking and other similar relationships exists.
17	**Reliance on third parties**	Exemption 5 to the FIC Act does not require the institution relying on third-party verification to immediately obtain the relevant CDD information; Exemption 5 does not require the accountable institution to satisfy itself that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the other institution 'without delay'; furthermore there is no explicit requirement that the financial institution satisfies itself of the adequacy of applicable AML/CFT measures applicable to the foreign

[126] FATF/ESAAMLG, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism*, South Africa, 26 February 2009, p. 6.

[127] *Ibid.*, p. 10.

[128] FATF/ESAAMLG, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism*, South Africa, 26 February 2009.

[129] See for more information: www.fic.gov.sa, Compliance Guidelines.

FATF No.	Issue/Topic	Present status of compliance in South Africa
		financial institution. Despite the lack of determinations by relevant supervisory bodies, some the responsible institutions are applying Exemption 5 and fully exempt all customers from FATF membership countries from the verification requirements under the FIC Act.
18	**Internal controls and foreign branches and subsidiaries**	South Africa is still non-compliant with regard to ensuring adherence of foreign branches and subsidiaries to the standards. To address the risks arising from foreign branches of some South African banks, the BSD has coordinated with its foreign counterparts in planning joint inspections of a few foreign branches of South African banks, which were to be conducted in 2015.
19	**Higher-risk countries**	Legislation creating additional obligations when dealing with high-risk countries is still absent. Some banks have developed frameworks to assess money laundering/financing terrorism risks and apply enhanced measures for high risk customers and business relationships such as domestic and foreign politically exposed persons, and cross-border correspondent banking relationships.
22	**DNFBPs: customer due diligence**	General deficiencies in consumer due diligence still apply. Casinos are fully exempted from collecting and verifying residential addresses and income tax registration numbers of natural persons (Exemption 14). More such examples for other sectors remain in existence.
24	**Transparency and beneficial ownership of legal persons**	In the absence of a legal requirement to identify and verify the identity of beneficial owners, the type of measures implemented by banks concerning beneficial owners varies. Some banks indicated that they identify beneficial owners when they consider the risks posed by a customer are higher. Nonetheless, it seems that the majority of banks do not try to identify individuals beyond legal ownership.

Source: FATF/ESAAMLG, *Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism*, South Africa, 26 February 2009.

The IMF's South Africa financial sector assessment (2015)

As part of the 'Financial Sector Assessment Program', the IMF carried out an assessment of South African measures aimed at combating money laundering and the financing of terrorism. The IMF concluded that South Africa had made significant progress in improving its AML/CFT legal and institutional framework since it was last assessed against the AML/CFT standard in 2008.[130]

[130] The 'AML/CFT standard' was developed by the FATF together with the World Bank and the IMF. As such, the Report did not assess South Africa's AML/CFT standard in the light of the FATF Recommendations, but rather conducted a review of specific aspects of South Africa's AML/CFT framework which were found deficient in the previous assessment.

Most notably, the AML/CFT supervisory framework for the financial sector, in particular the banking sector, had been strengthened by the FIC Amendment Act, which took effect in 2010, and the creation of the AML/CFT supervision team within the Banking Supervision Department (BSD) of the South African Reserve Bank (SARB). Law enforcement efforts had also been strengthened through the creation of the Directorate for Priority Crime Investigation (DPCI) within the South Africa Police Service as a specialised unit responsible for investigations of money laundering.[131] On a more critical note, the Report highlights that significant technical deficiencies remain, such as the absence of requirements to identify and verify the identity of beneficial owners of customers and to apply enhanced due diligence to high risk situations.[132] Furthermore, the Report stresses that structural capacity weaknesses frustrate the overall effectiveness of the efforts made by the South African law enforcing and prosecutorial authorities.[133] These findings are in line with the general assessment of the functional weaknesses of the AML systems in the developing countries included in this study, presented in section 3.5.3 of the empirical part of this study.

In order to address these remaining deficiencies, the South African government adopted another amendment to the FIC Act, the Financial Intelligence Centre Amendment Bill,[134] which is currently under consideration by the SA Parliament. More specifically, the amendment of the FIC Act will:

- Introduce the concepts of beneficial ownership, ongoing due diligence, and foreign and domestic prominent influential persons;
- Enhance the customer due diligence requirements;
- Provide for the adoption of a risk based approach in the identification and assessment of AML and CTF risks;
- Provide for the implementation of the UNSC Resolutions relating to the freezing of assets;
- Dissolve the Counter-Money Laundering Advisory Council ('the CMLAC');
- Extend the functions of the FIC in relation to suspicious transactions;
- Enhance the supervisory powers of accountable institutions; and
- Enhance certain administrative and enforcements mechanisms.[135]

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[131] IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 13.

[132] IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 12. See also: Transparency International: *South Africa: Beneficial ownership transparency*, 2012.

[133] *Ibid*., p. 22.

[134] Republic of South Africa, Treasury, Legislation, *Financial Intelligence Amendment Bill*, Government Gazette No. 39277, 9 October 2015.

[135] Government notice, National Treasury, No. 342, Invitation for Public Comments on the Draft Financial Intelligence Centre Amendment Bill, 22 April 2014.

These amendments are expected to address most of the remaining deficiencies in the legal framework for AML/CFT preventive measures and supervision of the financial sector.[136]

2.2.3.3 Tax evasion and elusion

A. Institutional framework

The South African Revenue Service (SARS) is the nation's tax collecting authority. Established by the South African Revenue Service Act 34 of 1997 as an autonomous agency, SARS is responsible for administering the South African tax system and customs service through: collecting and administering all national taxes, duties and levies; collecting revenue that may be imposed under any other legislation as agreed on between SARS and a State entity entitled to the revenue; providing a customs service that facilitates trade, maximises revenue collection and protects South African borders from illegal importation and exportation of goods; and advising the Minister of Finance on all revenue matters.[137]

The International Relations Division (IRD) of SARS is responsible for improving relations through contact with international tax and customs authorities. Among the duties of the IRD are the implementation of international tax and customs policies, strategies, procedures and instruments, and the monitoring of developments in this regard. Furthermore, the IRD is tasked with strengthening the relationships with foreign customs and tax administrations, both bilaterally and multilaterally, and through international organisations and the development of a regulatory framework. To conclude, the IRD is to protect the revenue base of South Africa by combating fiscal evasion through international cooperation.[138]

Implementation of international standards

South Africa is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes.[139] Membership to the Forum entails the implementation of certain standards with regard to: (1) availability of information; (2) access to information; and (3) exchange of information. In the latest peer review report, published in 2013, South Africa was deemed to be

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[136] IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 16.

[137] SARS, *About us*, available at: http://www.sars.gov.za/About/Pages/default.aspx.

[138] SARS, *About*, International Relations, available at:

http://www.sars.gov.za/About/HowTax/Pages/International-Relations.aspx.

[139] OECD, Information available at: http://www.oecd.org/tax/transparency/about-the-global-forum/members/.

'compliant' with the Global Forum's standards.[140] As such, South Africa is scheduled to conduct the first automatic exchanges of information under the Standard in 2017.[141]

Nevertheless, certain shortcomings in South Africa's implementation were identified. With regard to the availability of information, it was recommended that South Africa should monitor the availability of ownership of the information on partnerships, in particular where one or more of the partners are a trust.[142] With regard to exchange of information, South Africa still needs to improve implementation of its Exchange of Information network with all relevant partners.[143]

South Africa endorsed the Declaration on Automatic Exchange of Information in Tax Matters, adopted on 6 May 2014. The Declaration commits countries to implement a new single global standard on automatic exchange of information. The standard, which was developed by the OECD and endorsed by G20 finance ministers, obliges countries and jurisdictions to obtain all financial information from their financial institutions and exchange that information automatically with other jurisdictions on an annual basis.[144] South Africa and all EU Member States, except for Slovenia, Lithuania, Estonia and Latvia, have concluded bilateral agreements based on the OECD Agreement on exchange of information on tax matters.[145]

Several South African laws contain provisions for the purposes of preventing tax fraud.[146] For example, the Securities Transfer Act (Act No. 25, 2007) contains a provision on schemes for obtaining undue tax benefits.[147] The Minerals and Petroleum Resources Royalties Act (Act No. 28 2008) contains a 'general anti-avoidance clause' in order to ensure appropriate taxation of transactions. Transactions that have either the effect of avoiding liability for the royalty, or

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[140] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Peer Review Report Combined: Phase 1 + Phase 2, Incorporating Phase 2 Ratings: South Africa*, OECD, November 2013, p. 80.

[141] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2015: Report on Progress*, OECD, 2015, p. 19.

[142] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Peer Review Report Combined: Phase 1 + Phase 2, Incorporating Phase 2 Ratings: South Africa*, OECD, November 2013, pp. 17-50.

[143] *Ibid.*, pp. 60-80.

[144] OECD, information available at: http://www.oecd.org/ctp/exchange-of-tax-information/countries-commit-to-automatic-exchange-of-information-in-tax-matters.htm.

[145] Exchange of Tax Information Portal, Information available at:

http://www.eoi-tax.org/jurisdictions/ZA#agreements.

[146] SARS, home, legal and policy, Primary legislation, available at: http://www.sars.gov.za/Legal/Primary-Legislation/Pages/default.aspx.

[147] Article 9 STA.

which are not *bona fide,* or are not entered into at arm's length or are entered into solely for the purpose of obtaining a certain royalty benefit,[148] should be avoided at all times.

To conclude, South Africa is a State Party to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Convention was signed on 3 November 2011 and entered into force on 1 March 2014.[149] As a member of the G-20, South Africa was co-author of the 'G20 statement on transparency and exchange of information for tax purposes'.

2.2.3.4 Perceived EU influence on the implementation of international standards

Although not strictly dealing with the EU's influence over the process of the implementation of international standards in South Africa, the following development is at the least indirectly relevant here. The year 2015 was important in terms of promoting global sustainable development and poverty eradication. Two high-level international meetings were organised, respectively establishing the new 'Sustainable Development Goals' and the financial framework to underpin them. The latter agenda included international cooperation on tax matters and was discussed during the 'Third International Conference on Financing for Development' in Addis Ababa in July.[150]

Considering that international rule-making procedures concerning international cooperation on tax matters are largely in the hands of developed countries, developing countries and NGOs made 'global tax democracy' and reform of decision-making procedures a priority.[151] However, the EU did not support their proposal for the creation of a permanent global tax body, which would significantly enhance the influence of developing countries over the decision-making process surrounding international cooperation on tax matters. The EU took the position that, rather than creating new intergovernmental structures, the functioning of the existing structures should be strengthened,[152] and the cooperation with developing countries should be enhanced within these structures.[153] In Addis Ababa, none of the individual EU Member States challenged

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[148] Article 12 MPRRA.

[149] OECD, *Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters*, Status, 4 November 2015.

[150] European Commission, *A Global Partnership for Poverty Eradication and Sustainable Development after 2015*, COM(2015)44 final, Brussel, 5 February 2015, p. 2.

[151] See for example: *Statement on behalf of the Group of 77 and China by H.E. Ambassador Kingsley J.N. Mamabolo, Permanent Representative of the Republic of South Africa, Chair of the Group of 77, at the Round Table on Ensuring Policy Coherence and an Enabling Environment at all Levels for Sustainable Development at the Third International Conference on Financing for Development*, Addis Ababa, Ethiopia, 14 July 2015; Concord, *Destination Addis Ababa: The European Union's Responsibilities at the Third Financing for Development Conference*, Brussels, 26 February 2015.

[152] European Commission, *A Global Partnership for Poverty Eradication and Sustainable Development after 2015*, COM(2015)44 final, Brussel, 5 February 2015, p. 7.

[153] C. Barbière, A. Robert, 'Tax Evasion to Dominate Addis Ababa Development Conference', *Euractiv*, 17 July 2015.

the approach adopted by the EU. France was even among the staunchest opponents of upgrading the UN Committee of Experts on International Cooperation in Tax Matters system, opting rather for the OECD route. After three days of debate, the representatives of the UN Member States agreed on a compromise, namely to strengthen the capacities of the pre-existing UN Committee. The final text adopted in the UN General Assembly remained very general in nature.[154] Developing countries and NGOs stressed afterwards that, with outcomes like these, decision-making on global tax standards and rules remains largely in the hands of the OECD countries.[155] To illustrate the weight allocated to the compromised solution by the European Commission, its own conclusions as released after the conference made no mention of the enhanced powers of the UN's Committee.[156]

Even though the TDCA does not contain an explicit obligation for the Parties to cooperate on tax matters, this reading of the events at the Addis Ababa Conference questions the EU's commitment to the enhancement of international cooperation on tax matters *vis-à-vis* developing countries. Rather, it emphasises a desire to safeguard the bilateral relationships as laid down, for example, in DTAs, only marginally commit to closer cooperation within the framework of the existing structures of the UN and to consolidate power within the OECD framework, in which the developed countries have a dominant position.

2.2.4 Concluding remarks

South Africa's troubled recent history has translated into a strong desire to catch up with the rest of the world in terms of engagement with the international frameworks governing the global financial systems. South Africa's implementation of international standards pertaining to the combating of money laundering and tax evasion and elusion can be considered advanced. Complying with the relevant international standards has been and could continue to be problematic for African countries because of their inadequate human and financial resources and regulatory frameworks. Nevertheless, it is important for Africa to strive to be a part of the emerging global frameworks to tackle IFFs.[157]

The ongoing reforms concerning the supervision of the banking and insurance sectors seek to enhance South Africa's performance in this regard. The reforms introduced by the Financial Intelligence Centre Amendment Bill and the Financial Sector Regulation Bill are expected to address the remaining shortcomings in South Africa's implementation of the main international standards. Nevertheless, South Africa's position as the, by far, largest financial centre of the region and the presence of a strong extractive sector, which is often associated with lack of

[154] See more specifically: *Addis Ababa Action Agenda*, par. 22-23 and 29.

[155] C. Barbière, 'Addis Ababa Development Financing Conference Stumbles on Tax Evasion', *Euractiv*, 17 July 2015.

[156] Ibid.

[157] High Level Panel on Illicit Financial Flows from Africa, *Illicit Financial Flows: Track It, Stop It, Get It!*, Report commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, 2015, p. 46.

transparency, susceptibility to bribery and transfer-pricing practices, persistently renders the country very vulnerable to IFFs, money laundering and tax evasion.[158]

Overall, it is very difficult to assess the EU's role in the implementation process of international standards in South Africa, or more specifically, the role played by the TDCA therein. Many of South Africa's engagements with international standards were established after the TDCA came into force. However, it cannot be concluded that the improvement in implementation and adherence to international standards was a direct consequence of EU influence exerted through the bilateral structures of the TDCA. Rather, South Africa gained membership status of key international organisations through planned expansion of the membership of standard setting bodies – as such it was not specifically motivated by South African progress in a certain area or any EU involvement therein. Therefore, it can be concluded that no significant causality exists between the implementation of the TDCA and EU support therein on the one hand, and South Africa's performance with regard to adhering to international standards combating money laundering, and tax evasion and elusion on the other hand.

The wording of the relevant provisions in the TDCA can be considered weak when making a comparison with other provisions in similar, more recent, Agreements. Such general wording provides considerable room for manoeuvring in the implementation process, or moreover, the option of not undertaking meaningful action to improve cooperation at all. Without adequate implementation and subsequent monitoring mechanisms, a provision worded in such a way is at risk of being rendered meaningless. It has to be reiterated here though that the current South African government's position towards standards 'imposed' by developed countries through Bilateral Investment Treaties seems to suggest that such a strategy might be counterproductive.[159]

Another example of wording lacking strength and depth would be the limited references to the advancement of cooperation in the area of international tax matters. Rather, the focus is put on the prevention of potential interference of the functioning of the TDCA with bilateral tax treaties between South Africa and the EU Member States. The TDCA does not commit the Parties to cooperate on tax matters, but rather aims to ensure that nothing captured therein jeopardises the application of bilateral tax agreements. Indeed, both the EU Member States and South Africa are committed, through multiple international fora, to the implementation of far-reaching and elaborate frameworks for cooperation on tax matters. Nevertheless, tax evasion and elusion remain among the most pressing challenges to the safeguarding of the development process of South Africa.

[158] See Box 15, section 3.3.2.

[159] See for example: J. Lang and B. Gilfillan, *Bilateral Investment Treaties – a Shield or a Sword?*, Bowman Gilfillan African Group, Corporate Newsflash.

2.3 EU-Serbia Stabilisation and Association Agreement

2.3.1 Trade context

Box 5 Serbia's capacity to combat money laundering and tax evasion

- The lack of capacity for efficient law enforcement and effective adjudication, coupled with corruption and organised crime, reduce the achievements of Serbia's criminal justice sector
- The first judgment ever to be handed down in Serbia against a legal person in general and against money laundering in particular was rendered in the Omorika case by the Special Department of the High Court in Belgrade in June 2014.
- International supervision over Serbia's reform of anti-money laundering legislation by the Council of Europe's MONEYVAL Committee and the realisation of a joint capacity-building project (MOLI-Serbia) led by the EU and the Council of Europe have proven the added value of international cooperation in the field of money laundering and tax evasion.

2.3.1.1 Bilateral trade relations and the nature of the Agreement

Trade relations with the EU are crucial for the Serbian economy, because the EU is Serbia's most important trading partner. According to the official data of the Serbian Statistics Office, the latest reporting period (January-September 2015) shows that the EU accounts for no less than 66% of Serbia's total exports and 62.5% of its imports.[160] Conversely, in 2014, Serbia accounted for only 0.5% of the EU's total trade.[161] Nevertheless, the volume of the EU's total trade with Serbia has steadily grown, from €3.8 billion in 2005 to close to €17.5 billion in 2014.[162]

The free trade agreement between the EU and Serbia operates under the name of Stabilisation and Association Agreement (SAA).[163] It was signed on 29 April 2008 in Luxembourg and entered into force on 1 September 2013.[164] The SAA succeeds the Interim Agreement on Trade and Trade-Related Matters, which applied since 1 February 2010 in order to ensure a speedy

[160] Statistics Office of the Republic of Serbia, *Announcement no. 293 of 30 October 2015*, p. 7.

[161] European Commission, DG Trade, *European Union, Trade with Serbia*, 20 October 2015, p. 2.

[162] European Commission, DG Trade, *European Union, Trade with Serbia*, 20 October 2015, p. 3.

[163] 'Stabilisation and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Serbia, of the other part', [2013] *OJ* L 278/16.

[164] See the ratification process at: www.consilium.europa.eu/en/documents-publications/agreements-conventions/agreement/?aid=2007137.

provisional implementation of the trade provisions of the SAA, pending its entry into force.[165] This interim agreement was the first time Serbia and the EU entered into a contractual relationship.

The SAA was concluded in the context of Serbia's European integration process and it is, hence, not a typical free trade agreement of the EU, but one that seeks above all to ensure that this country meets the conditions for accession. In this regard, pursuant to a decision of the European Council, Serbia has held the status of candidate for EU membership since 1 March 2012. EU accession negotiations began on 21 January 2014, when the first EU-Serbia intergovernmental conference was held in Brussels. Therefore, the SAA will cease to apply once Serbia becomes a Member State of the EU and thus also a full member of its internal market.

Serbia's EU accession negotiations consist of 35 negotiating chapters, of which those on the free movement of capital (chapter 4), financial services (chapter 9), and financial control (chapter 32) are instrumental to combating money laundering and tax evasion. On 14 December 2015, the Second Intergovernmental Conference EU-Serbia officially opened two negotiating chapters, among which was that on financial control.

2.3.1.2 Institutional framework of the Agreement

The SAA establishes three bodies charged with ensuring it fulfils its objectives.[166] The *Stabilisation and Association (SA) Council* is composed of representatives of the European Commission and of the Council of the EU, on the one part, and of representatives of the Serbian Government, on the other part. It meets once a year at ministerial level and in special sessions at the request of one of the parties. It examines major bilateral and international issues of mutual interest and supervises the application and implementation of the SAA. To this end, it may adopt binding decisions and issue recommendations. The SA Council is also tasked with resolving any disputes that may arise between the EU and Serbia in relation to the application or interpretation of the agreement. Its dispute-settling decisions are binding. The SA Council is assisted in its work by a *Stabilisation and Association (SA) Committee.* The SA Committee meets typically at the senior civil servant level. It may also establish subcommittees to oversee the implementation of provisions in the relevant sectors of the SAA. In addition to the SA Council and the SA Committee, a *Stabilisation and Association Parliamentary Committee* was set up to provide a forum for the exchange of views between the members of the European Parliament and the Serbian National Assembly. Furthermore, *two joint consultative committees* are established: one gathering representatives of the EU's European Economic and Social Committee and of Serbia's social partners and civil society organisations; and the other gathering representatives of the EU's Committee of the Regions and Serbia's local and regional authorities.

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[165] When this Interim Agreement was signed, the EU declared its intention not to apply it before its entry into force. Conversely, to demonstrate its commitment to EU integration, Serbia decided to start applying it unilaterally on 16 October 2008 and began doing so on 1 January 2009.

[166] Articles 119-125 of the SAA.

2.3.2 Assessment of the Regulatory Framework for the Provision of Financial Services and Combating Illicit Financial Flows

2.3.2.1 Financial services

As a corollary of its specific nature as an agreement within Serbia's EU accession process, the SAA has a somewhat different structure of the provisions on financial services compared to EU free trade agreements with other countries. However, there are a number of provisions in the SAA that are of immediate relevance for financial services providers and for the efforts to combat illicit capital flows, money laundering and tax evasion. They primarily specify the objectives and means of cooperation between the contracting parties. In regulating market access, the SAA outlines the importance of granting national treatment and most favoured nation treatment to EU and Serbian operators in the financial sector. At the same time, while the agreement foresees the usual guarantees for prudential reasons, it also permits derogations where this is necessary for a contracting party to address exceptional adverse circumstances that impact its financial system. The SAA establishes a system of gradual liberalisation of capital flows, based on minimum cooperation commitments. These are chiefly aimed at enhancing Serbia's regulatory and legislative blueprints for financial services provision.

As a consequence, the Serbian Government and Parliament have successfully cooperated to achieve a moderately high level of implementation of the SAA, and, where this has not yet been done, plans have been made for the adoption of primary and secondary legislation to this end.

General provision

The SAA contains only one provision explicitly referring to *financial services*. In a very general fashion, this provides for cooperation between the two parties with the aim of 'establishing and developing a suitable framework of the banking, insurance and financial services sectors in Serbia based on fair competition practices and ensuring the necessary level playing field'.[167] A financial service is defined broadly 'as any service of a financial nature offered by a financial service provider of a Party'.[168]

Right of establishment

In the first place, the SAA enshrines equal treatment concerning the *right of establishment* of EU and Serbian companies on each other's territory. It obliges the parties to guarantee non-discriminatory conditions for the setting up of operations of their companies in the territory of the other party, whereby neither of the parties is allowed to subject the companies of the other party to conditions less favourable to those applicable to their own companies or companies of third countries.[169] However, as long as equal treatment is maintained, the parties are free to regulate the establishment and operation of companies on their territories. In the field of

[167] Article 91 of the SAA.

[168] See Annex VI of the SAA. This contains a list of services considered to be financial services.

[169] Article 53 of the SAA.

financial services, a prudential carve out is foreseen. This means that the parties may adopt measures for prudential reasons, which include but are not limited to: (a) measures for the protection of investors, depositors, policy holders, and persons to whom a fiduciary duty is owed by a financial service supplier; and (b) measures to ensure the integrity and stability of the financial system.[170] Yet, these measures may not be used to avoid the parties' obligations under the SAA. Furthermore, neither party is under a duty to disclose information on the affairs and accounts of individual customers or any confidential or proprietary information in the possession of public entities.[171] The SAA also enables companies of one party that are established in the territory of the other party to employ their own nationals in the territory of the other party under certain conditions.[172]

Supply of services

When it comes to the *supply of services*, the parties are prohibited from taking any measures or actions that would render cross-border provision of services 'significantly more restrictive' for the companies or nationals of the other party compared to the situation existing before the entry into force of the SAA.[173]

Movement of capital

With respect to *current payments and movement of capital*, the parties undertake to authorise any payments and transfers on the current account of balance of payments between the EU and Serbia.[174] As regards transactions on the capital and financial account of balance of payments, the parties are obliged to guarantee free movement of capital in respect of two groups of transfers. On the one hand, this duty applies to direct investments made in companies formed in accordance with the laws of the host country; investments made pursuant to the aforesaid rights of establishment; as well as the liquidation or repatriation of these investments and of any profit thus made. On the other hand, it applies to credits related to commercial transactions or cross-border provision of services, and to financial loans and credits with maturity longer than a year.[175] As of 1 September 2017, the EU and Serbia shall ensure free movement of capital in relation to portfolio investment and financial loans and credits with maturity shorter than a year.[176] While the SAA prohibits any new restrictions on the movement of capital between the EU and Serbia, each party is entitled to introduce safeguard measures in exceptional circumstances if: (a) movements of capital between them cause, or threaten to cause, serious

[170] Article 54(2) of the SAA.

[171] Article 54(3) of the SAA.

[172] Article 58 of the SAA.

[173] Article 60 of the SAA.

[174] Article 62 of the SAA.

[175] Article 63(1)-(2) of the SAA.

[176] Article 63(4) of the SAA.

difficulties for the operation of exchange rate policy or monetary policy; (b) such measures are strictly necessary; and (c) they are not in effect for longer than six months.[177]

Investment

Another matter of importance for financial services is that of *investment*. With a view to supporting Serbia's economic and industrial revitalisation, the EU and Serbia agreed to cooperate in the field of investment promotion and protection. This is aimed at creating a favourable climate for both domestic and foreign private investment through an improvement of Serbia's legal framework.[178]

2.3.2.2 Taxation

Collaboration in the area of *taxation* is of paramount significance for avoiding illicit capital flows. In this regard, the SAA has established several goals.[179] The first one refers to ensuring the effectiveness of tax collection and the fight against fiscal fraud, which is to be achieved through a further reform of Serbia's fiscal system and the restructuring of tax administration. The second goal seeks to eliminate harmful tax competition. This is to be carried out in accordance with the principles laid down in the legally non-binding but politically important Code of Conduct for Business Taxation, which was adopted by the Council on 1 December 1997.[180] The third goal is to: (a) strengthen the enforcement of measures aimed at preventing tax fraud, evasion and avoidance through enhanced transparency; (b) fight against corruption; and (c) exchange information with the EU Member States.

To these ends, Serbia has accepted the obligation to complete the conclusion of bilateral agreements with the EU Member States in coherence with the latest versions of the OECD's Model Tax Convention of Income and Capital and its Model Agreement on Exchange of Information in Tax Matters. Furthermore, the SAA lays down that it may not be construed in a way that would prevent the adoption or enforcement of national measures that seek to prevent tax avoidance or evasion pursuant to agreements on the avoidance of double taxation or national fiscal legislation.[181]

The implementation of these commitments has thus far yielded suboptimal results. This is primarily due to three factors: (a) Serbia's exclusion from global tax cooperation arrangements and networks; (b) weak cooperation between Serbia's administrative authorities in charge of tackling tax evasion; and (c) the unfavourable combination of extremely complex tax regulation and the operation of the shadow economy.

[177] Article 63(6) of the SAA.

[178] Article 93 of the SAA.

[179] Article 100 of the SAA.

[180] See Annex 1 of the 'Conclusions of the Ecofin Council Meeting of 1 December 1997 Concerning Taxation Policy', [1998] *OJ* C2/1, which identifies tests for verifying whether national tax measures give rise to harmful tax competition.

[181] Article 68(2) of the SAA.

2.3.2.3 Money laundering

The SAA further foresees cooperation in the fight against *money laundering*. As a general principle, Serbia undertook to contribute to regional stability and the development of good neighbourly relations, which is to be done by developing programmes of common interest, such as those related *inter alia* to money laundering, organised crime and corruption.[182]

In more concrete terms, the EU and Serbia seek to prevent the use of their financial systems and relevant non-financial sectors, on the one hand, for the laundering of proceeds from general criminal activities (in particular drug offences), and, on the other, for the purpose of financing terrorism. The key objective is to provide Serbia with administrative and technical assistance in order for it to implement relevant regulations and ensure the efficient functioning of the mechanisms to combat money laundering and terrorism financing in accordance with EU and international standards.[183] Key among them are the EU's 4th Anti-Money Laundering Directive of 2015 and standards adopted by the Financial Action Task Force. The latter were adopted in the form of Recommendations in February 2012 and updated in October 2015. Furthermore, the SAA provisions on combating organised crime and other illegal activities envisage cooperation on preventing and combating *inter alia* fiscal fraud.[184]

Therefore, the EU-Serbia free trade agreement creates a solid overarching framework for regulatory cooperation aimed at the liberalisation of trade in general and the prevention of illicit capital flows – particularly money laundering, tax fraud, and terrorism financing. This framework, however, lacks a detailed scheme and action plan for achieving these objectives. Trade in financial services as such is not a developed area of this agreement, but future rounds of accession negotiations between the EU and Serbia in this field will focus on harmonising the latter's legislation with the EU *acquis*.

[182] Article 6 of the SAA.

[183] Article 84 of the SAA. The goal of preventing and suppressing acts of terrorism and terrorism financing is also foreseen in Article 87 of the SAA.

[184] Article 86(1)(d) of the SAA.

Box 6 Impact of the EU-Serbia SAA

- As an EU candidate country, Serbia's FTA with the EU has been the most effective and most influential in occasioning domestic legal reform.
- The prospect of EU integration has contributed to the creation in Serbia of a Money Laundering Prevention Administration and to the strengthening of the supervisory prerogatives of the National Bank of Serbia, both of which have increased their regulatory and administrative action in the respective policy fields.
- Serbian law is largely compliant with FATF recommendations, while more work needs to be done on harmonisation with EU law (notably 4th AML Directive)
- While not a member of the FATF, Serbia is a member of the Egmont Group of financial intelligence units and engages in transnational cooperation with the European Banking Authority and the European Bank Coordination Initiative.

2.3.3 Assessment of the Serbian Legislation on Financial Services, Money Laundering, and Tax Evasion and Elusion

2.3.3.1 General framework for the harmonisation of Serbian law with EU law

To fulfil its duties under the SAA and ensure a timely and smooth harmonisation of domestic law with the EU *acquis*, the Serbian Government adopted the so-called *National Program for the Adoption of the EU Acquis*. This is prepared by the Government's European Integration Office and the latest such programme was adopted in July 2014 and covers the period of 2014-2018.[185] As far as the prevention of illicit capital flows is concerned, Serbia has carried out a number of legislative reforms, chiefly in the fields of financial services regulation, AML and counter-terrorism financing, and combating tax evasion. These are examined in turn below.

2.3.3.2 Financial services legislation

A. Banking

Substantive safeguards in the banking sector

The key piece of Serbian legislation in the area of financial services pertaining to banking is the *Banks Act* of 2005.[186] The amendments to this Act that were passed in 2010 to a significant extent harmonise Serbian law with the Basel II standards. However, EU law has advanced to adopt

[185] *Nacionalni Program za Usvajanje Pravnih Tekovina Evropske Unije* [National Programme for the Adoption of EU *Acquis*].

[186] *Zakon o Bankama* [Banks Act] (*Official Gazette* no. 107/2005 and 91/2010).

the Basel III standards,[187] rendering Serbian law only partially in line with the EU *acquis*. However, on 17 December 2013 the National Bank of Serbia (NBS), which is Serbia's central bank, adopted a Strategy for the introduction of Basel III in Serbia, which lays out a plan to implement EU law in three phases. Despite this, harmonisation with the requirements relating to the right of establishment and the supply of services by credit institutions from the EU Member States in Serbia is only planned for completion by the time Serbia accedes to the EU.

The currently applicable Serbian law does not permit the cross-border provision of banking services by foreign banks and other credit institutions through subsidiaries, but only through the establishment of a bank.[188] However, for a foreign bank to establish a bank in Serbia, the applicants must submit to the NBS evidence that the competent regulatory body of the foreign bank's country of origin has authorised the participation of such a bank in the establishment of a new bank in Serbia. Furthermore, a foreign bank may not acquire direct or indirect ownership in a Serbian bank without a prior authorisation of the NBS. This authorisation shall only be granted if control or supervision over the applying foreign bank is carried out in the latter's country of origin in a manner that satisfies the requirements prescribed by the NBS, if there exists adequate cooperation between the foreign bank's supervisory body and the NBS, and if other conditions are fulfilled. Namely, the NBS may require the submission of further information or documentation.[189]

However, the law contains an important shortcoming. Namely, while it expressly provides that the bank's licence may be revoked if the bank's activities are linked with money laundering, terrorism financing or other criminal acts,[190] it provides the NBS with the discretion to decide whether or not to withdraw the license where such a link exists. In other circumstances, such as 'critical undercapitalisation', no such faculty exists and the licence must be withdrawn. Thus, the approach to licence withdrawal in cases of banks' linkages with money laundering and terrorism financing is not sufficiently strict because it leaves a certain margin of discretion to the NBS. This in turn does not provide watertight safeguards that suspicious banks and suspicious operations would be outlawed at the very beginning of the process of their incorporation.

[187] 'Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, Amending Directive 2002/87/EC and Repealing Directives 2006/48/EC and 2006/49/EC', [2013] *OJ* L 176/338; 'Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation (EU) No 648/2012', [2013] *OJ* L 176/1.

[188] Article 11 of the Banks Act.

[189] Article 94 of the Banks Act.

[190] Article 130(2)(11) of the Banks Act.

Supervision over the banking sector

Control over the banking sector is carried out by the NBS, particularly through its *Administration for the Supervision over Financial Institutions*. EU and international regulatory action have strengthened the supervisory role of the NBS, which it conducts diligently and in line with global developments. A notable exercise in this regard is the completion in December 2015 of a 'special diagnostic investigation' of banks as part of a programme agreed with the International Monetary Fund. The objective of this exercise was to verify the level of the capitalisation of Serbian banks according to international standards of financial reporting. The results revealed that all 14 banks under scrutiny, which were chosen according to their systemic importance for Serbia's financial system, exceeded the regulatory capital requirement of minimum 12%.[191] As a result, the NBS' latest quarterly report on the control over the functioning of banks in Serbia, adopted in December 2015, reveals a 'satisfactory level of competition and a low level of concentration' of banking activities.[192]

When it comes to implementing its supervisory duties, the NBS adopted a Decision in 2009 laying down minimal procedural requirements that banks and insurance providers must follow to ensure customer due diligence.[193] These are expressly aimed at reducing client-derived risks of money laundering that various financial services providers may be exposed to. This Decision obliges all such providers to adopt concrete written procedural requirements for determining the acceptability of new and existing clients, for classifying clients according to risk factors, for knowing and tracking their clients' operations, for managing risks for money laundering and terrorism financing that clients may pose to such providers, and for training the staff who are in direct contact with clients or execute their transactions.

Specific further conditions apply to banks. They are under a duty to put in place procedures for establishing correspondent relations with other banks, especially foreign banks. In particular, they must refuse the establishment of correspondent relations with banks that apply AML and counter-terrorism standards lower than those applied at the EU level.[194] Furthermore, if a member of staff who is in direct contact with the client suspects that the client and/or the transaction requested pose a risk for money laundering or terrorism financing, an internal written report must be drawn up, and these reports are kept for the following 5 years.[195] Financial service providers must also establish adequate systems for discovering unusual or suspicious transactions and/or clients.[196]

[191] NBS, *Posebna Dijagnosticka Ispitivanja* [Special diagnostic investigations].

[192] NBS, Sector for Control over Banking Operations, Bankarski Sektor u Srbiji: Izvestaj za III tromesecje 2015. Godine [Banking Sector in Serbia: Report for III Quarter of 2015], p. 4.

[193] NBS, *Odluka o Minimalnoj Sadrzini Procedure 'Upoznaj Svog Klijenta'* [Decision on the minimal contents of the 'know your client' procedure] of 17 June 2009, (*Official Gazette* no. 46/2009).

[194] Point 12 of the Decision.

[195] Point 13 of the Decision.

[196] Point 16 of the Decision.

Moreover, the NBS concluded a multilateral memorandum of cooperation with the European Banking Authority (EBA) on 23 October 2015.[197] This non-binding statement of intent seeks to achieve a greater level of regulatory and supervisory coherence between the signatories. This is to be carried out by means of information exchange through a dedicated forum. The EBA undertook to provide information on the development of the Single Rulebook, the convergence of supervisory practices and the functioning of supervisory colleges in the EU to the participating Southeast European banking supervisory authorities. In return, the latter will supply information on the main risks and vulnerabilities in their national banking sectors and other data and analyses according to the EBA's risk assessment needs. These arrangements are consonant with the FATF recommendation on establishing other forms of international cooperation in combating money laundering and terrorist financing (no. 40).

Public-private sector dialogue and cooperation in the field of banking is further maintained within the European Bank Coordination Initiative, also known as the 'Vienna Initiative'.[198] This was established in January 2009 during the sub-prime mortgage global financial crisis and involved a large number of key institutions, including: (a) international financial institutions (the International Monetary Fund, the European Bank for Reconstruction and Development, the European Investment Bank and the World Bank); (b) EU institutions (the European Commission and the European Central Bank as observer); (c) home and host country regulatory and fiscal authorities of large cross-border bank groups; and (d) the largest banking groups operating in the region.[199] The initial goal of the Initiative (Vienna Initiative 1.0) was to support the stability of the financial sector in Central, Eastern and Southeast Europe (jointly referred to as 'emerging' Europe) by preventing the exodus of large cross border bank groups from these regions. After the outbreak of the sovereign debt crisis in the Eurozone, the participating institutions in January 2012 decided to change focus (Vienna Initiative 2.0) and concentrate on avoiding disorderly deleveraging and on supporting policy actions, especially with regard to financial supervision, with the potential involvement of the relevant fiscal authorities.

B. Insurance

Substantive safeguards in the insurance sector

In the area of insurance, Serbia's 2014 *Insurance Act*[200] implements the EU's *acquis* in the areas of life and other types of insurance and insurance mediation,[201] and partially in the area of taking-

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[197] The other signatories of the Memorandum are the Banking Agency of the Federation of Bosnia and Herzegovina, the Banking Agency of the Republic of Srpska, the National Bank of the Republic of Macedonia, and the Central Bank of Montenegro.

[198] See http://vienna-initiative.com.

[199] EBRD, *Vienna Initiative – Moving to a New Phase*, April 2012.

[200] *Zakon o Osiguranju* [Insurance Act], (*Official Gazette* no. 139/2014).

[201] See 'Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance; Third Council Directive 92/49/EEC of 18 June 1992 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Direct Insurance Other than Life Insurance and Amending Directives 73/239/EEC and 88/357/EEC'; and

up and pursuit of insurance and reinsurance.[202] Among other things, this Act transposes the EU requirements concerning the freedom of establishment of subsidiaries, the freedom of provision of insurance services and mediation, and the operation of subsidiaries from third countries.[203] Yet these safeguards will only become applicable upon Serbia's accession to the EU.

However, there are certain safeguards in the legislation in force against the negative influences that could result from cross-border insurance deals. Notably, one of the explicit conditions for acquiring qualified ownership in an insurance company in Serbia is the absence of reasonable doubt that such acquisition is aimed at, or can increase the risk of, money laundering or terrorist financing.[204] Furthermore, the NBS shall reject any requests for the authorisation of the acquisition of qualified ownership in an insurance company, where it determines that, taking into account the foreign law applicable to persons that the applicant is closely connected with and the way such law is applied, supervision over such a company would be significantly more difficult or impossible.[205] The same applies to rejections of applications for work licences.[206] In the case of foreign acquisitions of Serbian insurance companies, the Insurance Act provides for cooperation between the Serbian insurance supervisor – the NBS – and foreign insurance supervisors. This is aimed at ensuring that the foreign applicant is subject to regular supervision in the country of origin (determined through company seat or domicile), at establishing whether the applicant abides by the laws of the country of origin, and at determining whether other conditions foreseen under Serbian law are fulfilled.[207]

Serbian law also regulates insurance activities of Serbian insurance companies abroad and imposes on them the duty of obtaining prior authorisation from the NBS for the establishment of subsidiaries abroad, and the duty of notification where such activities are carried out directly without establishing a subsidiary.[208] The same provision on rejecting authorisation requests outlined above applies here too.

Moreover, foreign investment by insurance companies operating in Serbia is allowed upon obtaining permission from the NBS for each given investment. Yet the amount of foreign

'Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation'. See: [National Programme for the Adoption of EU Acquis](), p. 265.

[202] 'Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the Taking-up and Pursuit of the Business of Insurance and Reinsurance (Solvency II)', [2009] *OJ* L 335/1, as amended by' Directive 2013/58/EU of the European Parliament and of the Council of 11 December 2013'.

[203] See Chapter XIV (Articles 232-255) of the Insurance Act.

[204] Article 32(1)(6) of the Insurance Act.

[205] Article 34(1)(4) of the Insurance Act.

[206] Article 45(1)(7) of the Insurance Act.

[207] Article 35 of the Insurance Act.

[208] Article 81 of the Insurance Act.

investment is capped at no more than 25% of the base capital, which ranges from €2.2 million to €3.2 million depending on the type of insurance.[209]

Therefore, Serbian legislation provides a good level of protection against abuse and fraudulent action in the field of insurance in line with EU law requirements. This is performed through a high degree of involvement of the central authority – the NBS – in a variety of situations related to cross-border provision of insurance services.

Supervision over the insurance sector

As with banking, supervision in the field of insurance, including over the activities of foreign insurers operating in Serbia, is performed by the NBS.[210] Its supervision is relatively effective. As shown by the latest report, adopted in December 2015, the insurance sector recorded growth in almost all categories. Insurance companies' capital grew by 2% and their technical reserves grew by 10.8%, providing full coverage for both life and non-life insurance. The report also demonstrates that the NBS requires insurance companies to abide by risk management requirements laid down in the EU's Solvency II Directive, which was recast on 1 January 2016.[211]

To conduct supervision in the field of insurance, the NBS has been endowed with far-reaching competences. Importantly, the NBS may carry out supervision not only over the addressees of supervision but also over legal persons that have property, administrative or business links with the persons subjected to insurance supervision. Additionally, the NBS may have insight into the business records of all the participants in a deal that is the object of supervision.

It is also significant that the law expressly provides for cooperation between the NBS and other supervisory and other competent bodies in Serbia and abroad, as well as with international organisations. Specifically, the NBS may conclude cooperation agreements with these bodies and exchange information with them, under the conditions that these bodies and organisations are under a duty to keep this information confidential in a way that corresponds to the requirements of Serbian law.[212] Administrative provisions on customer due diligence in the field of banking apply to the field of insurance *mutatis mutandis*.

2.3.3.3 Anti-money laundering legislation

Serbia has had anti-money laundering legislation since 2001. The currently applicable legislation, the *Money Laundering and Terrorism Financing Prevention Act (AML/CFT Act)*, which repealed the previous 2005 Money Laundering Prevention Act, was enacted by the Serbian

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[209] Article 137 in conjunction with Article 27 of the Insurance Act.

[210] Articles 13-19 of the Insurance Act.

[211] NBS, Sector for Insurance Supervision, *Sektor Osiguranja u Srbiji: Izvestaj za Trece Tromesecje 2015. Godine* [Insurance Sector in Serbia: Report for III Quarter of 2015], p. 12.

[212] Article 187 in conjunction with Article 196(4) of the Insurance Act.

National Assembly on 18 March 2009 and was subsequently amended in 2009, 2010 and 2014.[213] The Act entered into force on 1 October 2015.

The current AML/CFT Act is expressly adopted with a view to implementing EU legislation. However, with the EU's adoption in May 2015 of the 4th Anti-Money Laundering Directive,[214] Serbian legislation will need to be amended to bring it into conformity with the requirements of the new Directive.

Other Serbian legislation of relevance to capital flows, which is not examined here for reasons of space and focus, includes the *Foreign Exchange Operations Act* of 2006 (last amended in 2014),[215] the *Foreign Trade Operations Act* of 2009 (last amended in 2015),[216] and the *Investments Act* of 2015.[217]

C. Substantive safeguards

Preventive arm

In accordance with EU law, FATF recommendations (no. 1), the International Core Principles (ICP) of the International Association of Insurance Supervisors (principle 22.0.3), and the Basel Committee Guidance on Banking Supervision (principle 29),[218] the AML/CFT Act takes a risk-based approach to combating money laundering and terrorism financing.

The core of this approach is to ensure customer due diligence, regarding which Serbian law fully complies with FATF recommendations (no. 10).[219] This entails a duty for obliged entities to carry out risk analysis on the basis of guidelines to be laid down by the competent

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[213] *Zakon o Sprecavanju Pranja Novca i Finansiranja Terorizma* [Money Laundering and Terrorism Financing Prevention Act] (*Official Gazette* nos. 20/2009, 72/2009, 91/2010). The latest amendment was published in the *Official Gazette* no. 139/2014 of 18 December 2014.

[214] 'Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing, Amending Regulation (EU) No 648/2012 of the European Parliament and of the Council', and 'Repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC', [2015] *OJ* L 141/73.

[215] *Zakon o Deviznom Poslovanju* (*Official Gazette* nos. 62/2006, as amended by 31/2011, 119/2012 and 139/2014)

[216] *Zakon o Spoljnotrgovinskom Poslovanju* (*Official Gazette* nos. 36/2009, 36/2011 of another Act, 88/2011 and 89/2015 of another Act).

[217] Zakon o Ulaganjima (*Official Gazette* no. 89/2015).

[218] Basel Committee on Banking Supervision, *Consultative Document–Guidance on the Application of the Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion*, 21 December 2015.

[219] See, in particular, Articles 8-9 (general requirements) and 34 (on the prohibition of the provisions of services that enable the concealment of the client's identity) of the AML/CFT Act.

supervisory authority in accordance with international standards.[220] The obliged entities include primarily financial institutions (e.g. banks, insurance companies, auditors, etc.), as well as designated non-financial businesses and professions. With regard to the latter, Serbian law applies to all the obliged entities recommended by the FATF (no. 22), except trusts and company service providers, and dealers in precious metals and precious stones.[221]

The AML/CFT Act is also in harmony with the FATF recommendations on the duty of obliged entities to report to the financial intelligence unit when there is a reasonable doubt that funds are proceeds of crime or are related to terrorist financing (no. 20),[222] on the use of third parties for customer due diligence purposes (no. 17),[223] on correspondent banking (no. 13),[224] on the use of new technologies (no. 15),[225] on foreign politically exposed persons (no. 12),[226] on internal controls and foreign branches and subsidiaries (no. 18),[227] and on the duty of confidentiality to the client (no. 21a).[228]

When it comes to 'tipping-off', the Serbian legislation provides several exemptions to the FATF recommendation (no. 21b) that obliged persons may not disclose the fact that a suspicious transaction report or related information is being filed with the financial intelligence unit. Namely, the Serbian AML/CFT Act allows 'tipping-off', first, when obliged entities receive a court request for information necessary for the determination of facts in a criminal proceeding; and, second, when information is sought by the competent AML/CFT supervisory authority. These exemptions are in harmony with the goal of ensuring the good functioning of the rule of law.

However, a third exemption is questionable. It allows lawyers, auditors, accountants and tax advisors to 'tip-off' if they attempt to dissuade the client from performing illegal activity.[229] This can frustrate the purpose of the prohibition of 'tipping-off' while not guaranteeing that dissuasion will succeed. Yet, in some cases, Serbian legislation exceeds FATF requirements. For instance, FATF recommendations suggest at least five years as the obligatory period for keeping records about the obliged entities' clients, transactions and data gathered through customer due diligence (no. 11). However, the AML/CFT prescribes ten years as the default period.[230]

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[220] Article 7 of the AML/CFT Act.

[221] Article 4 of the AML/CFT Act.

[222] Article 37 of the AML/CFT Act.

[223] Articles 23-26 of the AML/CFT Act.

[224] Article 29 of the AML/CFT Act.

[225] Article 29a of the AML/CFT Act.

[226] Article 30 of the AML/CFT Act.

[227] Articles 38 and 33-34 of the AML/CFT Act.

[228] Article 74 of the AML/CFT Act.

[229] Article 73(2) of the AML/CFT Act.

[230] Article 77 of the AML/CFT Act.

Furthermore, Serbian law mandates the application of enhanced measures of knowing and monitoring clients when: (a) establishing a correspondent banking relationship with a foreign bank or similar institution that does not adhere to international standards that are at least at the level of those applied in the EU; (b) the client is a foreign politically exposed person; and (c) when the client is not physically present during the process of establishing and verifying his or her identity.[231]

Additionally, in 2009 the NBS adopted a set of risk assessment guidelines for combating money laundering.[232] These guidelines, which are coherent with ICP in the field of insurance (principle 22.2), establish four categories of risks: geographical, client-related, transactional, and product-related. In assessing these risks, Serbia to a great extent relies on international and European standards. For example, geographically risky countries are defined as:

(a) countries against which the UN, the Council of Europe, the Office of Foreign Assets Control of the U.S. Department of Treasury and other organisations have applied sanctions, embargoes or similar measures;
(b) countries that credible institutions, such as FATF and the Council of Europe, have designated as not applying adequate measures to combat money laundering and terrorism financing, or as supporting or financing such activities or organisations; and
(c) countries that credible institutions, such as the World Bank or IMF, have marked as having a high level of corruption and crime.

On this basis, the Finance Minister draws up a list of countries that apply international standards at least to the level adopted by the EU (‘white list’) and of those that apply no standards in these areas (‘black list’). These guidelines specifically refer to international standards as a reference point for ensuring customer due diligence, regarding which three types of measures are foreseen: general, simplified and intensified.[233] All of these provisions ensure the implementation of the FATF recommendation on higher-risk countries (no. 19).

The implementation of EU and international standards in the AML field has yielded positive results insofar as the NBS carries out regular indirect control over the AML activities of the actors in the financial services sector. However, the latest NBS report, adopted in December 2015, unveils a number of fallacies that refer to inconsistencies and incompleteness of the data reported by banks. The risk of money laundering and terrorism financing is therefore at the medium level. However, the NBS underlines that banks have successfully installed risk management systems and that it is very positive that ‘all banks devote due attention to training’, above all of personnel who are in direct contact with clients or those who process financial transactions.[234]

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[231] Article 28 of the AML/CFT Act.

[232] *Odluka o Smernicama za Procenu Rizika od Pranja Novca* [Decision on the Risk Assessment Guidelines for Combating Money Laundering] of 17 January 2009.

[233] Point 9 thereof.

[234] NBS, Department for Special Control, Analiza Odgovora Banaka na Upitnik o Aktivnostima iz Oblasti Upravljanja Rizikom od Pranja Novca i Finansiranja Terorizma za Period April-Septembar 2015. Godine [Analysis of the replies of banks to the questionnaire on the activities

Corrective arm

The AML/CFT Act foresees sanctions for failure to comply with the duties laid down therein. The sanctions consist of fines ranging from 5,000 dinars (€40) to 3,000,000 dinars (approx. €25,000) depending on the severity of the infringement.[235] Money laundering is furthermore criminalised by the *Serbian Criminal Code*, which was adopted in 2005 and last amended in 2014.[236] The code follows the FATF recommendation on criminalising money laundering (no. 3).

Under the Criminal Code, money laundering occurs when one, knowing that property derives from a criminal act, carries out one of the following acts: (a) converts or transfers property with the intention of concealing or falsely representing the illegal origins of the property; (b) hides or falsely represents the facts with respect to such property; or (c) acquires, holds or uses property. This is punishable by imprisonment of 6 months to 5 years and a pecuniary fine. If the value of the property, or the amount of money laundered, exceeds 1,500,000 dinars, the imprisonment is 1-10 years and a pecuniary fine. If money laundering is committed by a group of people, the sanction is imprisonment of 2-12 years and a pecuniary fine. If a money launderer could know and was obliged to know that the property or money derives from a criminal act, he or she will be punished by imprisonment of up to three years. The Code also provides for the culpability of the responsible person within a legal person (e.g. a company). In all of these cases, the money and property in question will be confiscated.[237]

The Criminal Code also criminalises terrorism financing and foresees the sanction of imprisonment for 1-10 years as well as the confiscation of assets used to this end.[238] In addition to this, on 20 March 2015 the Serbian National Assembly adopted the *Act on Limitations on the Disposition of Property for the Purpose of Terrorism Prevention*.[239] This statute provides for a temporary prohibition of the transfer, conversion or management of property – whatever its nature or source – by natural and legal persons when they establish that they are dealing with persons designated as terrorists by the UN and other international organisations of which Serbia is a member or by the Serbian authorities on their own initiative or on the request of a third country. In this case, property is managed by the Directorate for the Administration of Seized

in the field of managing risks for money laundering and terrorism financing for the period April-September 2015], p. 4.

[235] Articles 88-91 of the AML/CFT Act.

[236] *Krivicni Zakonik* [Criminal Code] (*Official Gazette* no. 85/2005, last amendment published in *Official Gazette* no. 108/2014).

[237] Article 231 of the Serbian Criminal Code.

[238] Article 393 thereof.

[239] *Zakon o Ogranicavanju Raspolaganja Imovinom u Cilju Sprecavanja Terorizma* [Act on Limitations on the Disposition of Property for the Purpose of Terrorism Prevention] (*Official Gazette* no. 29/2015).

Assets,[240] which was created within the Ministry of Justice in 2008 pursuant to the *Act on the Confiscation of Property Derived from Crime*.[241] These legal provisions implement the FATF recommendations on the confiscation of property laundered or used for financing terrorism (no. 4) and on the criminalisation of terrorist financing (no. 5).

When it comes to the implementation of AML legislation, it is important to note that the first time a legal person was sentenced in general, and for money laundering in particular, in a court proceeding in Serbia took place in June 2014, when the Special Department of the High Court in Belgrade handed down a judgment against the company *Omorika*. The latter was sentenced to pay a fine of 1.5 million dinars (approx. €12,500), return the proceeds of over 21 million dinars (approx. €175,000) which had been acquired through extortion, and sentenced its director and owner to imprisonment for eight and a half years along with ten other persons.[242] This is an important milestone in the judicial fight against money laundering, albeit more resolve is needed to continue this initial step in the direction of enforcement of AML law.

Another significant channel for money laundering and financing of terrorism in Serbia goes through the non-profit sector. Particularly important is the legal gap existing with respect to religious organisations, which are not subject to registration with the Serbian Business Registers Agency.[243] This leaves unimplemented the FATF recommendation on the prevention of misuse of non-profit organisations for the financing of terrorism (no. 8). Yet the Action Plan for the implementation of the national AML/CFT Strategy foresees amendments to the legislation on the registration and ownership of non-profit organisations.[244]

D. Institutional safeguards

National institutional safeguards

Implementing a number of significant international standards, the AML/CFT Act establishes the *Money Laundering Prevention Administration* (MLPA) as the central financial intelligence unit in Serbia. It is established within the Ministry of Finance and is tasked with the prevention of crime in the field of money laundering and terrorism financing.[245] This is carried out by collecting, processing, analysing and forwarding information, data and documents to the

[240] *Direkcija za upravljanje oduzetom imovinom* [Directorate for the Administration of Seized Assets].

[241] Zakon o Oduzimanju Imovine Proistekle iz Krivicnog Dela is [Act on the Confiscation of Property Derived from Crime] (Official Gazette no. 97/2008).

[242] *Prosecutor's Office for Organized Crime v. Omorika Ltd*, judgment of 11 June 2014.

[243] A. G. Barker, *The Risks to Non-Profit Organisations of Abuse for Money Laundering and Terrorist Financing in Serbia* (Study), Strasbourg, Council of Europe, April 2013.

[244] Point 2.2.3; thereof, p. 10.

[245] *Uprava za Sprecavanje Pranja Novca* [Money Laundering Prevention Administration] www.apml.gov.rs.

competent state authorities.[246] The MLPA may impose both a temporary suspension of the processing of suspicious transactions and the monitoring over such transactions and clients. In return, the Administration must report back to the obliged entity on the results of the investigations carried out pursuant to the information provided by them.

Apart from the MLPA, the preventive arm of AML/CFT activities is performed by the aforesaid obliged entities themselves. Additionally, legal persons authorised to organise the securities market as well as the Central Securities Depository and Clearing House are also obliged to inform the MLPA of facts that could be related to money laundering and terrorism financing.[247]

Supervision over the application of the AML/CFT Act is primarily ensured by the MLPA and the NBS. Besides direct supervision over the banking and insurance sectors described above, the NBS performs indirect supervision. This is done through a questionnaire, which banks must return twice a year and which the NBS analyses in order to carry out aggregate as well as individual assessments of money laundering and terrorism financing risks in the banking sector. Other state organs in charge of AML/CFT supervision include ministries in charge of finance, trade and postal services, the Securities Commission,[248] the Tax Administration,[249] the Foreign Exchange Inspectorate,[250] the Bar Association of Serbia,[251] and the Chamber of Authorised Auditors.[252] All of these bodies and their operations are supported through the action of the police, the prosecutors' offices and courts.

These institutional arrangements to a great extent implement the essence of the ICP (no. 22.5) and FATF recommendations on national cooperation and coordination (no. 2), on the powers and responsibilities of competent authorities (nos. 26-32), as well as on sanctions (no. 35).

International institutional safeguards

An important component of the Serbian AML/CFT Act is the explicit regulation of international cooperation and mutual legal assistance.[253] Information obtained from third countries may only be used for AML/CFT purposes and under the conditions set by the third country. Conversely, Serbia may reject a third-country request for information if such a request fails to show that there is reasonable doubt that the information sought relates to money laundering or terrorism financing, or if providing information would jeopardise ongoing criminal proceedings in Serbia. As a consequence of a third-country request and under the condition of reciprocity, the MLPA may order the suspension of the targeted transaction, but may not impose the monitoring, which it may do in purely domestic matters.

[246] Articles 52-60 and 65 of the AML/CFT Act.

[247] Article 71 of the AML/CFT Act.

[248] Komisija za Hartije od Vrednosti [Securities Commission].

[249] Poreska Uprava [Tax Administration].

[250] Devizni Inspektorat [Foreign Exchange Inspectorate].

[251] Advokatska Komora Srbije [Bar Association of Serbia].

[252] Komora Ovlascenih Revizora [Chamber of Authorised Auditors].

[253] Articles 61-66 of the AML/CFT Act.

It is arguable whether these provisions conform to the FATF recommendation (no. 37) for countries to provide the 'widest possible range' of mutual legal assistance and for them to do so without placing 'unreasonable or unduly restrictive conditions' on the provision thereof. This is because Serbian authorities might decide to reject mutual legal assistance requests that seek information for reasons or circumstances that the third country may not fully disclose or for those that the authorities of the requesting country deem to exhibit reasonable doubt of money laundering but which Serbian might disagree to be of such a nature. However, it is justified for Serbian authorities to seek to provide the greatest possible extent of protection of personal data and privacy of natural and legal persons domiciled in Serbia. For these reasons, it is advised that any mutual legal assistance requests that Serbian authorities may assess as insufficiently substantiated are given the greatest possible degree of deference so as to enable the widest possible scope for the international exchange of information related to AML/CFT.

Moreover, Serbia has signed and ratified all international conventions aimed at combating money laundering and terrorism financing that are recommended by the FATF (no. 36). These include: the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (the Vienna Convention), the UN Terrorist Financing Convention of 1999, the UN Convention against Transnational Organised Crime of 2000 (the Palermo Convention), the UN Convention against Corruption of 2003, the Council of Europe Convention on Cybercrime 0f 2001, and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism of 2005.

When it comes to international cooperation in practice, Serbia is moderately well involved. While not a member of the FATF, Serbia is subjected to the evaluation process conducted by the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism – MONEYVAL.[254] This Committee was established in 1997 and performs self and mutual assessments of AML/CFT measures in force in the Member States of the Council of Europe that are not members of the FATF. As such, MONEYVAL is one of eight FATF-Style Regional Bodies (FSRBs). MONEYVAL is an essential monitoring mechanism because it provides recommendations on improvements of the AML/CFT systems above all in line with FATF recommendations. MONEYVAL also possesses enforcements mechanisms, which include reporting duties, the sending of a high-level diplomatic mission to the country concerned, and, as the strictest sanction, the expulsion of a non-complying country from the Council of Europe. MONEYVAL assessments are additionally important because they are used by the IMF and the World Bank for their own assessments. Serbia is currently preparing for the 5th round of mutual evaluation (2015-2021),[255] and Serbia and Armenia were the only two countries to have undergone pre-evaluation trainings in 2014, which are aimed at setting the ground for on-site visits.[256]

[254] See: www.nbs.rs/internet/cirilica/55/55_7/55_7_1/index.html.

[255] MLPA, *Izvestaj o Radu Uprave za Sprecavanje Pranja Novca za Period 1.1-31.12.2014. Godine* [Report on the work of the Money Laundering Prevention Administration for the period 1.1-31.12.2014], pp. 47-48.

[256] MONEYVAL, Annual Report for 2014, p. 53.

Another European project of importance is MOLI-Serbia, worth €2.2 million. The project was funded jointly by the EU (approx. 91% of the funds) and the Council of Europe (approx. 9% of the funds), and implemented by the latter organisation during the period of 42 months (15 November 2010-14 May 2014).[257] Its key objectives were to enhance the rule of law in terms of legislation, operations and capacities in the fight against money laundering, terrorism financing and other forms of economic and financial crime as well as to ensure Serbia's AML/CFT system complies with international standards.

The MOLI project has brought rather positive results in the fight against money laundering and terrorist financing. Concretely, it has been reported that the project has:

'successfully managed to complete a range of strategically important activities, including the drafting of the new AML/CFT Strategy and Action Plan, legislative reviews of over 40 relevant legislative and regulatory acts; conducted a number of sectoral risk assessments, as well as reviews of interagency cooperation practices and frameworks in the areas of law enforcement and supervision; a major IT upgrade for the Administration on the Prevention of Money Laundering was carried out'.[258]

The project resulted in the publication of the National Risk Assessment for Money Laundering in April 2013, the only such exercise ever done in Serbia.[259] The activities undertaken in the preparation of this report have significantly informed the drawing up of Serbia's latest *National AML/CFT Strategy* for the period 2015-2018, which the Serbian Government adopted on 31 December 2014.[260] This Strategy was designed specifically to take into account the most recent changes in international (FATF) and EU standards (4th AML Directive) with a view to elevating Serbia's AML/CFT efforts from the fulfilment of technical requirements to enabling an ongoing appraisal of the system's overall effectiveness in practice.

As concerns international efforts, although the IMF has since 2002 published so-called Detailed Assessment Reports on AML/CFT measures in different countries, Serbia was not among them.[261] Instead, the IMF relies on MONEYVAL assessments. Even so, the IMF's Financial

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[257] See:
www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Projects/MOLI_Serbia/Default_en.asp.

[258] See:
www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Projects/MOLI_Serbia/Default_en.asp.

[259] See:
www.coe.int/t/dghl/cooperation/economiccrime/corruption/Publications/MOLI-SE/National%20Risk%20Assessment%20in%20Serbia%20April%202013_EN.pdf.

[260] See:
www.slglasnik.info/sr/3-14-01-2015/27037-nacionalna-strategija-za-borbu-protiv-pranja-novca-i-finansiranja-terorizma.html.

[261] See: www.imf.org/external/ns/cs.aspx?id=175.

System Stability Assessment for Serbia, last carried out in May 2010, stated that it was 'clear that Serbia is taking a number of steps to update its AML/CFT legal and institutional framework'.[262]

Serbia furthermore joined the Egmont Group of financial intelligence units in July 2003. In addition, since June 2010 Serbia has also held observer status in the Eurasian Group on Combating Money Laundering and Terrorist Financing, which is another FSRB.

Finally, and most importantly, the European Commission assesses Serbia's financial sector through its reports on progress made by EU candidate countries. The latest such document, adopted in November 2015 and covering the period October 2014-September 2015,[263] evaluated Serbia as being 'moderately prepared' in the areas of the freedom of movement of capital, financial services and financial control. The European Commission underlined the need for Serbia to step up its efforts to investigate wider criminal networks and process money laundering cases.[264] It assessed that the MLPA needs 'greater administrative and analytical capacity' and is yet to establish a track record of 'proactive investigation, prosecution, final conviction and asset confiscation' in cases of organised crime, including money laundering.[265] Exchange of data and cooperation between the different agencies involved in combating money laundering, also needs improvement.[266] These concerns led the European Commission to appraise Serbia's AML capacity as 'weak'.[267]

These cooperative arrangements and assessment mechanisms show that Serbia has a solid AML/CFT legal framework in place and that this could serve as a basis for an efficient international exchange of financial intelligence. However, operational capacities required to implement this are still lacking.

2.3.3.4 Tax evasion legislation

A. Substantive safeguards

Preventive arm

In Serbia, tax evasion – particularly the non-payment of withholding tax – is one of the highest-risk predicate criminal offences for money laundering and accounts for some 15.5% of all the crimes reported in Serbia. This is carried out mostly by establishing so-called 'phantom firms'

[262] IMF, *Republic of Serbia: Financial Sector Assessment Program Update–Financial System Stability Assessment*, IMF Country Report No. 10/147, May 2010, p. 33.

[263] European Commission, *Staff Working Document 'Serbia 2015 Report', accompanying the EU Enlargement Strategy*, SWD(2015) 211 of 10 November 2015.

[264] *Ibid*., p. 15.

[265] *Ibid*., pp. 33 and 59.

[266] *Ibid*., p. 63.

[267] *Ibid*., p. 16.

or shell companies,[268] by submitting forged tax documentation, by inserting smuggled or illegal goods into legal trade flows, and generally by engaging in the activities of the 'grey' or 'shadow' economy. Equally conducive to tax evasion is the fact that many international trade transactions are carried out in cash in order to avoid tax duties.[269] According to the Belgrade Chamber of Commerce's announcement in March 2015, Serbia had lost some RSD 10 billion (approx. €82 million) due to tax evasion in the previous 14 months.[270]

An important legal provision linking tax evasion and the provision of financial services is laid down in the Serbian Banks Act. This exempts banks from their duty of confidentiality to the customer (the so-called 'bank's secret' in Serbian law) when it comes to disclosure of such data to the Tax Administration.[271] This aims to prevent banks from withholding information that can provide leads in tax evasion investigations. This is in line with the FATF recommendation on financial institution secrecy laws (no. 9).

One of the key problems in curbing illicit money flows through trade, including money laundering and tax evasion, remains insufficient coordination and cooperation between, on the one hand, the MLPA, the Tax Administration and the Customs Administration, and, on the other hand, the prosecutorial bodies.[272] However, eliminating tax evasion needs to be tackled in conjunction with combating the wider, systemic phenomena of corruption and organised crime with which it is entangled.[273]

Corrective arm

The Serbian Criminal Code criminalises tax evasion in the following way. Tax evasion is punishable if carried out with the intention of fully or partially avoiding the payment of tax or other fiscal duties. This happens in several instances: (a) when the tax addressee gives false information about the legally acquired income, objects and other facts of relevance for determining these duties; (b) when, with respect to these information, he or she fails to report legally acquired income where such reporting is obligatory; and (c) when he or she otherwise hides information of relevance for determining the fiscal duties owed. This is sanctioned by imprisonment of six months to five years and a pecuniary fine, where evasion concerns an

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[268] I. Raonic and Z. Vasic, , '*Poreska utaja PDV u Srbiji i Fenomen Fantomskih Firmi*' [VAT Fraud in Serbia and the Phenomenon of Shell (Phantom) Companies], *Ekonomika*, Vol. 60, No. 2, 2014, p. 99.

[269] J. Pantelic, *National Risk Assessment for Money Laundering in the Republic of Serbia*, Council of Europe (Office in Belgrade), April 2013, p. 15.

[270] See: http://inserbia.info/today/2015/03/serbia-loses-rsd-10-bln-through-tax-evasion-in-14-months.

[271] Article 48(1)(8) of the Banks Act.

[272] J. Pantelic, *National Risk Assessment for Money Laundering in the Republic of Serbia*, Council of Europe (Office in Belgrade), April 2013, p. 29.

[273] B. Simonovic and G. Boskovic, Symbiosis of Politics, the Shadow Economy, Corruption, and Organized Crime in the Territory of the Western Balkans: The Case of the Republic of Serbia, in M. Edelbacher et al. (eds), *Corruption, Fraud, Organized Crime, and the Shadow Economy* (Boca Raton, FL: CRS Press, 2016), p. 120.

amount of up to 150,000 dinars (approx. €1,250). If the amount exceeds 1,500,000 dinars (approx. €12,500), the sanction is imprisonment of 1-8 years and a pecuniary fine, and if it exceeds 7,500,000 dinars (approx. €62,000), the sanction is imprisonment of 2-10 years and a pecuniary fine.[274]

It has recently been argued in the literature that Serbia's system of sanctions for tax evasion is 'relatively well defined' and 'appropriate', but that problems arise because of the 'inappropriate and inconsistent application of the available penal mechanisms' and inadequate Government practices (e.g. writing off interest for late tax payments). However, tax evasion and shadow economy are partly facilitated by the sheer number of small businesses and the great complexity and variety of types of taxes existing in Serbia. These factors lower the ability of taxpayers fully to comprehend their duties (which can lead to tax evasion by omission), for courts to sanction convoluted tax evasion schemes (e.g. so-called 'VAT carousel'), and for tax inspectors to audit all tax types.[275] These deficiencies point to the low probability of detecting tax evasion, which encourages shadow economy.

B. Institutional safeguards

National institutional safeguards

The Tax Administration, established within the Ministry of Finance, is the central government authority for assessing, controlling and collecting public revenue as well as for issuing and revoking authorisations exchange activities and auditing of such activities. Within this body, two sectors are particularly important for combating tax evasion and money laundering. The Sector of Tax Police was formed in 2003 and is charged with detection and investigation of tax crimes (especially tax evasion) and their perpetrators in accordance with the Tax Procedure and Tax Administration Act of 2002, last amended in 2014.[276] The Sector for Foreign Exchange and Games of Chance exercises control over the activities of both resident and non-resident operators in these two areas. It also supervises operators in the field of factoring, forfeiting and international money transfers.

The Tax Administration has been ill-equipped to carry out efficient control over the process of tax collection. This is mainly due to the lack of human and technical resources, inadequate staff

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[274] Article 229 of the Serbian Criminal Code.

[275] M. Arsic et al., Causes of the Shadow Economy, in G. Krstic and F. Schneider (eds), *Formalizing the Shadow Economy in Serbia: Policy Measures and Growth Effects*, (Springer, 2015), pp. 24-25.

[276] *Zakon o Poreskom Postupku i Poreskoj Administraciji* [Tax Procedure and Tax Administration Act]. See specifically Article 135 thereof.

structure, the lack of exchange of information with other agencies, and the lack of automation of business processes.[277]

International institutional safeguards

At present, Serbia does not seem to be sufficiently involved in the international exchange of tax information. It is not a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, which consists of 130 states or territories across the world. This makes Serbia the only European country apart from Bosnia and Herzegovina, Montenegro, Kosovo,[278] Moldova and Belarus, still remaining outside this Forum.[279] As a result, Serbia does not participate in the creation and implementation of international standards of tax transparency and information exchange. It also does not take part in the Forum's in-depth peer review processes aimed at establishing a level playing field in the application of these standards worldwide. Serbia is also not a state party to the Convention on Mutual Administrative Assistance in Tax Matters, which was jointly developed by the OECD and the Council of Europe, signed in 1988 and came into effect in 1995.[280]

However, in July 2015 Serbia joined the EU's Fiscalis 2020 programme (2014-2020) – an EU cooperation programme worth €234 million.[281] This is aimed at supporting the exchange of information and expertise between the tax authorities and experts of the participating countries (EU Member States and EU candidate states that join) with a view to combating tax fraud and tax evasion, increasing the level of tax collection, and ensuring the implementation of EU law in the field of taxation. This is an important development given the European Commission's assessment of November 2015 that 'despite some improvements in the reporting period, instruments to fight and reduce tax evasion, fraud and the informal economy need to be further strengthened'.[282]

To fulfil this, Serbia adopted an Action Plan to implement the National AML/CFT Strategy, which also addresses tax evasion.[283] In particular, plans have been made to achieve the following three goals that are paramount for tackling tax evasion. The first is to improve the legislative and regulatory framework relating to the registration of economic actors, so as to

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[277] M. Arandarenko, Analysis of the Administrative Capacity of the Institutions in Charge of Overseeing the Operations of Business Entities, in G. Krstic and F. Schneider (eds), *Formalizing the Shadow Economy in Serbia: Policy Measures and Growth Effects*, (Springer, 2015), p. 110.

[278] In Europe, Kosovo is not recognised as an independent country by Serbia, Bosnia and Herzegovina, Ukraine, Belarus, Moldova, and 5 EU Member States: Spain, Greece, Romania, Cyprus and Slovakia.

[279] See the map at: www.eoi-tax.org/#default.

[280] See: www.oecd.org/ctp/exchange-of-tax-information/Status_of_convention.pdf.

[281] See: http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/fiscalis_programme/fiscalis_2020/index_en.htm.

[282] European Commission, *Staff Working Document 'Serbia 2015 Report', accompanying the EU Enlargement Strategy*, SWD(2015) 211 of 10 November 2015, p. 73.

[283] Points 2.2.3. at p. 10; 3.1.1.-3.1.2. at pp. 14-15; and 3.2.1. at p. 17.

prevent the setting up of 'phantom firms' and enhance the transparency of, and access to information on, the ownership of legal persons. The second is to strengthen the mechanisms for domestic and international cooperation and exchange of information on money laundering, terrorism financing and tax evasion. The third is to establish joint working groups and operational teams to deal with particularly large cases and areas of high level of priority, such as tax crimes and corruption.

2.3.4 Concluding remarks

The above analysis shows that Serbia exhibits a good degree of legislative responsiveness, but that problems arise in applying AML/CFT and tax legislation in practice. This is mainly due to the insufficient operational capacity of administrative authorities and systemic problems related to corruption and the enforcement of the rule of law.

Nevertheless, the EU, acting through the medium of the SAA, has exerted substantial and direct legislative influence on Serbia in the area of combating of illicit capital flows, especially money laundering, terrorist financing, and tax evasion. The origin of this influence lies in Serbia's aspiration to become an EU member state, which entails harmonisation of Serbian law with the EU *acquis*. The EU has therefore provided an invaluable incentive in developing Serbia's legal capacity for AML/CFT and anti-tax evasion activities.

In this regard, the requirements imposed by the SAA have been a decisive instrument in stimulating the incorporation of international and European standards into Serbian law. Although up-to-date compliance assessments by international bodies are largely missing, the insights into the relevant laws and regulations presented above reveal that numerous FATF recommendations have been implemented. However, as EU law evolves, Serbia needs to put additional efforts to harmonise its legislative and administrative acts accordingly. This is notably the case with the EU's tax transparency package, initiated by the European Commission in the wake of the 2014 Luxembourg Leaks scandal. The core of this package is the Directive requiring mandatory automatic exchange of information in the field of taxation, adopted in December 2015.[284] Finally, it must be noted that Serbia's position in the EU's foreign trade strategy is fairly exceptional, because, except for some countries of the Western Balkans and of the Eastern Partnership, the EU's external trade partners are typically not countries that seek EU accession. However, this means that the closer the ties with the trading partner the greater the EU's influence.

[284] 'Council Directive (EU) 2015/2376 of 8 December 2015 Amending Directive 2011/16/EU as Regards Mandatory Automatic Exchange of Information in the Field of Taxation', [2015] *OJ* L 332/1. See also: European Commission, *Communication on Tax Transparency to Fight Tax Evasion and Avoidance*, COM(2015) 136 of 18 March 2015.

2.4 EU-Republic of Korea Free Trade Agreement

2.4.1 Trade context

Box 7 Impact of the EU-Korea Free Trade Agreement

- Trade between the EU and Korea has increased significantly, lifting the EU's trade deficit with Korea and generating a trade surplus in EU's favour.
- The Committee on Trade in Services, Establishment and Electronic Commerce convened numerous times but has not reported in detail its deliberations about Financial Services sector. Korea regularly and extensively updated its legislation and regulation concerning the sectors and subject areas governed by the FTA.

2.4.1.1 Bilateral trade relations and the nature of the Agreement

The Republic of Korea (Korea) is a member of the G20, it is classified as an *advanced* economy by the IMF, and its trade surplus for December 2015 is estimated at $10.4 billion.[285] The EU has had a strategic partnership with Korea since 2010. The relations are governed by two key agreements on the following topics: *political dialogue* under the EU-Korea Framework Agreement;[286] and *trade* under the EU-Korea Free Trade Agreement (hereinafter called the 'EU-Korea FTA').[287] In October 2010 the EU, its Member States and Korea signed the new agreements at the EU-Korea Summit in Brussels. Both agreements update and replace the *1996 Framework Agreement for Trade and Cooperation between the EU and the Republic of Korea*. As far as domestic support for the FTA goes, Mazur observes that, '[a]lthough representatives of manufacturing industry supported the conclusion of the FTA with the EU, some reluctance has been observed within the [Korean] groups involved in the liberalisation of services'.[288]

As of 1 July 2011 the EU-Korea FTA was applied provisionally[289] until its entry into force on 13 December 2015.[290] The FTA stipulates a gradual approach to liberalisation, with 1 July 2016 as

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[285] See http://www.tradingeconomics.com/south-korea/balance-of-trade.

[286] *Free Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part*, 2010.

[287] Ibid.

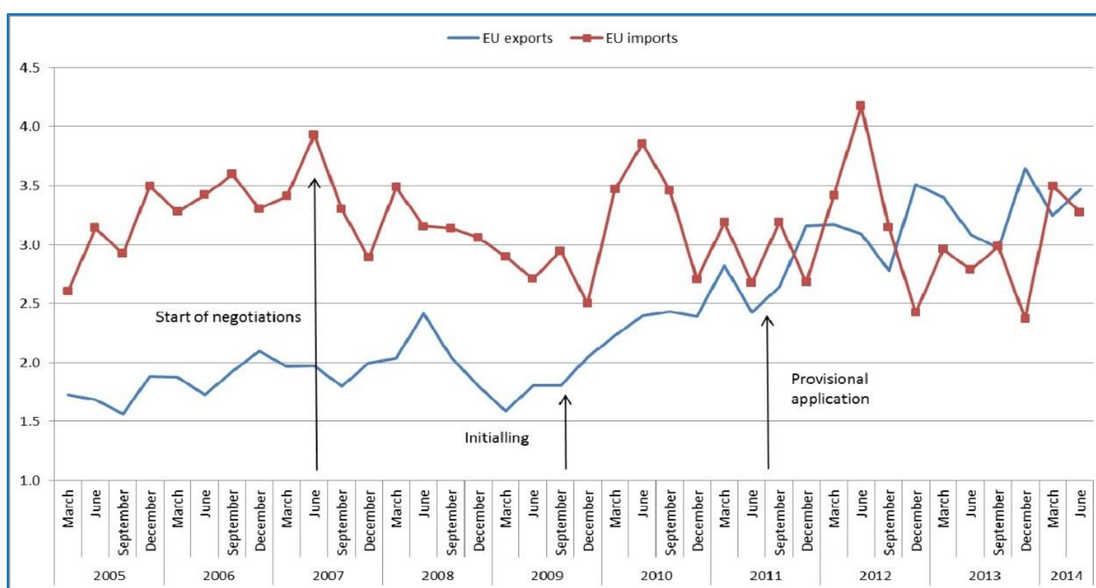
[288] G. Mazur, The European Union–South Korea Free Trade Agreement. A New Model of Trade and Economic Cooperation between Developed Countries, Research Papers of Wroclaw University of Economics, Issue 257, 2012, p. 40.

[289] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22011X0628(01)&from=EN.

[290] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22015X1125(01)&from=EN.

the date for the elimination of most import duties on products except for a limited number of agricultural products.[291] It is expected that the FTA will also impact the free trade of goods and services, especially in relation to the electronics sector, the car industry, the pharmaceutical sector, and the shipping industry. Bilateral trade exchange between the EU and Korea amounted to €65 billion in 2008, while this trade exchange had increased to €81 billion in 2014.[292]

Figure 1 EU exports to and imports from Korea, 2005-2013 (€ billion)



Sources: COMEXT & Chief Economist Note (ISSN 2034-9815)[293]

As for the (financial) services sector, the LSE reported in 2010 that the regulatory framework for the Korean financial services sector has remained highly discriminatory; and that the FTA makes important progress towards removing discrimination against EU suppliers and that the agreement has also an important impact on market access.[294] It underlines that costs savings alone, resulting from the FTA's provisions, are expected to measure in the tens of millions of euros for EU financial services. Furthermore the LSE report noted that the FTA will ensure greater transparency and predictability of the future business environment in Korea, partly due to the 'negative list' (itemising restrictions, and deeming everything else restriction free) and more transparency in regulatory procedures.[295]

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[291] http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/.

[292] http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113448.pdf/.

[293] C. Lakatos and L. Nilsson, *The EU-Korea Free Trade Agreement: Anticipation, Trade Policy Uncertainty and Impact*, Chief Economist Note, European Commission, DG Trade, Issue 2, June 2015, p. 6.

[294] *An Assessment of the EU-Korea FTA*, LSE and Political Science and Consortium Partners, Ed.: R. Bendini, Parliament's Committee on International Trade, June 2010, p. 94.

[295] Ibid.

The (financial) services sector has seen growth ever since the provisional implementation of the FTA (as seen from the statistics of DG Trade).[296] The 2014 Annual Report on the Implementation of the EU-Korea Free Trade Agreement describes the impact on the services sector as follows: '[s]ervices trade data is produced with a severe time lag and is very aggregated, making it impossible to make the same kind of up-to-date and detailed comparisons as with goods. The comparison has thus been made for calendar year 2011, compared to 2010, i.e. the year when the FTA was "half implemented" compared to the calendar year before the FTA was provisionally applied. On this basis, EU exports of services (GATS modes 1 and 2) to Korea increased by 9% in 2011 compared to 2010. At the same time imports of services from Korea decreased by 2%, leading to an increased surplus for the EU's trade in services.'[297] The total trade shows a similar trend. The 2015 *Annual Report* describes that the EU's trade deficit with Korea (€7.6 billion) turned into a trade surplus (€3.6 billion); and that the EU's share in Korea's total imports increased from 9% before the FTA to 11% in the third year. Over the same period of time, the EU's share in total exports from Korea declined from 11% to 9%.[298]

2.4.1.2 Institutional framework

The implementation of the EU-Korea FTA is overseen by numerous *specialised committees*[299] and *working groups*[300] which focus on specific sectors or detailed aspects of the trade relations. The specialised committees convene on an annual basis (unless the FTA specifies another regularity for a specific committee) while the working groups convene on an *ad hoc* basis, at request of either party or of the Trade Committee.

This *Trade Committee* carries the responsibility to ensure the proper operation of the FTA, to supervise and facilitate the implementation and application, to supervise the specialised committees and working groups, and to consider ways to enhance trade relations between the parties.[301] The Trade Committee convenes once a year.[302] The Trade Committee has the power to dissolve, establish or change the task assigned to specialised committees and working groups.[303] The existence of a special committee or working group does not preclude either Party

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[296] http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/.

[297] European Commission, *2014 Report from the Commission tot the European Parliament and the Council: Annual Report on the Implementation of the EU-Korea Free Trade Agreement*, 28 February 2014, Brussels, p. 6.

[298] European Commission, *2015 Report from the Commission tot the European Parliament and the Council: Annual Report on the Implementation of the EU-Korea Free Trade Agreement*, 26 March 2015, Brussels.

[299] Article 15.2 EU-Korea FTA. Notably the Committee on Trade in Services, Establishment and Electronic Commerce, see also next section.

[300] Article 15.3 EU-Korea FTA.

[301] Article 15.1(3) EU-Korea FTA.

[302] Article 15.1(2) EU-Korea FTA.

[303] Articles 15.2(5) and 15.3(5) EU-Korea FTA.

from bringing any matter directly to the Trade Committee.[304] The powers of the Trade Committee are specified in Article 15.1(4). The Trade Committee can make decisions that are binding upon the Parties.[305] However, the Trade Committee shall draw up decisions and recommendations by agreement between the Parties.[306]

Furthermore the relevant professional bodies in the respective territories of the parties to the FTA also assume an important role for the operation of the FTA. The Agreement provides that the Parties must encourage these bodies to jointly develop and provide recommendations on mutual recognition to the Trade Committee, for the purpose of the fulfilment, in whole or in part, by service suppliers and investors in services sectors, of the criteria applied by each Party for the authorisation, licensing, operation and certification of service suppliers and investors in services sectors and, in particular, professional services, including temporary licensing.[307]

The institutional framework of the EU-Korea FTA furthermore encompasses the Joint Committee established under the EU-Korea Framework Agreement which focuses on the political dialogue between the EU and Korea.[308] The Trade Committee must report to the Joint Committee about its activities, and that of the specialised committees and working groups.[309] Upon the entry into force of the FTA, the Parties must also designate coordinators in order to facilitate communication and ensure effective implementation of the FTA.[310]

2.4.2 Assessment of the Regulatory Framework for the Provision of Financial Services and Combating Illicit Capital Flows

The EU-Korea FTA contains various provisions relating to financial services. Article 7.37 defines a *financial service* as: 'any service of a financial nature offered by a financial service supplier of a Party. Financial services include the following activities: (a) [i]nsurance and insurance-related services; and (b) [b]anking and other financial services'.[311] The provision details an extensive list of activities which fall under the two categories.[312] Furthermore, the provision defines a *financial service supplier* as 'any natural person or juridical person of a Party that seeks to provide or provides financial services and does not include a public entity' and specifies what constitutes a *public entity* for the purposes of the FTA.[313] The FTA provides that each Party must 'to the extent practicable, ensure that internationally agreed standards for regulation and

304 Articles 15.2(4) and 15.3(4) EU-Korea FTA.

305 Article 15.4(1)(2) EU-Korea FTA.

306 Article 15.4(3) EU-Korea FTA.

307 Article 7.21(2) EU-Korea FTA.

308 Article 44 EU-Korea Framework Agreement.

309 Article 15.1(5) EU-Korea FTA.

310 Article 15.6(1) EU-Korea FTA.

311 Article 7.37(2) EU-Korea FTA.

312 Article 7.37(2) EU-Korea FTA.

313 Article 7.37(2) EU-Korea FTA.

supervision in the financial services sector and for the fight against tax evasion and avoidance are implemented and applied in its territory',[314] and provides a non-exhaustive overview of such international standards.[315]

The FTA establishes the Committee on Trade in Services, Establishment and Electronic Commerce which oversees the implementation of the FTA in matters concerning services.[316] The FTA also incorporates a clause on *new financial services* – defined as 'a service of a financial nature, including services related to existing and new products or the manner in which a product is delivered, that is not supplied by any financial service supplier in the territory of a Party but which is supplied in the territory of the other Party'.[317] In this regard, it is important to note that the FTA recognises that the financial service providers of one Party established in the territory of the other Party can provide any new financial service that the Party would allow to its own financial service providers under its domestic law in similar circumstances. The limitations to this rule are that the rule: does not 'require a new law or modification of an existing law'; and that a Party can 'determine the institutional and juridical form through which the service may be provided and may require authorisation for the provision of the service'.[318]

The Committee on Trade in Services, Establishment and Electronic Commerce convened on 27 September 2012 in Seoul, 12 June 2013 in Brussels and 16 December 2014 in Seoul.[319] The European Commission's reports do not elaborate the details of the Committee's deliberations about financial services other than to say that the meeting in 2012 provided a useful exchange of information on the implementation of both Parties' commitments resulting from the FTA;[320]

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[314] Article 7.24 EU-Korea FTA.

[315] Article 7.24 EU-Korea FTA, the cited international standards are: (i) the Core Principle for Effective Banking Supervision of the Basel Committee on Banking Supervision; (ii) the Insurance Core Principles and Methodology, approved in Singapore on 3 October 2003 of the International Association of Insurance Supervisors; (iii) the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions; (iii)the Agreement on Exchange of Information on Tax Matters of the Organisation for Economic Cooperation and Development (hereinafter referred to as the 'OECD'); and (iv) the Statement on Transparency and Exchange of Information for Tax Purposes of the G20, and (vi) the Forty Recommendations on Money Laundering and Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force).

[316] Article 7.3 EU-Korea FTA.

[317] Article 7.37(2) EU-Korea FTA.

[318] Article 7.42 EU-Korea FTA. Where such authorisation under domestic law for a new service is required, "a decision shall be made within a reasonable period of time and the authorisation may be refused only for prudential reasons".

[319] The 2015 report about the implementation of the EU-Korea FTA has yet to be published.

[320] European Commission, *2013 Report from the Commission tot the European Parliament and the Council: Annual Report on the Implementation of the EU-Korea Free Trade Agreement*, 25 February 2013, Brussels.

and that the meetings in 2013 and 2014 had discussed a broad range of issues in the area of financial services.[321]

Foreign financial institutions in Korea constitute roughly 11% of the financial sector's assets. With a 15% market share in the banking sector and a 12% market share in the insurance sector, the financial sector has the highest presence of foreign companies in Korea. There are 41 foreign-owned banks (2 subsidiaries, 39 branches) from 16 countries, making up 14% of the Korean banking sector. There are also 12 insurance companies' subsidiaries from 5 countries, making up 10% of the Korean insurance sector.[322] The EU-Korea FTA does not fully liberalise financial services. Those activities which are liberalised under Mode 1 (cross-border supply) are, among others, specific banking services such as the transfer of financial information and data processing, and insurance services for maritime shipping and goods in international transit.[323] Figure 1 illustrates the total export and import growth between the EU and Korea.Table 3

Box 8 Korea's capacity to combat money laundering

- FTA was applied provisionally and has recently entered into force. Full impact of the FTA is yet to be observed while growth has been noted.
- Overall mismatch observed between FTA policy and implementation, especially on a social, cultural and institutional level.
- Korean law is largely compliant with FATF recommendations, minor legislative adjustments and improvements are required.

2.4.3 Assessment of Korean Legislation on Financial Services, Money Laundering, and Tax Evasion and Elusion

2.4.3.1 General framework

Domestic rules concerning the Banking and Insurance Sectors and rules related to preventing and countering money laundering and tax evasion are shaped by the following acts (year of last amendment): the Bank of Korea Act (2012); the Act on the Establishment, etc. of Financial

[321] European Commission, *2014 Report from the Commission tot the European Parliament and the Council: Annual Report on the Implementation of the EU-Korea Free Trade Agreement*, 28 February 2014, Brussels; and *2015 Report from the Commission tot the European Parliament and the Council: Annual Report on the Implementation of the EU-Korea Free Trade Agreement*, 26 March 2015, Brussels.

[322] IMF, *Financial Sector Assessment Program, Crisis Preparedness and Crisis Management Framework – Technical Note*, January 2015, IMF Country Report No.15/5.

[323] Y. Decreaux, *The Economic Impact of the Free Trade Agreement (FTA) between the European Union and Korea*, Report for the European Commission, CEPII/ATLASS, Contributors: C. Milner and N. Péridy Final Report, May 2010, p.29.

Services Commission (2011) [FSC Establishment Act (2011)]; the Banking Act (2011); the Insurance Business Act (2011); the Enforcement Rules of the Insurance Business Act (2011); the Act for the Coordination of International Tax Affairs (2009); the Corporation Tax Act (2009); and the Act on Reporting and Use of Certain Financial Transaction Information (2011). Additional decrees enforcing these acts are: the Enforcement Decree of the Bank of Korea Act (2012); the Enforcement Decree of the Act on the Establishment, etc. of Financial Services Commission (2011) [Enforcement Decree of the FSC Establishment Act (2011)]; the Enforcement Decree of the Banking Act (2011); the Enforcement Decree of the Insurance Business Act (2011); the Enforcement Decree of the Act for the Coordination of International Tax Affairs (2009); the Enforcement Decree of the Corporation Tax Act (2009; and the Enforcement Decree of the Act on Reporting and Use of Certain Financial Transaction Information (2011).

The Financial Services Commission (hereinafter referred to as the 'FSC') and the Financial Supervisory Service (hereinafter referred to as the 'FSS') are tasked with the duty to 'maintain fairness and secure transparency' and 'check the autonomy of financial institutions in performing their affairs'.[324] The FSC has responsibility over a wide range of affairs, ranging from policy to supervision and inspection, to authorisation and sanctions.[325] The FSS has the responsibility to conduct the inspection of financial institutions and to supervise the sector.[326] The instruments and authority equipping the FSC and FSS in order to fulfil these tasks are elaborated under Chapter IV of the FSC Establishment Act.

2.4.3.2 Financial services legislation

As regards the implementation if Financial Services provision in the FTA, there is neither a single body of code implementing the provision – for the obvious reason that much of domestic law and institutional framework on the subject matter already existed – nor has there been any legislative amendment or institutional rearrangement since 2011 that was specifically for the purposes of implementing the FTA. Rather what occurs is that, under various specialised global fora, specific aspects of the financial service sector are addressed, reported, reviewed and incorporated for follow-up action. While Korea achieves overall high compliance levels in various reports on these specific aspects, no evaluation occurs of the financial sector as such, and none so about the implementation of the FTA provision and any matter beyond the legal-organisational-economic concerns (such as the social and environmental considerations).

A. Banking sector

The Bank of Korea Act defines the duties and rules of the Bank of Korea (BOK) in supervising and carrying out monetary and credit policies in Korea. Chapter V of the Bank of Korea Act describes the powers of the BOK to request materials from banking institutions and to request the FSC to examine banking institutions within a determined specific range.[327] The ability to

[324] Articles 1 and 2 FSC Establishment Act.

[325] Article 17 FSC Establishment Act.

[326] Article 21 FSC Establishment Act.

[327] Articles 87 and 88 Bank of Korea Act.

inspect and the forms of inspection by the FSS are described in Chapter IV of the FSC Establishment Act[328] and Chapter VII of the Banking Act.[329] The Banking Act aims to 'contribute to the stability of financial markets and the development of the national economy by pursuing the sound operation of financial institutions, enhancing efficiency of the fund brokerage functions, protecting depositors and maintaining the order of credit'.[330]

It defines *banking business* as a business of lending funds raised by bearing debts from many unspecified persons through the receipt of deposits and issuance of securities and other bonds; and *financial institutions* are defined as 'all legal persons other than the Bank of Korea regularly and systematically engaging in the banking business'.[331] Any person desiring to be engaged in the banking business is subject to authorisation by the FSC.[332] The authorisation involves an assessment of feasibility of a business project, the appropriateness of capital stock, the stockholders' composition and stock subscription capital, managerial abilities and probity of the organisers or the management.

Chapter IX of the Banking Act is devoted to domestic branches of foreign financial institutions. Article 58 establishes the authorisation rules applicable to a foreign operator (defined as 'financial institution which presently runs the banking business overseas after having been established pursuant to foreign Acts and subordinate statutes'[333] and extended also to the *branches* and *agents* of a financial foreign institution[334]), while the cancellation of authorisation is addressed under Article 60 and the rules concerning closure and liquidation and domestic assets and capital stock under Articles 61-63. The FSC is designated as the entity responsible for issuing and revoking authorisation to any financial institution, including those established abroad, and it is also the FSC to which a foreign financial institute must file a report in advance of an intention to relocate or close its branch or agency, for which authorisation has been granted under Article 58(1). Cancellation of authorisation is possible in cases where the authorised entity: ceases to exist due to a merger or transfer of business operations; has been subject to disciplinary action due to causes such as unlawful acts or unsound business activities; or (temporarily) suspends business.[335] The various implementation and enforcement details of the Banking Act are subject to further description under Presidential Decree.[336]

[328] Article 62 FSC Establishment Act.

[329] Articles 44-54 Banking Act.

[330] Article 1 Banking Act.

[331] Article 2(2) Banking Act.

[332] Article 8(1) Banking Act.

[333] Article 58(1) Banking Act.

[334] Article 59(1) Banking Act.

[335] Article 60(1) Banking Act. [Translation of the text describes it cumulatively (use of "and").]

[336] Enforcement Decree of the Banking Act (2011).

Core principle for effective banking supervision of the Basel Committee

In its Country Report assessing compliance on the Basel Core Principle for Effective Banking Supervision (BCP), the IMF describes Korea's compliance level as observed.[337] While the BCP's concern is much broader than countering money laundering and tax evasion and elusion, assessment reports about its implementation provide some information about the effectiveness of domestic supervision of banking activities in Korea. Recognising the strength and effectiveness – albeit also the complexity – of the regulatory framework, in its 2014 report the IMF recommends various steps in order to achieve higher standards of effective supervision. These steps include:

- Expanding FSC and FSS responsibilities, objectives and powers;
- Checks and balances in the independence, accountability for supervisors;
- Considerations on certain definitions used for licensing criteria by the FSC; and
- Strengthening of models used by FSC to ensure capital adequacy.[338]

The IMF report also notes that the FSC and FSS need to enhance the length of time to communicate the results of their supervisory activities.

B. Insurance sector

The Insurance Business Act (2011) and the Enforcement Rules of the Insurance Business Act (2011) govern the insurance sector. The Insurance Business Act defines an *insurance business* as 'the business of underwriting insurance, receiving premiums, paying insurance proceeds, etc. which arise in selling insurance products, and refers to a life insurance business, a non-life insurance business and a Type 3 insurance business.'[339]

The insurance products are specifically defined in Articles 2(1) and 4(1), excluding health and employment insurance as prescribed by the National Health Insurance Act and Employment Insurance Act respectively. The FSC is designated as the authority which can licence an insurance business.[340] A *foreign insurer* is defined as 'any person incorporated under Acts and subordinate statutes of any country other than the Republic of Korea who runs the insurance business in a country other than the Republic of Korea'.[341]A foreign insurer is among those categories of persons entitles to obtain a licence for the insurance business.[342] Specific licence requirements are established for foreign insurers under Articles 6(2) and 9(3) of the Insurance Business Act and Articles 9(3)(2) and 14 of the Enforcement Rules of the Insurance Business

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[337]IMF and the World Bank, *Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision*, Financial Sector Assessment Program, IMF Country Report No.14/310, October 2014.

[338] Ibid.

[339] Articles 2(2) and 4(1) Insurance Business Act.

[340] Article 4(1) Insurance Business Act.

[341] Article 2(8) Insurance Business Act.

[342] Article 4(6) Insurance Business Act.

Act.[343] Further rules concerning a foreign insurer's local office(s) in Korea are specified in Article 12 of the Insurance Business Act. Section 4 addresses the additional rules to which the local branches of foreign insurers are subject, such as: the situations that may lead to revocation of licenses,[344] obligations to hold local assets,[345] representation of local branches,[346] the filing of registration,[347] the application of certain provisions of other domestic Korean legislation,[348] and the exclusion of certain provisions of the Insurance Business Act.[349]

Korea's observance of the BCPs is deemed *high* in the *Joint World Bank-IMF Financial Sector Assessment Program* report.[350] The implementation of the majority of the 26 core principles is qualified as *observed*, the highest level attainable. However, in accordance with the assessment, certain core principles need additional improvement. Concerning *supervision* (ICP2), the report's recommendations suggest the enhancement of legal protection in practice and reducing the risk of politicisation of the leadership positions (in the FSS and FSC). The core principles concerning *risk management and internal controls* (ICP8) are deemed as *largely observed*. However, no specific recommendations are suggested. It is expected that observance will be fully achieved as industry capacity improves and internalises the risk management approaches throughout the business operations.[351]

The core principles on *supervisory cooperation and coordination* (ICP25) and *cross-border cooperation and coordination on crisis management* (ICP26) require additional improvement, especially on the level of deepening engagement in cooperation activities with groups by exploring exchange of understanding of supervisory issues at operational levels and contingency planning and by exploring exchange of understanding.[352] One subject on which Korea received lower scores – at the level of 'partly observed' – is the core principle on *group-wide supervision* (ICP23). On this matter, the IMF's recommendation is that Korea should advance supervisory college considerations with respect to larger groups that are internationalising, and that the FSS should request participation in colleges for foreign insurers utilising their international network to minimise costs and to consider strengthening the voluntary nature of the laws on financial holding companies with either strong indirect oversight or compulsion.

[343] Articles 6(2) and 9(3) Insurance Business Act.

[344] Article 74 Insurance Business Act.

[345] Article 75 Insurance Business Act and Article 25-2 Enforcement Rules of the Insurance Business Act.

[346] Article 76 Insurance Business Act.

[347] Article 78 Insurance Business Act.

[348] Articles 79, 80 and 80-2 Insurance Business Act.

[349] Article 82 Insurance Business Act.

[350] IMF and the World Bank, *Insurance Core Principles: Detailed Assessment of Observance*, Financial Sector Assessment Program, Republic of Korea, May 2014.

[351] Ibid.

[352] Ibid.

2.4.3.3 Anti-money laundering legislation

A. Substantive safeguards

Domestic rules on AML are established in the Act on Reporting and Use of Certain Financial Transaction Information (2014) [FTRUA] and the Enforcement Decree of the Act on Reporting and Use of Certain Financial Transaction Information (2011) [EDFTRUA]. The purpose of the FTRUA is to 'provide for matters concerning reporting on, and the use of specific financial transaction information necessary for regulating money laundering and the financing of terrorism using financial transactions, such as foreign exchange transactions, so as to prevent crimes and furthermore contribute to laying the foundation for facilitating sound and transparent financial transactions'.[353] It defines money laundering as, *inter alia*, (a) crimes under Article 3 of the Gains from Crimes Regulation Act; (c) hiding the acquisition or disposition of assets, or the causes of accrual thereof or concealing the assets, with the intention to commit a crime under Article 3 of the Punishment of Tax Evaders Act, Article 270 of the Customs Act, or Article 8 of the Act on the Aggravated Punishment, etc. of Specific Crimes.[354]

Article 2(1) of the Act provides an exhaustive list of the financial institutions which carry an obligation to report while Article 2(2)(a) allows the inclusion of other entities, not yet defined, to be included by presidential decree. The EDFTRUA establishes that the financial institutions may verify the authenticity of information from documents, information or other reliable sources when they have doubts about the veracity of customer data.[355]

The 2014 FATF Korea Report has examined and addresses several inadequacies found by the FATF. One concern was the discretion that financial institutions enjoyed in Customer Due Diligence (CDD).[356] Article 24(2) of the AML/CFT Regulation requires financial institutions to undertake CDD when there are suspicions that the existing customer information may be incorrect. The threshold for suspicious transactions that must be reported is set at $10,000.[357] This threshold for Suspicious Transaction Reports (STR) was lowered before. On that occasion, the FATF already expressed concern that lowering the STR threshold would significantly undermine the STR reporting obligation.[358] Furthermore, Article 10-2(3) EDFTRUA provides that these financial institutions 'may' verify the authenticity of information.[359] The FATF reports that this inadequacy has been addressed.[360]

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[353] Article 1 FTRUA.

[354] Article 3 FTRUA.

[355] Article 10(2)(3) EDFTRUA.

[356] Under Korea's Anti Money Laundering/Countering the Financing of Terrorism (AML/CFT) Regulation.

[357] Article 6 EDFTRUA.

[358] FATF and APG, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Korea*, June 2009, p. 124.

[359] FATF, *8th Follow-up Report: Mutual Evaluation of Korea*, June 2014.

[360] *Ibid.*, p. 9.

Moreover, the period in which financial institutions are expected to find linked extensions has been increased from a twenty-four hour period to seven days in order to provide sufficient time to identify structured transactions intended to avoid the threshold for occasional transactions.[361] Korea has also amended the AML/CFT Regulation to require financial institutions to check the authority of natural persons acting for legal persons[362] and obtain the name of the legal person, its identification number and address, and to check the existence of the legal person through the corporate registry or other sources.[363]

The FATF report identified deficiencies and needs for improvements in the provisions concerning CDD. On this subject, the FATF observes that Korea has addressed include, *inter alia*: the need to require financial institutions to review existing documentation data and information on a regular basis;[364] the need to prohibit financial institutions from opening accounts, commencing business relations or performing transactions when they are unable to perform effective CDD for a new customer;[365] the need to require financial institutions to file a suspicious transaction report when they are unable to complete the CDD;[366] the need to include internal controls to mitigate the risk posed by transactions undertaken before the completion of the CDD process;[367] and the need to introduce a rule expressly requiring CDD to be applied to pre-existing customers (before the 2008 amendment of the FTRUA).[368] The FATF observes the following CDD concerns that need to be (fully) addressed: the inclusion of the termination of existing business relations; the consideration of whether to file a suspicious transaction report when the pre-existing customer is unable to complete the CDD process;[369] and the inclusion of a formal assessment which can justify the exclusion of small financial institutions.[370]

B. Institutional safeguards

The Korea Financial Intelligence Unit is founded under the FTRUA, *inter alia*, to supervise and inspect the business tasks carried out by financial institutions. Financial institutions carry the obligation to immediately report transactions presumed illegal to the Korea Financial Intelligence Unit. The FTRUA also has a specific clause on the notification of Data of Foreign Exchange Transactions which are subject to approval or reporting under Article 17 of the Foreign Exchange Transactions Act (FETA) and notification under Article 21 of the FETA.[371] Article 8 of the FTRUA establishes the framework within which the Korea Financial Intelligence

[361] Article 23(2) AML/CFT Regulation.

[362] Article 38(3) AML/CFT Regulation.

[363] Articles 38(2) and 38(4) AML/CFT Regulation.

[364] Article 34(2)(ii) AML/CFT Regulation.

[365] Article 44(1) AML/CFT Regulation, Article 5-2(4) FTRUA.

[366] Article 5-2(5) FTRUA.

[367] Article 10-5 EDFTRUA.

[368] Article 25 AML/CFT Regulation.

[369] Article 33 AML/CFT Regulation.

[370] FATF, *8th Follow-up Report: Mutual Evaluation of Korea*, June 2014, p. 13.

[371] Article 6 FTRUA.

Unit may exchange information and cooperate with foreign countries. Korea has been a member of FATF since 2009 and a member of the Asia/Pacific Group on Money Laundering (APG) that falls under FATF auspices.

As regards AML, the FATF provides data on Korea's valuable commitments and efforts. It is to be noted, however, that the FATF examines the risks of money laundering and its mitigation in the context of countering terrorism financing. While the FATF reports do not provide information about any correlation between FTAs and money laundering, they do provide information about the legislative and institutional efforts of its Member States to mitigate money laundering. Initially the FATF reported that the FIU lacked sufficient human resources for effective analysis for the large volumes of STRs, and that other authorities – other than the FSC and FSS – lacked sufficient resources to supervise AML (see also Table 3 for statistics on STR analysis and dissemination).[372]

Table 3 Suspicious Transaction Report (STR) Analysis and Dissemination

	2009	2010	2011	2012	2013
Number of STRs analysed	13,053	19,012	16,494	21,376	25,030
Number of STRs disseminated	7,711	11,868	13,110	22,173	29,703

Source: 8th Follow-up Report: Mutual Evaluation of Korea, FATF, June 2014, p. 16.

Also in a previous report dating from 2014, the FATF observed that the sanctions imposed by Korea on legal persons convicted of money laundering are insufficiently effective and not dissuasive or proportionate and those imposed on natural persons not effectively implemented.[373] On this matter, Korea has provided statistics about the number of investigations, indictments and convictions between 2007 and 2013 to demonstrate the improvement of its commitment. The figures show a clear trend of an increase in all three levels of law enforcement.[374] There is, however, no qualitative information about the nature, context, impact, and consequences of these proceedings and convictions except the fact that they relate to money laundering. Moreover the statistics are not retrieved in a centralised, systematically prepared manner which distorts the consistency of the data. The FATF recommends centralising the information system for supervision and examination.[375] It is important to note that AML regulations are not applied to any Designated Non-Financial Business Professions (DNFBPs) – i.e. business venues that are attractive for criminals – other than casinos.[376] The situation on this matter remains unchanged. Given the diversity of the financial services market in Korea, this

[372] FATF and APG, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Korea*, June 2009, p. 153.

[373] FATF, *8th Follow-up Report: Mutual Evaluation of Korea*, June 2014, p. 23.

[374] Ibid.

[375] *Ibid.*, p. 33.

[376] Ibid.

may warrant further scrutiny. Finally the FATF also reports on Korea's international cooperation in the field of AML and law enforcement. Korea has (at the time of the report) 29 mutual legal assistance treaties. Furthermore, the report indicates that Korea is also willing to assist on the basis of reciprocity in situations where a mutual legal assistance treaty is absent.[377]

Table 4 Number of money laundering investigations, indictments and convictions since 2007

		2007	2008	2009	2010	2011	2012	2013
Number of Investigations	Cases	120	130	138	153	249	248	350
	Persons	254	208	240	280	607	430	605
Number of Indictments	Cases	71	86	78	80	126	109	248
	Persons	99	114	97	114	152	134	351
Number of Convictions	Cases	55	76	75	62	84	79	141
	Persons	67	99	73	87	107	98	173

Source: 8th Follow-up Report: Mutual Evaluation of Korea, FATF, June 2014, p. 16.

2.4.3.4 Tax evasion legislation

Korea's corporate tax regime is embodied by the Corporation Tax Act and the Enforcement Decree of the Corporation Tax Act. The Foreign Investment Promotion Act aims to provide a one-stop service, and various benefits and tax incentives to attract foreign direct investment, while the Act for the Coordination of International Tax Affairs (ACITA) and the aforementioned Act's Enforcement Decree govern the taxation matters of an international dimension. Chapter IV of the Enforcement Decree specifies the corporation tax for each business year applicable for foreign corporations. Korea's National Tax Service is the authority that administers and collects taxes.

International regimes

Korea is a State Party to the Agreement on Exchange of Information on Tax Matters of the OECD, the OECD Convention on Mutual Administrative Assistance in Tax Matter, a member to the Global Forum on Transparency and Exchange of Information for Tax Purposes, and supports the Statement on Transparency and Exchange of Information for Tax Purposes of the G20. The Korean National Tax Service (KNTS) is tasked with directing and conducting investigations (Model 1, OECD). The regional taxation bureaus of the KNTS have criminal investigation departments which may submit investigation cases to the public prosecutor. Since 2013, Korean tax authorities have access to STRs for civil purposes. While prior to 2013 the FIU only provided information on criminal cases, the amendment to the FTRUA allows the FIU to

[377] FATF and APG, Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Korea, June 2009, pp. 184-185.

share STR information for the purposes of selecting and conducting tax audits and collecting tax debts. For this reason the OECD reports that Korea proves an interesting case study about the benefits of FIUs sharing STRs with tax administration. Korea reported to the OECD that in 2013 an additional 367 billion Korean Won (*ex ante*, approximately $337 million) was assessed as a result of, or facilitated by, STR information.[378] Furthermore, the OECD notes that Korea reports a record amount of tax assessment for the first quarter of 2014 as a result of the use of STR and CTR information for civil purposes.

2.4.4 Concluding remarks

Due to the fact that the EU-Korea FTA only recently entered into force and the fact that it liberalises the market gradually, it is premature to provide any conclusive assessment or recommendations regarding the full impact of the FTA has yet to materialise. As Wróbel concludes, after exploring the various expected effects, 'it should be stressed that the actual effects of the EU-Korea trade agreement will not be evident until successive stages in the reduction of trade barriers are implemented'.[379]

In 2011 when the Parties and interested organisations convened at the Conference on the Implementation of the EU-Korea Free Trade Agreement, the report of this conference referred to some of the expectations and challenges.[380] Back then, no challenges surrounding FTA-related money laundering and tax evasion were reported. Nevertheless, interestingly, the report did note that the banking sector should benefit from the FTA 'quite significantly'. In contrast to this expectation, the sources examined so far do not provide detailed information about the impact of the FTA for the financial services sector, let alone any significant impact. Thus, there is a discrepancy between the initial high expectations of the FTA's impact for the banking sector and the limited amount of detail in the reports concerning the FTA's impact on financial services.

Given that 2016 is the year in which liberalisation is to be expanded, prudence seems necessary in examining the compatibility of Korea's domestic law with the standards set out in the provisions of the FTA. Cherry makes an observation that globalisation in Korea produced a mismatch between policy and implementation. She states that this mismatch is caused by 'soft' social, cultural and institutional barriers, which in turn leads to the lack of predictability, consistency and transparency in the regulatory environment.[381] Furthermore, she states that this policy-implementation gap may be increased due to an inability or perhaps even an

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[378] OECD, *Improving Co-operation between Tax and Anti-Money Laundering Authorities: Access by Tax Administrations to Information held by Financial Intelligence Units for criminal and Civil Purposes*, September 2015, p. 14.

[379] A. Wróbel, *The EU–Korea Free Trade Agreement*, Stosunki Miedzynarodowe - International Relations, Issue 1 (45), 2012, p. 258.

[380] http://trade.ec.europa.eu/doclib/docs/2011/november/tradoc_148383.pdf.

[381] J. Cherry, 'Upgrading the 'Software': The EU–Korea Free Trade Agreement and Sociocultural Barriers to Trade and Investment', *The Pacific Review*, Vol. 25, No. 2, May 2012, pp. 248 and 252.

unwillingness to increase transparency and that the EU-Korea FTA will not resolve these issues unless changes occur that are initiated from within Korean society.[382] On this issue, Cherry states about Korea's rationale that: '[t]he decision to pursue a range of FTAs with developing and developed countries was a key element of the Korean government's ongoing commitment to achieving a greater degree of integration into the global economy. However, the ability of the government and its agencies to implement that policy – Korea's "institutional capacity" – was constrained both by concerns that it would be perceived as favouring foreign firms over domestic interests and the awareness of the lingering fear of foreign domination and economic control. Thus, expressions of economic nationalism and anti-foreign capital sentiment could hinder the implementation of the policy by undermining the government's efforts to create a business-friendly environment for foreign traders and investors.'[383] While this critical view may be too general, it points to the dangers of overburdening governments with some of the text-based rules which may be disconnected from actual practice.

Nonetheless, an extensive review of the domestic Korean law is ongoing in the field of AML regulation and banking regulations, as observed in the FATF and BCP reports. While these reports do demonstrate Korea's commitment to countering money laundering and tax evasion and elusion, they do not identify the particular motivation of this commitment. No information is available that identifies particular action by Korea as a result of or in relation to the financial services provisions of the EU-Korea FTA. More detailed information concerning FATF statistics about Korea's number of investigations, indictments and convictions in relation to money laundering would facilitate an increased understanding of the practices and effectiveness of Korean law enforcement against money laundering. Moreover a comparative examination of legislation and practice by EU28, on the one hand, and Korea, on the other hand, seems missing. This may be warranted as coordinated and concerted actions may be necessary in the context of the FTA's implementation.

[382] *Ibid*., pp. 257 and 262.

[383] *Ibid*., p. 266.

2.5 EU-Colombia/Peru Trade Agreement

2.5.1 Trade context

2.5.1.1 Bilateral trade relations and parties

Box 9 Aspects of the EU-Colombia/Peru FTA

- The Colombia/Peru FTA encompasses the far-reaching liberalisation of current account transfers, rather than limiting the liberalisation to financial transfers related to trade, loans and investments as the EU- Korea agreement does. Given the challenges in the two countries, a more prudent approach to liberalisation and/or more safeguards or measures aimed at cooperating between the parties to the FTA on fighting money laundering and tax evasion seem necessary.
- The provision allowing for non-disclosure of information relating to the affairs and accounts of individual customers may not contribute to the fight against tax evasion.
- The FTA contains weak worded provisions in which parties 'take note' of international information exchange and transparency mechanisms, and make their 'best endeavours to ensure' that international AML standards are implemented.

Trade relations between the European Union and the Andean Community, a customs union comprising of Bolivia, Colombia, Ecuador and Peru,[384] rose from €9.1 billion in 2000 to €15.8 billion in 2007, representing an average annual growth rate of 8.25%. After the USA, the EU was the largest trade partner for the Andean countries, accounting for 14.2% of total trade in 2007. Conversely, trade with Andean countries accounted for 0.6% of EU total trade, i.e. some € 10 billion in 2007. Trade between the EU and Colombia accounted for 50% of the total trade with the Andean countries, while trade with Peru accounted for 27%, with Ecuador for 19% and with Bolivia for 5%.[385] By 2014, the total trade of the EU with the Andean countries was worth some

[384] The trade bloc was called the Andean Pact until 1996 and came into existence when the Cartagena Agreement was signed in 1969. Its headquarters are in Lima, Peru. Originally, Chile was also a party, but it withdrew in 1976. In the meantime, Venezuela had joined in 1973, but withdrew later on. In Spanish the organisation is called Comunidad Andina, CAN. The website of Andean is

http://www.comunidadandina.org.

[385] Development Solutions, Centre for Economic Policy Research (CEPR) and Institute for Development Policy and Management, School of Environment and Development, University of Manchester, *EU-Andean Trade Sustainability Impact Assessment*, Final report, 2009, p. 9. It can be noted that this Trade Sustainable Impact Assessment (Trade SIA), prepared by independent consultants, should have guided EU negotiators. As the report was finalised by October 2009, a reaction from the side of the Commission in the form of a so-called position paper was issued

€28.8 billion, representing a share of 0.9% of total EU trade. At the same time, the EU is now the third largest trading partner for the Andean countries, after the USA and China. The Andean countries export predominantly primary products to the EU.[386] The EU exports consist mostly of manufactured goods.[387]

In 2004, it was agreed to strive for a region-to-region association agreement between the EU and the Andean Community. Negotiations started in April 2007, but were suspended in June 2008 after disagreement about approaches to a number of key trade issues. Bolivia decided to withdraw in September 2008, after which negotiations resumed with the remaining three Andean countries. Later on, Ecuador also withdrew and negotiations were concluded with Peru and Colombia in 2010. The agreement with the latter two countries was signed in June 2012 under the name Trade Agreement,[388] encompassing a free trade area in conformity with Article XXIV of GATT 1994 and Article V of GATS.[389] It has been provisionally applied with Peru since 1 March 2013 and with Colombia since 1 August 2013. In July 2014, negotiations were concluded for the accession of Ecuador to the agreement. After ratification by all parties this extension of the agreement will take effect. Bolivia might still join the trade agreement at a later moment in time.

In December 2012, an NGO published a report that claimed the EU-Colombia/Peru Trade Agreement is lagging behind other EU trade agreements in which stronger commitment to cooperation and implementation of actions against money laundering, crime and tax evasion or avoidance are incorporated.[390] This was described as a cause of grave concern, considering the fact that the UN Office on Drugs and Crime (UNODC) estimates that the flow of Andean cultivated drugs generates $9.9 billion in gross transit profits. The Greens in European Parliament were against the agreement as well, *inter alia*, they strongly opposed the

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only in November 2010. This Trade SIA position paper was thus presented after the negotiations of the Multiparty Trade Agreement with Colombia and Peru had already been concluded. As it thus could not fulfill its actual purpose any more, instead it focused on explaining how the Trade SIA recommendations were taken into account in the Agreement.

[386] Agricultural products (40.5%), fuels and mining products (52.3%).

[387] Notably machinery and transport equipment (48%), and chemical products (19.1%). Source: European Commission, *Trade in goods with Andean community*, 20 October 2015.

[388] 'Trade Agreement between the European Union and its Member States, of the one part, and Colombia and Peru, of the other part', [2012] *OJ* L 354/3. The text of the Trade Agreement is also available at: http://trade.ec.europa.eu/doclib/press/index.cfm?id=691.

[389] Article 3 Trade Agreement.

[390] M. Vander Stichele, *Free Trade Agreement EU–Colombia & Peru: Deregulation, Illicit Financial Flows And Money Laundering*, Commissioned by GUE/NGL Group (German Delegation), Stichting Onderzoek Multinationale Ondernemingen (SOMO), Amsterdam, 2012. The report was commissioned after a publication by the organisation Global Financial Integrity on the increased illicit flows between the USA and Mexico after NAFTA had entered into force (*Mexico: Illicit Financial Flows, Macro-economic Imbalances and the Underground Economy*, 2011). The latter report claims that illicit money flow in Mexico has soared up to $50 billion a year.

deregulation of the finance sector as foreseen under the agreement as increasing risky products without provisions on stronger oversight or capital controls is felt to encourage money laundering.[391] Before signing up to the EU Trade Agreement, Peru had also concluded trade agreements with the USA and with China. Colombia likewise concluded an agreement with the USA, known as the U.S.–Colombia Trade Promotion Agreement (TPA).[392] Recently, it was stressed that the lack of coordination between Chinese and Latin American regulators and authorities meant that financial infrastructure can be exploited by money launderers.[393] In Colombia, it was estimated by UAIF that in 2012 some $10 billion was laundered.[394]

The European Parliament managed to get additional instruments drafted before it agreed with the Trade Agreement. The roadmap drafted by Colombia was described by the European Commission as a 'useful instrument in furthering the protection of human rights, labour rights, and the environment'. Asked what it intended to do against human rights violations, it added that while the responsibility for implementing the roadmap lies with Colombia, 'the Commission and the HR/VP stand ready to support their implementation, alongside the European Parliament, through the mechanisms established in the context of our bilateral relations, including through the Trade Agreement'.[395]

2.5.1.2 Institutional framework of the EU-Colombia/Peru Trade Agreement

The Trade Agreement encompasses the establishment of a general body and an extensive number of specialised bodies that are to ensure that the agreement fulfils its objectives.[396] First, a Trade Committee was established, comprising representatives of the EU and representatives

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[391] The Greens in the European Parliament, *EU Free Trade Agreement. Proposed Roadmap Fails To Resolve Human Rights Issues With Colombia And Peru Trade Deal*, Press Release of 11 December 2012.

[392] See https://ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text. Also see P. de Micco, *The US And EU Free Trade Agreements With Peru And Colombia: A Comparison*, In-depth analysis for the European Parliament's Committee on International Trade, Brussels, 2014.

[393] A. Daugherty, 'Colombians Charged in Massive China-based Money Laundering Scheme', *InSight Crime*, 11 September 2015.

[394] As explained by M. Vander Stichele, Schriftelijke verklaring voor expertmeeting 'Hoe de vrijhandelsovereenkomst tussen de EU en Colombia en Peru bijdraagt aan financiële deregulering, illegale geldstromen en het witwassen van geld' (Written statement for expert meeting 'How the free trade agreement between the EU and Colombia and Peru contributes to financial deregulation, illegal financial flows and money laundering'), 30 May 2013, p. 2. Unidad de Información y Análisis Financiero (UIAF) is Colombia's financial and economic intelligence unit; see www.uiaf.gov.co for further information.

[395] 'Answer to MEP questions on the Free Trade Agreement with Colombia and Peru given by High Representative/Vice-President Ashton on behalf of the Commission', 11 February 2014, *OJ* C 231, 17/07/2014.

[396] Articles 12-16 TA.

of each signatory Andean Country, and this Committee meets at least once a year at the level of Ministers or the representatives that the Ministers designate. In addition, the Trade Committee may meet at any time at the level of senior officials designated to take the necessary decisions. *Inter alia*, the Trade Committee is to: supervise and facilitate the operation of the Agreement and the correct application of its provisions, and consider other ways to attain its general objectives; evaluate the results obtained from the application of the Trade Agreement; supervise the work of all specialised bodies established under this agreement and recommend any necessary action; evaluate and adopt decisions as envisaged in the agreement regarding any subject matter which is referred to it by the specialised bodies; and supervise the further development of the Trade Agreement.[397] Its decisions are to be adopted by consensus and are binding upon the Parties.[398]

Several specialised bodies are mentioned in the Trade Agreement, notably the Sub-committees on Market Access, on Technical Obstacles to Trade and on Customs, Trade Facilitation and Rules of Origin. These bodies consist of representatives of the EU Party, and representatives of each signatory Andean Country. Their scope of competence and duties are defined in the relevant titles of the Trade Agreement. Further sub-committees, working groups or any other specialised bodies may be established by the Trade Committee in order to assist it in the performance of its tasks.[399]

Colombia and Peru are not members of FATF, nor do they have observer status. Like Mexico, they are full members of GAFILAT (formerly GAFISUD), a regional FATF style organisation.[400] GAFILAT supports its members in the implementation of the 40 FATF Recommendations as national legislation and the creation of a regional prevention system against money laundering and terrorist financing. The two main GAFILAT tools are training measures and mutual evaluations. The last (3rd round) GAFILAT mutual evaluations of Colombia and Peru are from 2008.[401] After the evaluation reports were approved, it was determined that the follow up process for the two countries would be to check the progress made in order to overcome the deficiencies identified in the report. The countries had to submit an action plan with concrete dates and measures for compliance with the main international standards on the matter.

[397] Articles 12 and 13 TA.

[398] Article 14 TA.

[399] Article 15 TA.

[400] Financial Action Task Force of Latin America (GAFILAT) is a regionally based inter-governmental organisation that gathers 16 countries in order to combat money laundering and terrorist financing by means of a commitment for continuous improvement of the national policies against both scourges, and the enhancement of different cooperation mechanisms among its member countries.

[401] The last mutual evaluation of Mexico also stems from 2008.

Follow up-reports for the two countries were issued in 2009.[402] For Peru, a 3rd follow-up report was also issued.[403] Further information on the procedures for legal cooperation on money laundering in Peru was published in July 2015.[404] In December 2009, GAFILAT and the EU signed an agreement on a project known as 'Support to the fight against money laundering in the Latin America and the Caribbean countries', details of which are set out in Annex 3 to this report.

2.5.2 Assessment of the Regulatory Framework for the provision of Financial Services and Combating Illicit Financial Flows

2.5.2.1 Financial services

The objectives of the Trade Agreement include: the progressive liberalisation of trade in services, in conformity with Article V of the GATS; the development of an environment conducive to an increase in investment flows and, in particular, to the improvement of the conditions of establishment between the Parties on the basis of the principle of non-discrimination; and to facilitate trade and investment among the Parties through the liberalisation of current payments and capital movements related to direct investment.[405] As the Trade Agreement has only been provisionally applied since March 2013 (Peru) and August 2013 (Colombia), the effects of the provisions on services are still hard to evaluate, particularly due to a lack of data.[406] Where possible, some remarks on the apparent strengths or weaknesses of the provisions of the agreement will be made, though, notably, by comparing the provisions with those in the other agreements investigated in this report.

Title IV of the TA deals with trade in services, establishment and electronic commerce.[407] Title V deals with current payments and the movement of capital.[408] Title IV starts with general provisions. 'Services' includes any service in any sector except services supplied in the exercise of governmental authority, i.e. any service that is neither supplied on a commercial basis nor in

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[402] Secretaría Ejecutiva GAFISUD, *II Informe de Avance de la Evaluación Mutua de Colombia/Perú. Seguimiento Intensificado*, http://www.gafilat.org/UserFiles/documentos/en/informe_de_avance/1er_Informe_Avance_Colmbia_2009.pdf, and http://www.gafilat.org/UserFiles/documentos/en/informe_de_avance/2ndo_Informe_Avance_Peru_2009.pdf.

[403] http://www.gafilat.org/UserFiles/documentos/en/informe_de_avance/3er_Informe_Avance_Peru.pdf.

[404] http://www.gafilat.org/UserFiles//Biblioteca/Evaluaciones/Avances/Informe%20de%20Seguimiento%20de%20Peru%20(julio%20de%202015).pdf.

[405] Article 4 sub c, d and e TA.

[406] European Commission, *Second Annual Report on the Implementation of the EU-Colombia/Peru Trade Agreement*, COM(2016)58, at p. 6.

[407] Articles 107-167 TA.

[408] Articles 168-171 TA.

competition with one or more service suppliers.[409] It is stressed that, subject to the provisions of this Title, each Party retains the right to exercise its powers and to regulate and introduce new regulations in order to meet legitimate public policy objectives.[410]

Financial services are defined as 'any service of a financial nature offered by a financial service supplier of a Party. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance)' followed by a list of activities.[411]

2.5.2.2 Right of establishment

The *right of establishment* is regulated by Chapter 2 of Title IV.[412] This Chapter applies to measures of the Parties affecting the cross-border supply of all services sectors with some exceptions, such as audio-visual services and air transport services.[413]

With respect to market access through establishment, the Trade Agreement prescribes that each Party shall provide treatment no less favourable than that provided for in the specific commitments contained in Annex VII (List of Commitments on Establishment) to establishments and investors of another Party. In sectors where market access commitments are undertaken, a Party shall not maintain or adopt, unless otherwise specified in Annex VII (List of Commitments on Establishment), limitations: (a) on the number of establishments; (b) on the total value of transactions or assets or on the total number of operations; (c) on the total quantity of output; (d) on the total number of natural persons that may be employed in a particular economic activity; (e) on the participation of foreign capital in terms of a maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; and (f) measures which restrict or require specific types of establishment (subsidiary, branch, representative office) or joint ventures through which an investor of another Party may perform an economic activity.[414] Parties are to grant establishments and investors from the other parties' treatment no less favourable than that they give to their own like establishments and investors.[415]

2.5.2.3 Cross-border supply of services

Market access through the *cross-border supply of services* is regulated in Chapter 3 of Title IV.[416] Each Party to the Trade Agreement shall accord services and service suppliers of another Party treatment no less favourable than that provided for in the specific commitments listed in Annex

[409] Article 108 TA.

[410] Article 107(5) TA.

[411] Article 152 TA.

[412] Articles 110-116 TA.

[413] Article 111 TA.

[414] Article 112 TA.

[415] Article 113 TA.

[416] Articles 117-121 TA.

VIII (List of Commitments on Cross-Border Supply of Services). In sectors where market access commitments are undertaken, Parties shall not maintain or adopt, unless otherwise specified in Annex VIII, limitations on: (a) the number of services suppliers; (b) the total value of service transactions or assets; and (c) the total number of service operations or on the total quantity of service output.[417]

In the sectors where market access commitments are listed in Annex VIII, and subject to any conditions and qualifications set out therein, Colombia and Peru shall grant to EU services and service suppliers, with respect to all measures affecting the cross-border supply of services, treatment no less favourable than that they accord to their own like services and service suppliers. The same holds true for the EU where Colombian or Peruvian services and service suppliers are concerned.[418]

Parties are not to apply licensing and qualification requirements, procedures and technical standards that nullify or impair their specific commitments in a manner which: (a) does not comply with certain GATS criteria;[419] and (b) could not reasonably have been expected of that Party at the time the specific commitments were made. In determining whether a Party is in conformity with its obligations under these obligations, the international standards of relevant international organisations[420] applied by that Party shall be taken into account. A recent KPMG report, it shows that in the case of Peru the current government is ensuring that the rights of foreign companies are well secured in these and other aspects.[421] A 2010 report from the same organisation was positive about the rights of foreign investors in Colombia as well.[422]

Current payments and movement of capital are dealt with in Title V of the Trade Agreement.[423] The Parties are obliged to authorise, in freely convertible currency,[424] any payments and transfers on the *current account* of balance of payments between the Parties.[425] Parties are also to ensure free movement of capital relating to direct investments and relating to investments and other transactions made in accordance with the provisions of Title IV (trade in services, establishment and electronic commerce), as well as the liquidation and repatriation of these investments and

[417] Article 119 TA.

[418] Article 120 TA.

[419] Namely Article VI:4 (a), (b), (c) GATS.

[420] A footnote in the TA explains that this refers to international bodies whose membership is open to the relevant bodies of the Parties.

[421] KPMG, *Investment in Peru*, 2015.

[422] KPMG, *Doing Business in Colombia*, 2010.

[423] Articles 168-171 TA.

[424] And in accordance with the provisions of Article VIII of the Articles of Agreement of the IMF.

[425] Article 168 TA.

of any profit stemming therefrom.[426] It has been noted that in other EU trade agreements, no such far reaching liberalisation of current account transfers was incorporated.[427] For instance, in the EU-Korea agreement, the liberalisation only applies to financial transfers related to trade, loans and investments.[428]

The signatory countries are allowed to take safeguard measures in case of serious difficulties for the operation of exchange rate policy or monetary policy.[429] The final provisions of Title V stress that with the aim of supporting a stable and secure framework for long-term investment, the Parties shall consult with a view to facilitating the movement of capital between them, in particular the progressive liberalisation of capital and financial accounts.[430]

2.5.2.4 Taxation

The Trade Agreement contains several general provisions on taxation. Notably, each of the signatory countries is to implement and enforce measures that aim at collecting direct taxes and at preventing tax avoidance or evasion. These measures may distinguish between residents and those whose residence or capital is abroad.[431]

As part of the provisions which are specific for the financial sector (covering banks, hedge funds, trusts, etc.), one provision stipulates that no signatory country is required neither to disclose information relating to the affairs and accounts of individual customers nor of any confidential proprietary information in the possession of public authorities.[432] Such a clause does not seem to support actions to tackle tax evasion and avoidance for which (automatic) information exchange across borders is essential. It also seems to run counter to what is recommended in several of the international standards for regulation and supervision in the financial services sector that the parties promised to implement and apply (see below).

The signatory countries are merely asked to 'take note' of the Ten Principles for Information Sharing issued by the G-7 Ministers of Finance and the Agreement on Exchange of Information on Tax Matters of the OECD, and of the Statement on Transparency and Exchange of Information for Tax Purposes of the G20.[433] This is even weaker than a best endeavour clause

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[426] Article 169 TA. The provision explains in a footnote that "direct investment" does not mean credits related to foreign trade, portfolio investment according to domestic legislation, public debt and related credit.

[427] M. Vander Stichele, *Free Trade Agreement EU–Colombia & Peru: Deregulation, Illicit Financial Flows And Money Laundering*, Commissioned by GUE/NGL Group (German Delegation), Stichting Onderzoek Multinationale Ondernemingen (SOMO), Amsterdam, 2012, p. 8.

[428] Article 8.2 EU- Korea FTA.

[429] Article 170 TA.

[430] Article 171 TA.

[431] Notably article 296 TA.

[432] Article 154 TA.

[433] Article 155(5) TA.

like the one included in the EU- Korea Agreement.[434] Both Colombia and Peru are members of the Global Forum on Transparency and Exchange of Information for Tax Purposes, just like Mexico and South Africa (of the countries investigated in this study, only Serbia is not a member). As will be explained below, Peru recently joined and thus, no peer reviews are available yet for this country. As for Colombia, it was judged to be compliant with the internationally agreed standards of transparency and exchange of information in the tax area. A new standard on the automatic exchange of financial account information will be implemented by Colombia in 2017. The same holds true for 27 of the EU Member States (Austria will follow in 2018), Korea, Mexico and South Africa.

The definition of 'establishment' explains that it means any type of business or professional establishment. This 'includes the establishment in any productive economic activity, whether industrial or commercial, relating to the production of goods or supply of services'.[435] 'Service supplier' is defined as any natural or juridical person that 'seeks to supply and supplies a service', but a 'juridical person' needs to have a real and continuous link with the host country.[436] It has been noted that these definitions provide for some, but not full, guarantees that companies that establish themselves or operate in any of the signatory countries undertake real economic activities and not only transfer money or evade or avoid taxes. However, it is not certain whether the (ultimate) owners of foreign companies are known and can be easily traced.[437] It can be noted that inside the EU, the newly adopted Directive against Money Laundering[438] will oblige EU Member States to set up a central registry of beneficial owners of corporate and other legal entities incorporated within their territory by 26 June 2017 at the latest.[439] Only a handful of other countries around the world have similar legislation in place.[440]

Colombia and Peru both allow for the establishment and cross-border supply of tax advisory services from EU countries.[441] Given the essential role of some tax advisory companies in designing and providing tax evasion and avoidance mechanisms, it has been stressed that liberalising those services with some legal requirements but without instruments to stop them

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[434] Article 7.24 EU-Korea FTA.

[435] Article 110, footnote 19 TA.

[436] Article 108 TA.

[437] SOMO, 2012, p. 13. M. Vander Stichele, *Free Trade Agreement EU–Colombia & Peru: Deregulation, Illicit Financial Flows And Money Laundering*, Commissioned by GUE/NGL Group (German Delegation), Stichting Onderzoek Multinationale Ondernemingen (SOMO), Amsterdam, 2012, p. 13.

[438] 'Directive (EU) 2015/849 on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing', *OJ* L 141 of 5.6.2015, p. 73.

[439] Article 30 Directive (EU) 2015/849. The UK already has such a system in place.

[440] Notably Norway, see http://www.access-info.org/frontpage/16968.

[441] Article 126(2) sub c and d TA.

from advising on tax dodging might increase tax evasion.[442] For instance, it does not reduce the risks of tax advisers or clients in the EU to link up with tax advisers from Colombia and Peru, which could stimulate (new ways of) tax avoidance and evasion.

2.5.2.5 Money laundering

As explained above, the Trade Agreement deals with financial services in Chapter 5 section 5. One provision in this section deals specifically with money laundering.[443] This provision demands that parties make their 'best endeavours to ensure' that international standards for regulation and supervision in the financial services sector and for the fight against money laundering and the financing of terrorism are implemented and applied in its territory.[444]

If we compare this provision with similar ones in other EU FTAs, it can be noted that stricter formulations are used. In the EU-Korea FTA for instance, it is stated that '[e]ach party *shall*, to the extent practicable, ensure that internationally agreed standards (…) are implemented and applied in its territory'. Furthermore, it is also worth noting that:

- Articles 167 and 170, 295, 297 of the FTA allow the signatory countries to take safeguard measures that could be useful for the prevention or halting of illicit financial flows; and
- According to Article 154, countries may adopt measures and laws regarding financial services and capital flows for prudential reasons, such as for ensuring the integrity and stability of the financial system and protecting investors and clients of financial service suppliers. This could mean that measures regarding money laundering could be allowed to protect the integrity of the financial sector. These 'prudential carve-out' measures are not allowed to be 'more burdensome than necessary to achieve their aim'. Also, these rules do not allow for discrimination between domestic financial services and their suppliers, and those from the other signatory countries.

2.5.2.6 Data protection

According to Article 157 of the FTA, each Party shall permit financial service suppliers to transfer information in electronic or other form into and out of its territory. However, adequate safeguards for the protection of the right to privacy and the protection of personal data need to be adopted.

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[442] Notably by SOMO, 2012, p. 14. Notably by M. Vander Stichele, *Free Trade Agreement EU–Colombia & Peru: Deregulation, Illicit Financial Flows And Money Laundering*, GUE/NGL Group (German Delegation), 2012, p. 14.

[443] Article 155(4) TA.

[444] The international standards are identified in article 155 as the Core Principle for Effective Banking Supervision of the Basel Committee, the Insurance Core Principles and Methodology of the International Association of Insurance Supervisors, the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions, the Forty Recommendations on Money Laundering, and the Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force.

2.5.2.7 Transparency aspects

Questions of transparency are covered in Title X and also in parts of Title III. Like most of the other Titles reviewed here, the Title X lays down a framework within which willing governments can ensure certain minimum standards and, if agreeable, advance these over time. It establishes the basic requirements for the provision of trade-related information.

While Article 155 Trade Agreement aims at 'effective and transparent regulation' it also provides that the countries shall endeavour that all interested persons have an opportunity to comment before a measure of general application is adopted. In practice, the interested persons who have the capacity to monitor and give comments on measures that are proposed for adoption mostly consist of lobbyists from the financial industry, not in the least those from the foreign financial industry. This article in practice provides a legal basis through which lobbyists have a right to request to comment before a financial regulation is adopted, and thus influence its final outcome.

The choice of words employed could allow an unwilling government to keep certain matters opaque. Article 289 excludes from its purview confidential information defined in various ways, including cases where a government deems that publication would 'be contrary to the public interest'.

All in all, the EU-Colombia/Peru Trade Agreement offers a framework for liberalising trade in goods and services and offers some possibilities to prevent illicit capital flows like money laundering, tax evasion and terrorist financing. The Agreement does not seem to offer strong incentives to ensure that illicit flows are investigated and prosecuted.

2.5.3 Assessment of Colombian and Peruvian Legislation on Financial Services, Money Laundering, and Tax Evasion and Elusion

2.5.3.1 Money laundering

Money laundering in Colombia

According to reports, the laws on money laundering have been modestly effective.[445] In 1985, money laundering constituted 10% of Colombia's GDP, while by the end of the millennium this had grown to 14%. From 2000 to 2013, the illicit share of the GDP decreased. Notably, this drop is assigned to the implementation of the Plan Colombia - a U.S.-backed security package aimed at increasing Colombia's military strength and fighting drug trafficking – and anti-money laundering efforts by the Financial Intelligence Unit of Colombia (*Unidad de Información y Análisis Financiero*, UIAF). The UIAF is in charge of conducting operations related to unusual financial operations reported by (i) certain sectors of the economy who are obligated to make such reports, or (ii) any person or entity, voluntarily.[446]

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[445] See http://www.insightcrime.org/news-briefs/money-laundering-two-percent-of-colombia-gdp.

[446] Law 526 of 1999.

Relevant legislation includes:

- Decree 663 of 1993. Sets out general 'know your customer' rules applicable to financial institutions, as well as general patterns in agreement with which the Superintendence of Finance has to set forth specific rules for money laundering prevention.
- Regulation 007 of 1996, as amended by Regulation 022 of 2007 with annexes and Regulation 062 of 2007 with annexes, issued by the Superintendence of Finance. Regulation 007 sets out the specific obligations that financial institutions have to comply with and Regulation 062 sets out the specific obligations for securities issuers.
- Law 599 of 2000. This law defines the scope of the crime of money laundering. In particular, Article 323 of this law defines money laundering as the acquisition, investment, transportation, custody or administration of funds with the purpose of concealing their illegal source.[447]

A recent U.S. report finds that 'despite the Government of Colombia's fairly strict AML/CFT regime, the laundering of money primarily from Colombia's illicit drug trade continues to penetrate its economy and affect its financial institutions'. The report mentions many financial services related to ways to repatriate illicit proceeds to Colombia, including the postal money order market, wire transfers, the securities markets and remittances in the USA, and, in Colombia, prepaid debit cards and electronic currency.[448]

It also highlights that criminal organisations with connections to financial institutions in other countries smuggle merchandise to launder money through the formal financial system using trade and the non-bank financial systems. In the black market peso exchange, goods are bought with drug dollars from abroad and are either smuggled into Colombia via Panama or brought directly into Colombia's customs warehouses, thus avoiding various taxes, tariffs, and customs duties. In other trade-based money laundering schemes, goods are over- or under-invoiced to transfer value.[449]

Evasion of the normal customs charges is said to be frequently facilitated through the corruption of Colombian oversight authorities. In 2013, 67 prosecutions and 8 convictions related to money laundering were reported.[450] In 2014, there were 46 prosecutions and 57 convictions.[451]

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[447]https://www.unodc.org/doc/enl/2010/Colombia_Law_747_July2002_Amend_Penal_Code_Law_599of2000_R-09-99_English.pdf.

[448] The use of bulk cash smuggling, trade of counterfeit items and illegal mining are also mentioned, as is the gaming industry which includes casinos and regionally-run lotteries called 'Chance'. 'Chance' has more transactions per day than all other financial transactions in the country combined, and indications are that much money laundering activity has moved here.

[449] Making the WTO cases about Colombia's efforts to get a grip on trade with Panama all the more relevant.

[450] Bureau of International Narcotics and Law Enforcement Affairs, 2014 International Narcotics Control Strategy Report.

[451] Bureau of International Narcotics and Law Enforcement Affairs, *2015 International Narcotics Control Strategy Report*.

Money laundering in Peru

The recently introduced improvements of national laws regarding money laundering were described as rather rudimentary steps in October 2015.[452] The existence of major challenges had been confirmed by Peru's Justice Minister in 2012, when he revealed that the country had no standing convictions for money laundering. Of the roughly 120 cases investigated by the competent authorities, only four had resulted in judicial proceedings at this stage. A commission had been set up within the Justice Ministry to work on new laws to combat the crime.[453] These efforts seem to have paid off a little bit. In 2013, 238 money laundering prosecutions were reported (though no convictions), and by 2014 there were 158 ongoing criminal prosecutions and two convictions for money laundering.[454] Nevertheless, the latest GAFILAT progress report notes that a number of key FATF recommendations were only partially complied with, and some were not complied with at all.[455]

In May 2015, it was announced that the Peruvian government was planning to step up the fight against money laundering further by bringing more transactions into the financial system. Peru's Financial Intelligence Unit, the 'Unidad de Inteligencia Financiera del Perú' (UIF-Peru), was to present a bill to congress in June 2015 that aims to make it mandatory that purchases of properties above a set value are made via banks. Inspired by similar rules in Mexico, UIF is proposing that all transactions above $40,000 be made via bank deposit. Such legislation would also help to reduce the large amount of cash that is still used in Peru.[456]

The UIF-Peru is a specialised unit of the Peruvian Regulator for Banks, Insurance Companies and Pension Funds (SBS). It is responsible for receiving, analysing, processing, and transmitting relevant information in order to detect money-laundering and/or the financing of terrorism. It also contributes to the implementation of specialised systems by the individuals or organisations covered by the AML and/or counter terrorist financing legislation in order to detect operations of money laundering and/or financing of terrorism. The main national legislation and rules are:

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[452] See http://www.insightcrime.org/news-briefs/peru-tackles-money-laundering-currency-exchange.

[453] See http://www.andina.com.pe/agencia/noticia-estado-dara-fuertes-golpes-contra-lavado-activos-este-ano-anuncia-ministro-jimenez-398125.aspx.

[454] Bureau of International Narcotics and Law Enforcement Affairs, *2015 International Narcotics Control Strategy Report, Volume II Country Database*.

p. 354. The low number of convictions might have to do with the fact registrations are done under a different predicate crime; there exists no common database tracking money laundering convictions (*Ibid.*, p. 355).

[455] GAFILAT, *Informe de Avance de la Evaluación del Perú. Seguimento Intensificado*, GAFILAT 15 I GTEM 4.5, 2015. The report notes that 44% of reported suspicious transactions stem from banks, and 30% from notaries, p. 10.

[456] Until now, it is possible to buy a house for $1 million without the transaction going through the financial system, UIF-Peru's deputy director Sergio Espinosa told state news agency Andina.

- Resolution CONASEV No. 033-2011-EF of 9 May 2011, amended by Resolution SMV No. 007-2013-SMV-01: Regulation relating prevention of money laundering and terrorism financing;
- Supreme Decree No. 057-2011-PCM of 30 June 2011: National Plan to Combat Money Laundering and the Financing of Terrorism and the Creation of the Executive Multi-sectoral Commission against Money Laundering and Terrorist Financing;
- Legislative Decree No. 1106 of 19 April 2012: Legislation to Fight against Money Laundering and other crimes linked with Illegal Mining and Organised Crime. This decree empowers the FIU and SBS to freeze bank accounts in cases suspected of links with money laundering or terrorist financing within 24 hours of a request made by a judge, regardless of whether a criminal case was filed and allowing for the enforcement of UN sanctions. The FIU successfully requested a complementary bill that provides more legal clarity in the implementation of this authority.
- Supreme Decree No. 093-2012-PCM: Regulation of Legislative Decree No. 1104;
- Resolution SBS No. 8930-2012 of 28 November 2012: Regulation of Infractions and Sanctions relating to the Prevention of Money Laundering and Financing of Terrorism;
- Resolution SBS No. 5709-2012 of 10 August 2012, amended by Resolution SBS No 4034-2013: Special regulation relating to prevention of money laundering and terrorism financing applies to notaries;
- Law No. 30077 of 20 August 2013: Law against Organised Crime. It reflects international standards and allows police to seize assets linked to organised crime without the prior approval of a prosecutor, which reduces the likelihood of pre-emptive criminal asset removal.[457] On 1 July 2014, implementing regulations were put into effect, removing obstacles that had impeded investigations to prosecute organised crime and money laundering. The new regulations allow for heavier sentencing, they establish modern investigative techniques, and redirect all cases involving organised crime to the National Superior Criminal Court.[458]
- Resolution SBS No. 6729-2014 of 13 October 2014 expands the list of entities and persons that must now report to the UIF.[459] In the 2015 GAFILAT progress report, it is noted that UIF has a lack of human and logistical resources appropriate to adequately perform its supervisory powers.[460]

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[457] Bureau of International Narcotics and Law Enforcement Affairs, *2014 International Narcotics Control Strategy Report.*

[458] Bureau of International Narcotics and Law Enforcement Affairs, *2015 International Narcotics Control Strategy Report*, p. 354.

[459] Activities to be reported: the trade and/or rental of machinery and equipment that can be used for illegal mining and/or logging, the production and/or trade of chemicals and controlled substances/goods, agencies and non-governmental organisations that receive donations, and the sale and/or trade of vehicles, currency, construction, jewellery, art, real estate, and pawned goods.

[460] GAFILAT, *Informe de Avance de la Evalución del Perú. Seguimento Intensificado*, GAFILAT 15 I GTEM 4.5, 2015, p. 3.

- Resolution SBS No. 2660-2015 of 18 May 2015 approving the 'Regulation of Risk Management of Money Laundering and Financing of Terrorism', which took effect on 1 July 2015. This Regulation incorporates rules for financial companies supervised by the SBS, representing the most important sector among remittance of funds, and includes rules on beneficial ownership.

The Latin American Debt, Development, and Rights Network (LATINADD) estimates that the $9.1 billion that left Peru between 2002 and 2011 can be attributed to the illegal activities. From these statistics, an average rate of $910 million can be attributed to the amount "lost" to the nation's GDP annually. Taking into account Peru's annual GDP of $368 billion, the average amount lost equates to 0.25% of the GDP. According to LATINADD's study, illegal transnational movements (bribes, drug trade, and tax evasion by large companies) in Peru amounted to $5.9 trillion during the cited decade.[461]

Peru's bank secrecy law remains a primary obstacle to effective investigation and enforcement. The National Plan emphasises the importance of adopting legislation that allows the SBS and FIU to have greater access to bank and tax records. In 2013, the Peruvian Congress rejected a bill intended to reduce banking secrecy and provide authorities with greater access to bank and tax records; bank secrecy continues to be a highly-sensitive issue. In August 2013, new implementing regulations were passed that allow the Peruvian Customs and Tax Authority (SUNAT) to seize cash holdings above $30,000 from individuals crossing the border. SUNAT is required to immediately inform the FIU of the seizure, and the owners of the seized currency have 72 hours to submit evidence to the FIU that the cash is of licit origin. The FIU can now initiate investigations on suspicious electronic transactions over $10,000.

A U.S. report from 2015 summarises the situation as follows: Peru should recognise the 'growing threat of money laundering and associated crimes' and allocate sufficient resources to its existing AML/CFT infrastructure. The report concludes that, '[m]ost importantly, the political will must be developed to aggressively recognize, investigate, and prosecute money launderers'.[462]

2.5.3.2 Tax evasion and elusion

Tax evasion and elusion in Colombia

Colombia's tax system has been criticised for its 'low efficiency, inequality, and an inefficient tax collection system, with high levels of tax evasion'. The intake was described as 'poor, which suggests that few people or companies pay taxes'.[463] The OECD has recommended strengthening the tax administration and increasing penalties in order to reduce tax evasion in

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[461] A. Rivera , 'Over US$ 9 Million Leaves Peru Illegally Each Year', Peru this week (website), 12 October 2014.

[462] Bureau of International Narcotics and Law Enforcement Affairs, *2015 International Narcotics Control Strategy Report*, Volume II Country Database, p. 356.

[463] *OECD Investment Policy Reviews: Colombia 2012*, Paris, 2012, p. 64.

January 2015.[464] Unlike other jurisdictions, Colombian tax law 'did not provide for general tax-avoidance rules; rather, it has adopted a limited number of anti-avoidance provisions, whose main purpose is to address specific situations concerning the shift of income to foreign jurisdictions (especially tax havens) (…) and the transfer of assets for less than their fair market value'.[465] Regulatory reforms to improve the system are ongoing. Colombia is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, and was peer reviewed twice. In the latest report from 2015, the country was assigned the rating 'compliant' for nine out of ten elements, and 'largely compliant' for the remaining element.[466]

As of 1 January 2013, a general anti-avoidance rule applies which introduces the substance over form principle. This rule allows the Colombian tax authorities to disregard or re-characterise a transaction in cases where an abuse is present. Other main aspects include:

- Colombia's transfer pricing rules require that taxpayers follow the arm's length principle in transactions between Colombian taxpayers and foreign related parties. Such transactions must be valued according to reasonable prices in normal market conditions, such as between independent parties. In controlled transactions, Colombian law specifies that when the tax authorities conclude that the pricing is not set at arm's length, adjustments can be made.
- Parties are deemed to be related if there is any subordination of control, or if they are members of the same economic group within the meaning of the Tax and Commercial Codes. Control can be individual or joint, without any participation in stocks or by a principal head office established abroad.
- Taxpayers are obligated to maintain records of all transactions involving non-resident related parties for five years. They annually must report to the tax authorities all transactions with such parties that meet certain thresholds.

In December 2014, a new tax bill proposed to introduce administrative sanctions instead of criminal penalties for tax evasion. It appears the bill was not passed, however.[467]

[464] *OECD*, *Economic Survey of Colombia 2015*, Paris, 2015.

[465] *Ibid*., p. 66.

[466] OECD, *Peer Reviews: Colombia 2015: Phase 2: Implementation of the Standard in Practice*, OECD Publishing, Paris, 2015.

[467] KPMG, 'Investment in Peru 2015', p. 26 explains that punishment for fraudulent tax evasion can involve up to 12 years imprisonment.

Box 10 Colombia/Peru and the combat against money laundering and tax evasion

- The lack of convictions for money laundering and tax evasion in both Colombia and Peru and the size of drugs related crimes demonstrate that there are large challenges in these countries.
- The first two money laundering crime convictions ever to be handed down in Peru stem from 2014.
- Instead of general tax-avoidance rules, until recently Colombia only had a limited number of anti-avoidance provisions addressing specific situations.
- The drop in money laundering as percentage of Colombia's GDP in the period 2000-2013 is said to be due to a U.S. backed security package.

Tax evasion and elusion in Peru

The effectiveness of the national laws of Peru on tax evasion and elusion has been described as uncertain.[468] The Peruvian Customs and Tax Authority (SUNAT) reported that $105 million in taxes went unpaid in 2013. International transfers are expected to be responsible for much of the manipulation, as international funds are able to enter tax free or with low rates.[469]

Decree Legislative 1121 of 18 July 2012 introduced, through provision XVI of the Tax Code's preliminary title, a regulation against tax evasion in Peru. In this regard, the national Tax Administration of Peru has been granted authority to claim a tax debt or reduce the amount of deductions or credits in favour of the taxpayer, in the event the administration detects tax evasion.

Transfer pricing rules are based on the arm's length principle as interpreted by the OECD. However, in Peru these rules not only apply to transactions between related parties (both domestic and cross-border) but also to transactions with companies resident in tax havens. Moreover, they must be considered only for income tax purposes, not for Value Added Tax purposes. Taxpayers must carry out an independent transfer pricing study to support the value of their transactions with related parties. Moreover, the taxpayers are obliged to submit a Transfer Pricing Return informing the type of transactions performed with related parties or companies resident in tax havens.

The following situations, among others, are not considered as permanent establishments in Peru: (i) using facilities destined solely to store or display goods or merchandise which belongs to a company, corporation, etc. from abroad; (ii) maintaining a place or location destined solely

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[468] See http://www.business-anti-corruption.com/country-profiles/the-americas/peru /show-all.aspx.

[469] A. Rivera, 'Over US$ 9 million leaves Peru illegally each year', Peru this week (website), 12 October 2014.

to the purchase of goods or merchandise to supply a foreign entity; and (iii) maintaining of a place or location destined solely to the conduction of activities of a preparatory or ancillary nature.

Like Colombia, Peru is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes. As the country only joined recently, it has not yet been peer-reviewed.

2.5.4 Concluding remarks

The scope of the services provisions in the EU-Colombia/Peru Trade Agreement is broad. Services in general are broadly defined, and so are financial services. Virtually all services are included with a few selected exceptions, such as services provided by public entities. It was noted that in some aspects, more services are liberalised in this agreement than in some other EU agreements with trade partners, notably with Korea. This is because of the fact that the latter agreement only liberalises financial transfers related to trade, loans and investments, whereas the EU-Colombia/Peru Agreement liberalises all current account transfers. Given the challenges related to effectively implementing FATF recommendations in Colombia and Peru, and the low number of convictions for money laundering in these countries, a more prudent approach to liberalisation and/or more safeguards or measures aimed at encouraging cooperation between the parties to the agreement would seem necessary.

Where tax evasion and elusion are concerned, the Trade Agreement contains a clause allowing parties not to disclose information about customers in the financial sectors. This does not seem supportive of actions to tackle money laundering, tax evasion and avoidance, for which (automatic) information exchange across borders is essential. It also seems to run counter to what is recommended in several of the international standards for regulation and supervision in the financial services sector that the parties promised to implement and apply. The latter promise is worded in a rather weak manner. Parties are merely required to 'take note' of the relevant international principles and standards of the G7, G20 and OECD. This wording is even weaker than a 'best endeavour' clause like the one included in other agreements. Article 155 does demand that parties make their 'best endeavours to ensure' that international standards for regulation and supervision in the financial services sector and for the fight against money laundering and the financing of terrorism are implemented and applied in its territory.

Furthermore, Colombia and Peru both allow for the establishment and cross-border supply of tax advisory services from EU countries. In Colombia, the tax law seems to have deficiencies, notably where it concerns the absence of general tax-avoidance rules and the reliance on a limited number of anti-avoidance provisions addressing specific situations. Furthermore, a systemic lack of effectiveness seems to be at hand. Reforms to remedy these deficiencies are ongoing. In Peru, tax law probably could also be improved and similarly seems to suffer from a systematic lack of effectiveness.

Despite the willingness of Colombia's government to fight AML/CFT, the law seems to experience a lack of effectiveness. The challenges are still acute, although slightly decreasing since 2000, through, *inter alia*, the help of U.S. support. The 2010-2013 numbers of prosecutions

and convictions for money laundering crimes in Colombia showed a declining number of convictions: 2010 – 115 prosecutions, 95 convictions; 2012 - 97 prosecutions, 80 convictions; and 2013 - 67 prosecutions, 8 convictions. Convictions picked up in 2014 - 46 prosecutions, 57 convictions.

In Peru, the situation seems even more challenging. While the AML/CFT infrastructure is taking shape, it lacks resources, knowledge and the political will to recognise, investigate and prosecute money launderers. As a result, prior to 2012 there had been no convictions for money laundering crimes in Peru. The situation has improved only slightly since then. In 2013, 238 money laundering prosecutions were reported (though no convictions), while in 2014 the first two money laundering convictions were reported, in addition to 158 prosecutions. The issues of effectiveness and enforcement are dealt with in more detail in the empirical part of this study.

2.6 Key Findings of the Comparative Legal Analysis

This chapter provides an analysis of the legal provisions relevant to financial services included in the five FTAs that the EU has concluded with Mexico, South Africa, Serbia, Korea and Colombia/Peru. The domestic legislation of these countries in the relevant fields has also been examined, and some preliminary facts were added regarding the enforcement or lack thereof in practice, including the number of convictions for money laundering. In light of this examination, the following key findings from the comparative analysis can be presented.

2.6.1 Key findings concerning the legal frameworks of EU FTAs

- The EU-Serbia Agreement seems to lay down the most far-reaching obligations in all sectors analysed. This is perhaps unsurprising given that Serbia is an EU candidate country on its way to accession. The strong wording of the Agreement – mirrored by the relatively advanced stage of Serbian legislation – is therefore inextricably intertwined with the specific situation of Serbia in its relations with the EU. However, as we shall see in the conclusions of this study, this does not necessarily exclude that some features of the EU-Serbia Agreement cannot be replicated in Agreements concluded with non-candidate countries.
- The degree of sophistication of the Agreements in question is inversely proportional to their lifespan. The older the Agreement, the weaker the obligations contained therein. Older Agreements like the one between the EU and Mexico and the EU and South Africa lay down only very weak and vague obligations in virtually all parts relevant to this study. Newer agreements contain in principle more detailed language. One notable exception seems to be the EU-Colombia/Peru Agreement, which, despite its recent conclusion, only contains vague obligations.
- The scope of the Agreements is quite broad. All of them contain broad definitions of financial services and financial services suppliers, covering virtually all the major existing financial services, including banking and insurance. The scope of the EU-South Africa Agreement appears somewhat more limited.
- Despite the previous point, all Agreements also contain prudential carve-outs, leaving the supply of some services outside the scope of the Agreements, at least under certain circumstances. Typically, such carve-outs are connected with public policy considerations, as in the case of monetary or balance of payments difficulties.
- Taxation measures are generally excluded from the scope of the Agreements.
- All Agreements establish one or more governing bodies responsible for the supervision and implementation of their respective Agreement. All of them, on the EU side, include representatives of the Council and the European Commission. The European Parliament is not directly involved.
- There is no direct correspondence between the degree of sophistication of the Agreements and the degree of advancement of the domestic legislation of the countries involved. For example, while the EU-Mexico Agreement is relatively rudimentary, Mexican legislation appears to be quite advanced in many of the fields examined.
- All countries analysed have undertaken – although to a different extent –– significant efforts in recent years in the attempt to improve their legislation and create a legal environment more amenable to business and investment while tackling illicit capital

flows. However, there is no clear relation, or at least no evidence thereof, between such efforts and the conclusion of the Agreements with the EU.

- Serbia stands as an exception to the above. As far as this country is concerned, the Agreement with the EU and EU action in general has directly occasioned the reforms undertaken by this country.
- When it comes to transparency, tax evasion and money laundering, the EU-Colombia/Peru, EU-South Africa and EU-Mexico Agreements contain only minimal obligations, mostly in the form of 'best endeavours' obligations or, even worse, 'willingness' obligations, which use vague language such as 'the Parties take note of' internationally agreed standards.
- The EU-Korea and EU-Serbia Agreements are quite detailed and far-reaching in prescribing observance of international standards.
- In line with the need for consistency in its external action as set out in Article 21(3) TEU, the new role of the European Parliament regarding international trade and investment agreements and the new *Trade for All* strategy, the Commission should submit annual reports to the European Parliament and the Council not only on the implementation of the EU-Colombia/Peru and EU-Korea trade agreements, but also on the older trade agreements with South Africa and Mexico. In the same vein, the European Parliament should have an opportunity to hold an *ad hoc* meeting of its responsible committee with the European Commission within 1 month from it publishing these reports in order for the European Commission to explain any issues related to the implementation of these agreements.
- The existing annual reports from the Commission lack information on the implementation of the provisions on financial services, money laundering and tax evasion. Such reports should provide detailed information on these issues using the example of assessments of the trade and sustainable development chapters in the existing annual reports on the EU-Colombia/Peru and EU-Korea trade agreements.

2.6.2 Key findings concerning third-country implementation of EU FTAs

- All country reports reveal a certain level of compliance with international and European standards in the area of AML and tax evasion.
- South Africa has made significant progress in in improving its AML/CFT legal and institutional framework. However, significant shortcomings remain, such as legal requirements pertaining to the identification of beneficial owners and the lack of application of enhanced due diligence to high risk situations.
- Recently introduced amendments of Peru's national laws regarding money laundering have been described as rather rudimentary steps. More resources are needed to improve the existing AML/CFT infrastructure, as is real political commitment to investigate and prosecute money launderers.
- Korea is committed to continuous improvement of its AML legislation within the framework of FATF review.
- Almost all domestic jurisdictions analysed – with the notable exception of Korea – are considerably affected by poor implementation of the law, albeit to a different extent and for different reasons. While in Mexico, for example, a low level of law enforcement

seems mainly connected with endemic levels of corruption, in Serbia the main cause seems to be the weak capacity of the Serbian administration. This issue is further elaborated in the empirical part of this study.

- Among the countries examined, Peru, Colombia and Serbia are neither members nor observers of FATF, which is the key international body that sets AML/CFT standards and reviews how its members implement them. However, Peru and Colombia are members of GAFILAT, whose activities fall under the auspices of FATF. Serbia is engaged in other forms of international cooperation in the field of money laundering, such as the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism – MONEYVAL.
- South Africa was in majority 'compliant' or 'largely compliant' with the Basel Core Principles. With regard to supervision of the insurance sector, considerable room for improvement still exists. A major reform of the supervisory system of the financial sector is expected to further address shortcomings in both banking and insurance supervision by the end of 2016 or early 2017.
- Serbia's main problem seems to be its tax legislation and administration. In particular, it seems that the country suffers from structural systemic inefficiencies in this sector, which is mirrored by its relatively scarce involvement in international initiatives concerning tax evasion and avoidance.
- Although Korea has scored high on its compliance level with the Basel Core Principles, important challenges remain. These include: mitigating the risks of politicisation of the leadership positions of the FSC and FSS; and deepening the engagement in cross-border cooperation activities by exploring exchange of understanding of supervisory issues at operational levels and contingency planning.
- Unlike other jurisdictions, Colombian tax law did not provide for general tax-avoidance rules. Rather, it consisted of a limited number of anti-avoidance provisions, addressing specific situations, notably concerning the shift of income to foreign jurisdictions. Regulatory reforms to improve the system are ongoing.
- Mexico has the lowest tax revenue to GDP among the 34 OECD Member States, way below the OECD average. Korea is also low on the OECD list. As non-OECD countries, Colombia and Peru are not represented in the OECD lists, but it seems that challenges with tax revenues also exist there.
- Peruvian bank secrecy law constitutes a serious obstacle for information exchange and, as a result, the fight against illicit capital flows.
- Human resources of the Korean supervisory authorities need to be strengthened in view of the increase of STRs and law enforcement activities. More contextual details about and systematic retrieval of law enforcement activities would improve understanding of the AML activities in Korea.

2.6.3 Concluding remarks

As the findings outlined above demonstrate, all Agreements possess deficiencies and could benefit from improvements. This is especially true for the older ones, such as the EU-Mexico and EU-South Africa Agreements. The examination of the domestic jurisdictions of all the third countries examined has also brought into the open structural weaknesses that ought to be corrected. It is true that the EU's power to influence third countries is limited for obvious

reasons, not least because of the international law obligation not to interfere with their sovereignty. It is also clear, however, that at least some degree of influence can (lawfully) be exercised through the conclusion of trade instruments. The EU-Serbia Agreement has clearly demonstrated this. Elements of the EU's approach taken in this agreement could also be useful elsewhere. The concluding part of this study will provide some policy recommendations focused on how to improve EU external trade instruments in order to combat money laundering, tax evasion and elusion. It will also build on the findings of the empirical part of this study.

Part 3: Empirical Analysis – Effects of Liberalisation of Financial Services between the EU and Third Countries on Money Laundering, Tax Evasion and Elusion

3.1 Introduction

After having looked at the selected EU Free Trade and Association Agreements (FTAs) from a comparative legal perspective, we now turn to the empirical analysis of the effects of the liberalisation of trade, particularly in financial services, envisaged by these agreements on money laundering, tax evasion and elusion in third countries. Given that financial services are the focus of the present study, the empirical investigation concentrated on money laundering, due to its close connection with the use of the international financial system with a view to concealing the proceeds of crime. Notably, tax evasion has been considered insofar as it constitutes an aspect of money laundering.[470]

In the course of the empirical study, the research team examined whether the conclusion of the EU FTAs has increased the threat of money laundering facing, respectively, Mexico, South Africa, Serbia, Korea and Colombia/Peru. In particular, the team focused on the effects of the liberalisation of financial services under the EU FTAs in this area. In light of the findings concerning a similar impact of the North America Free Trade Agreement (NAFTA), which liberalised trade in goods and services between Canada, Mexico, and the United States,[471] the study started from the hypothesis that the conclusion of the EU FTAs has increased the risk of money-laundering facing the above-mentioned third countries.

The chosen methodology, as elaborated in the introduction to this study, allowed the research team to: (a) establish to what extent the existing data concerning the impact of the liberalisation of financial services under the selected EU FTAs on money laundering between the EU and third countries are comprehensive and identify gaps in evidence; and (b) determine whether the hypothesis concerning the negative effects of the EU FTAs in these areas holds.

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[470] The interplay between money laundering and tax evasion has been largely unexplored. According to Unger, for example, the relationship between the two is precarious: 'Tax evasion can be part of fiscal or financial fraud, which constitutes a predicate crime for money laundering in most countries. However, when looking at legal definitions of money laundering and at law enforcement in different countries, one can see that a large part of tax evasion is often excluded from the money laundering definitions or from enforcement.' See B. Unger, 'The gravity model for measuring money laundering and tax evasion.' Paper prepared for the Workshop on Macroeconomic and Policy Implication of Underground Economy and Tax Evasion, February 5-6, 2009 at Bocconi University, Milan Italy, available at: http://www2.econ.uu.nl/.../ unger/.../Unger%20for%20BUSATOconference.doc.

[471] D. Kar, Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy, Global Financial Integrity, 2012, available at: http://www.gfintegrity.org/wp-content/uploads/2014/05/gfi_mexico_report_english-web.pdf, points to a substantial increase in illicit financial flows from Mexico after the implementation of NAFTA.

It should be noted from the outset that the study has revealed a lack of statistical data pointing to a causal link between the conclusion of the EU FTAs and an (increase in) illicit financial flows between the EU and third countries. This finding emerged from the analysis of the existing data concerning the illicit financial flows and it was also confirmed by all the respondents involved in the study. At present, there are no exact statistical estimates of illicit financial flows affecting each developing country in general either. In view of the complexity involved in calculating how much money is being laundered and a lack of consensus as to how this should be done, such estimates vary and are heavily debated.

The hypothesis that the conclusion of the EU FTAs has increased the threat of money laundering facing the third countries in question cannot therefore be verified by precise statistical estimates. However, this does not mean that the hypothesis is false as far as the five developing countries in question (i.e. Mexico, South Africa, Serbia, Colombia, and Peru) are concerned. In fact, as will be shown below, the available data provide a strong indication that the liberalisation of trade in goods and services, including financial services, between the EU and developing countries increases the threat of money laundering faced by these countries. At the same time, the available data does not support this conclusion with regard to Korea.

In order to present our argument in the context of the major findings from the empirical study, this part of the report will be structured as follows. First, it will discuss the concept of illicit financial flows, which is key to studying the impact of the EU FTAs on money laundering and their potential scale as well as the complexity involved in defining and estimating such flows (sections 3.2 and 3.3). Particular attention will be given to the role of the EU FTAs in fostering illicit financial flows from developing countries. Subsequently, the analysis will turn to the impact of illicit financial flows on developing countries (section 3.4) and the causes of such flows (section 3.5). This part of the report will conclude with a summary of the key points concerning the effects of the liberalisation of trade envisaged by the selected EU FTAs on money laundering in the developing countries in question (section 3.6).

3.2 Defining Illicit Financial Flows

3.2.1 Illegal or illicit?

The concept 'illicit financial flows' (IFFs) is central to the study into the effects of the EU FTAs on money laundering in the developing countries parties thereto. After all, in order to be able to estimate such flows and establish a possible link with the EU FTAs, they first need to be defined. The concept of 'IFFs' has emerged relatively recently, reflecting a growing concern about the apparent abuse of the international financial system by money launderers from developing countries.[472] The IFFs are most commonly defined as money (understood as funds or assets) illegally earned, transferred, or used. However, while the term 'IFFs' is increasingly used, at present there is no general consensus on its precise meaning. The ongoing international debate largely focuses on where to draw the line between *legal* and *illicit* flows.

[472] See, in particular, R.W. Baker, Capitalism's Achilles Heel: Dirty Money and How to Renew the Free Market System, New Jersey: John Wiley & Sons, Inc, 2005.

According to a legal conception of IFFs, the latter are flows that are *illegal* under formal law. The focus on activities that have a clear connection with illegality is reflected, for example, in the definition of IFFs provided by Kar and Cartwright-Smith from the GFI – a leading international non-profit organisation in the field of research into IFFs from developing countries:

'Illicit financial flows involve the transfer of money earned through activities such as corruption, transactions involving contraband goods, criminal activities to shelter wealth from a country's tax authorities. Such flows may involve funds from a country's tax authorities. Such flows may also involve funds that were earned through legitimate means. It is in transferring earned funds in direct contravention of applicable capital controls that the transfer becomes an illicit flow, regardless of the fact that the funds were earned in a legitimate activity.'[473]

A similar definition of IFFs has been advocated by the World Bank Group and the High Level Panel on Illicit Financial Flows from Africa that also place emphasis on activities that are *illegal* under national laws.[474] This implies that what constitutes 'illicit financial flows' will vary from country to country, given the differences in national legal frameworks.

The legal definition of IFFs generally covers the illegal practices of money laundering, focusing on two major sources of such flows: 1) proceeds of criminal activities (for example, corruption or organised crime); and 2) legally generated revenue and income that become illegal either because of their transfer (for example, tax evasion in breach of tax laws) or use (for example, for terrorism financing).

An alternative view advocated by a number of academics and non-governmental organisations in the context of IFFs affecting developing countries is that the IFFs should be understood in a broader sense, covering not only formally illegal but also immoral activities. The proponents of this conception of IFFs criticise the legal definition for being too restrictive, given its emphasis on the formal law, regardless of whether the regime enacting the law is socially legitimate. According to Everest-Phillips, for example:

'International capital transfers become illicit if they originate from an illegal source (evasion, corruption, or criminality) or are illegal by bypassing capital controls, but also *immoral in undermining the state's willingness and capacity to deliver better lives for its citizens*.'[475]

In the same vein, recognising that the term 'illicit' has strong moral undertones, Blankenburg and Khan use the concept 'illicit capital flows' and point to an underlying concern with

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[473] D. Car and D. Cartwright-Smith. 2008, *Illicit Financial Flows from Developing Countries, 2002-2006*.

[474] See respectively: World Bank Group, *Illicit Financial Flows (IFFs)* and High Level Panel on Illicit Financial Flows from Africa, *Illicit Financial Flows: Track It! Stop It! Get It!*.

[475] M. Everest-Phillips, The Political Economy of Controlling Tax Evasion and Illicit Flows, in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, Washington, World Bank, 2012 (emphasis added).

developmental damage that particular capital flows can inflict. In this context, they provide the following extensive definition:

'[A]n illicit capital flow (…) [is] a flow that has a negative impact on an economy if all *direct* and *indirect* effects in the context of the *specific political economy* of the society are taken into account. Direct effects refer to the immediate impact of a particular illicit capital flow on a country's economic growth performance, for example, through reduced private domestic investment or adverse effects on tax revenue and public investment. Indirect effects are feedback effects on economic growth that arise from the role played by illicit capital flows in the sustainability of the social and political structure and dynamics of a country.'[476]

Obviously, by extending its scope, the morality-focused definition of IFFs could include not only business practices related to money laundering and tax evasion, but also practices associated with tax elusion which do not fall under the legal definition of IFFs. Such practices may include, for instance, those aimed at reducing tax liability and diminishing country revenue – such as tax holidays or transfer pricing – which are legal as such, but may nevertheless be economically damaging for developing countries.

3.2.2 Money laundering

Given the focus of the present study on the relationship between the liberalisation of *financial services* between the EU and third countries, on the one hand, and the IFFs, on the other, money laundering deserves particular attention in this context. This is due to its close connection with the use of the international financial system with a view to concealing the proceeds of crime and making illegal money appear legal. Traditionally, money laundering involves the following three phases (see Box 11).

[476] S. Blankenburg and M. Khan, 'Governance and Illicit Flows', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, Washington, World Bank, 2012.

Box 11 Traditional money laundering process

Phase 1: Placement

In the first phase the criminal money that was collected, for example through drug sales on the street, is placed in a financial institution. This first phase, of bringing cash to some financial institution, is called the placement phase (or the pre-wash phase).

Phase 2: Layering

After the 'dirty money' is integrated into the financial system, the second phase, the layering or main wash, starts. The money gets transferred to the bank account of company X, is then sent via a wire transfer to an offshore centre corresponding bank at, say, the Seychelles. The Seychelles bank gives company Y a loan, which pays for a false invoice from company X. So now the origin of this money, namely company X itself, is not easily traceable anymore. The more often the money gets transferred around the globe in the layering phase, the less traceable its criminal origins are.

Phase 3: Integration

The third phase consists of integrating the now clean money. This after wash phase includes the purchase of luxury commodities, assets, making financial investments or buying companies.

Source: B. Unger, *The Scale and Impacts of Money Laundering*, Cheltenham/Northampton: Edward Elgar, 2007, p. 89.

As this description of the money laundering process shows, the financial sector can play a major role in all three phases involved therein. In fact, each phase knows its own money laundering techniques, ranging from the use of wire transfers or electronic banking to move funds into the banking system to the purchase of securities or insurance policies to facilitate fund transfers.[477]

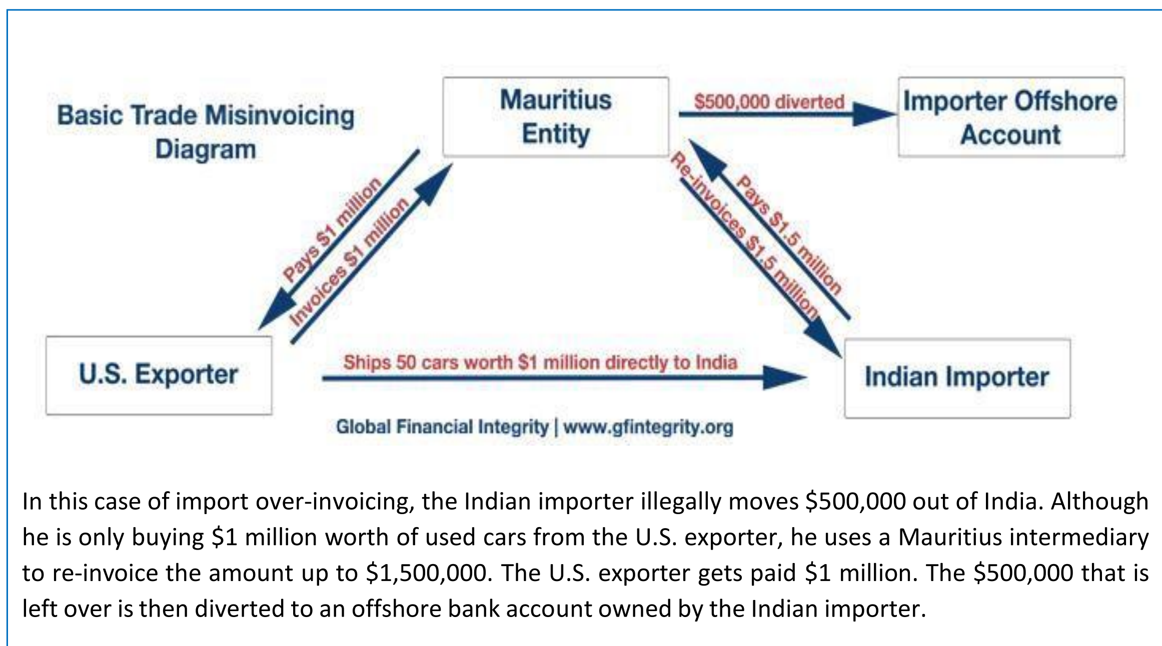
Corresponding banking has proved to be particularly vulnerable for the misuse by money launderers in the international context.[478] Such banking implies that one bank (the 'correspondent bank') carries out financial transactions for the clients of another bank (the 'respondent bank'). By establishing corresponding banking networks at the international level, banks are able to provide financial services in countries where they do not have offices. However, when doing so, correspondent banks have to rely on the respondent banks to perform all the necessary client checks. This can pose serious problems with regard to 'know your customer' rules, given that in some jurisdictions such rules or their application in practice can be much more lax than in others.

[477] B. Unger, *The Scale and Impacts of Money Laundering*, Cheltenham/Northampton, Edward Elgar, 2007, p. 89 *et seq*.

[478] B. Unger, *The Scale and Impacts of Money Laundering*, Cheltenham/Northampton, Edward Elgar, 2007, p. 93 *et seq*.

Money laundering by making use of the official financial sector, which is central to this study, is also known as 'money laundering through the front door'.[479] However, it should be noted that money laundering increasingly takes place 'through the back door', i.e. by mispricing internationally traded goods and services.[480] Trade-based money laundering was defined by the FATF as 'the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins'.[481] By fraudulently manipulating the price, quantity, or quality of a good or service on an invoice, criminals can transfer significant amounts of money across international borders. Mispricing occurs in two major forms: (1) overvaluing imports; and (2) undervaluing exports – both of which also allow taxes to be evaded. How this works is further illustrated in Box 12.

Box 12 Trade-based money laundering



In this case of import over-invoicing, the Indian importer illegally moves $500,000 out of India. Although he is only buying $1 million worth of used cars from the U.S. exporter, he uses a Mauritius intermediary to re-invoice the amount up to $1,500,000. The U.S. exporter gets paid $1 million. The $500,000 that is left over is then diverted to an offshore bank account owned by the Indian importer.

Source: Global Financial Integrity, *Trade Misinvoicing*.

As will be shown in section 3.3 below, money laundering through the international financial system and money laundering through the mispricing of trade transactions constitute two major channels through which capital can illicitly flow in or out of a country.

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479 J. Zdankovich, 'Detecting Money Laundering and Terrorist Financing via Data Mining', 47 *Communications of the ACM* (2004), p. 53.

480 J. Zdankovich, 'Detecting Money Laundering and Terrorist Financing via Data Mining', 47 *Communications of the ACM* (2004), p. 53.

481 Financial Action Task Force, *Trade Based Money Laundering*, Paris, France, Financial Action Task Force (FATF), June 23, 2006), p. 3.

3.2.3 Outflows and inflows of illicit money

It is important to bear in mind that IFFs can manifest themselves as *outflows* and *inflows*. The term 'illicit financial outflow' refers to a situation when the laundered money is transferred out of a country by its recipient. This term implies that there is not only a source of illicit money but also a destination where it is going to.

Illicit money coming out of developing countries generally flows into developed countries, particularly in North America and Europe. Thus, for example, according to the GFI's case study on Mexico – the associated EU FTA became operational concerning trade in services in 2001 – over a 41-year period from 1970 to 2010, the cross-border holdings of bank deposits reported to the Bank for International Settlements (BIS) show that the United States, offshore financial centres or tax havens in the Caribbean, and tax havens in Europe listed as such by the International Monetary Fund (among which are Luxembourg and Switzerland) are the three top destinations for Mexican private sector deposits.[482] What is more, the next most favoured destination for such deposits is the group of banks in developed European countries (among them are Austria, Belgium, France, Germany, the Netherlands, and the United Kingdom).[483] Deposits in these banks more than doubled from $1.2 billion in 2002 to $3.0 billion in 2010.[484] In fact, as the recent study into the economic and legal effectiveness of AML and combating terrorist financing policy for the European Commission has found:[485]

'[T]he threat of money laundering is greatest in the United Kingdom, Luxembourg and other west-European countries, as a result of their relatively sophisticated financial markets, their relatively high GDP per capita levels, their trade, as well as cultural links to a wide range of proceeds of crime-generating countries. Hot money will generally flow from eastern Europe to the west, and from the rest of the world to Europe's financial centres, in search of safer havens for investment.'

The case study in Box 13 provides a good illustration of an illicit financial outflow from Mexico to Europe in the context of high-level corruption during the presidency of Carlos Salinas de Gortari (from 1988 to 1994).

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[482] D. Kar, *Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy*, (Global Financial Integrity, January 2012), available at:, p. 45.

[483] D. Kar, *Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy*, (Global Financial Integrity, January 2012), available at: Box 13. Groupings of Deposits from Non-Bank Private Sector in Mexico to Developed Country Banks and Offshore Financial Centers 1.

[484] D. Kar, *Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy*, (Global Financial Integrity, January 2012), available at:, p. 45.

[485] Project 'ECOLEF' *The Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy*' (led by B. Unger): Final Report, Utrecht, 2013, p. 13.

Box 13 Case study 'Illicit Financial Outflows'

'Upon the election of his brother as president of Mexico, Raul Salinas was appointed to several positions, one of which was to manage Conasupo, a store set up to sell basic goods to the underprivileged at subsidized prices. Raul Salinas used this position to create disguised profits that he diverted to himself, often by reporting prices for Conasupo's purchases that were higher than the sums actually paid or by selling subsidized products at market rates. In one case, at an extremely low price, Conasupo imported 39,000 tons of powdered milk contaminated at Chernobyl and then sold the milk to the poor at a profit. In another case, corn provided by the United States for distribution to the poor was sold by Conasupo at market rates; the corn was made into tortillas and sold back to the United States. The hidden profits were then transferred to personal accounts in Mexican banks. Raul may also have profited by financing winning bids during privatisation. An example of this was the government sale of Azteca Television to Ricardo Salinas Pliego through Salinas Associates. Profits from Azteca were used to make payments to Raul, which Pliego claimed were repayments on a loan Raul had made to him to finance the acquisition. The loan was provided at a suspiciously low interest rate. To show that there had been a loan and that the payments were not kickbacks, Raul made payments from his account to finance the loan, in effect showing he was only an intermediary. Raul would deposit the funds into Mexican banks. Then his wife, Paulina, acting under the alias of Patricia Rios, would withdraw the funds and transport them to a Mexican branch of Citibank. This money would be transferred into a mass concentration account used by Citibank to transmit internal funds. A vice-president at the Mexican Division of Citibank would then extract these funds from the concentration account and transfer them to London and Switzerland to Citibank accounts of Trocca, a shell corporation formed by Cititrust in Cayman Islands and controlled by Raul through nominees.

Raul Salinas may have used his influence over two banking groups, Grupo Financiero Probursa and Grupo Finaciero Serfin, both purchased from the Salinas government during privatization, to convince them not to apply extended (or indeed any) due diligence to accounts controlled by him and his confederates (...)'

Source: M. Levi, 'How Well Do Anti-Money Laundering Controls Work in Developing Countries?', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries,* Washington, World Bank, 2012, p. 373, at 394-395.

Conversely, the term 'illicit financial inflow' describes a case when the foreign revenues from illicit activities, such as drug trafficking, are laundered and brought back to a country of their recipient. The following paradigmatic case presented by the Egmont Group of Financial Intelligence Units illustrates how drug traffickers use the international financial system to carry out their activities (see Box 14).

Box 14 Case study 'Illicit Financial Inflows'

'Rick, an American citizen who claimed to be a European, was the key organiser of a group of individuals that used to belong to a larger drug cartel. The majority of the original cartel had been arrested and imprisoned by law enforcement several years previously. Since the destruction of the cartel, Rick had continued to control a significant part of the money raised from the cartels drug trafficking activity, and had used the funds to restart his own drugs trafficking operation on a smaller scale. Furthermore, during his involvement with the original group, Rick had learned several laundering techniques, which were to prove extremely helpful to his plans for his own gang.

The drug money entered the American country in cash shipments by boat or plane. Rick's group received the money in sealed cash bundles, and sought to launder the drug money through a series of layering transactions in several different countries. Following initial cash deposits into a range of bank accounts, Rick facilitated the laundering by authorising an agent abroad to transfer funds from the initial accounts to the personal accounts of a number of intermediaries overseas. The intermediary arranged a back-to-back transfer of the funds back into the country to accounts at the National Central Bank, and obtained authorisation for the fund transfers from that institution. Before the money was transferred back, Rick always called the intermediary again to request a cancellation of the transfer. The intermediary was left with the funds in his or her account. The funds were then withdrawn in cash and wired back into the country to yet other accounts, with the authorisation documentation from the National Central Bank as a prepared explanation of the origin of the funds. The National Central Bank was being used unwittingly to give additional probity to the drugs funds.

Once the funds had been moved through several layering processes, Rick was able to use the monies to purchase real estate. In order to do so, he utilised lawyers, bank managers, and other professionals, paying a commission of between 3 to 5 percent of the value of the transferred money in order to minimise questions. The commission rates were slightly above normal market rates, in order to ensure that the firms concerned welcomed the business. Lastly, Rick did not want the real estate to be registered in his own name, and used a number of other individuals and companies as nominal owners in order to further confuse the money trail – whilst some of these individuals were aware of the criminal source of the funds, a number of other firms were used unwittingly. The use of such financial professionals gave additional probity to the fund movements.

To implement his laundering scheme, Rick used more than half a dozen banks and a wide range of accounts at each institution (…) [I]t was estimated that Rick's scheme had involved a turnover of about US$720,000,000 over a number of years."

Source: *FIU's in action: 100 cases from the Egmont Group*, 2000, case No. 25.

As will be demonstrated in section 3.4 below, both outflows and inflows of illicit capital can have a profoundly negative impact on developing countries and are contrary to the EU Treaty obligation to promote sustainable development and fight poverty in developing countries.

3.3 Estimating Illicit Financial Flows

3.3.1 The complexity of estimating illicit financial flows

While the issue of IFFs is at the forefront of the current international agenda, the exact scale of the problem is unknown. This is not surprising, given a lack of agreement on the meaning of the term 'IFFs' and, even more importantly, because of a great deal of intricacy involved in estimating precisely what is, by definition, a hidden activity. As one of our respondents observed: 'It is true that it is really difficult to monitor illicit flows of money because they tend to be either very difficult to detect or not obviously illicit.'

In order to measure illicit financial flows, and thus the extent of money laundering, several methods have been proposed in the literature. While some methods build upon the economic analysis of statistical discrepancies in official data, others are based on field and case studies.[486]

For example, one method in the former category is to analyse the net errors and omissions in a country's external accounts ('hot money narrow' method or HMN). The net errors and omissions figure balances credits and debits in a country's balance-of-payments account and is supposed to reflect unrecorded capital flows and statistical errors in measurement. A persistently large and negative net errors and omission figure is considered to be an indication of IFFs.

An alternative economic method of estimating IFFs is the World Bank Residual Mode which measures a country's source of funds (inflows of capital) against its recorded use (outflows of capital). Source of funds includes increases in net external indebtedness of the public sector and the net inflow of foreign direct investment. Use of funds includes the country's current account deficit. Under this model, an excess source of funds over the recorded use points to a loss of unaccounted-for capital, and hence, to an IFF.

Yet another important economic method of estimating trade-related IFFs is the Trade Misinvoicing model. This approach involves a double comparison. First, a country's exports to the world are compared to what the world reports as having imported from that country. In addition, a country's imports from the world are compared to what the world reports as having exported to that country. Discrepancies in country-partner trade data, which show over-invoicing of imports and/or under-invoicing of exports, are an indication of IFFs.

These and other economic models that have been developed so far for estimating IFFs have their own serious shortcomings and are generally viewed to be unable to provide precise scientific estimates of IFFs. To use the words of Reuter and Truman, '[t]he review of the (…) methods

[486] For an overview, see, for example, B. Unger, 'Money Laundering – A Newly Emerging Topic on the International Agenda', 5 *Review of Law and Economics* (2009), p. 807; B. Unger, *The Scale and Impacts of Money Laundering*, Cheltenham/Northampton, Edward Elgar, 2007, ch. 3; P. Reuter and E.M. Truman, *Chasing Dirty Money – The Fight against Money Laundering*, Washington, Institute for International Economics, 2004, ch 2.

comes to a simple conclusion: neither yields estimates of the volume of laundered money that can be considered as anything more than an indicative order of magnitude'.[487] While this conclusion was reached in 2004, it still very much holds true today. It is notable that in 2015 Reuter even spoke about 'the failure of the economics profession to engage with such an important and interesting phenomenon [as IFFs]'.[488]

In addition to economic models, several approaches have emerged that attempt to estimate the IFFs based on field and case studies. One such approach is to analyse criminal cases, wherein the proceeds of money laundering have been confiscated, focusing on the amounts of money involved.[489] The main problem with such an approach, however, is that it is unclear to what extent they represent the total money laundering activities in a certain country. After all, many such activities may never result in a criminal conviction.

Another method worth mentioning in this context is to examine unusual or suspicious transactions reported to financial intelligence units (FIUs) established in most countries to monitor and control money laundering. However, this approach is also unable to produce accurate data on the extent of IFFs. Being dependent on the financial and other sectors for information, the FIUs may simply not avail themselves of comprehensive and reliable data. In particular, financial institutions may not only under-report unusual or suspicious transactions, but also over-report such transactions in order to avoid accusations of not having informed the authorities.

In addition, it should be borne in mind that transactions reported as unusual or suspicious to the FIUs may not necessarily involve illegal activity. Whether or not a person will be convicted for money laundering normally depends on whether the public prosecutor brings the case to court and is ultimately for the court to determine. However, together with other data obtained from economic analyses and/or criminal case studies, the FIUs reports may give an indication of the extent to which a certain country is affected by money laundering.

3.3.2 The potential scale of the problem

In view of the complexity involved in calculating how much money is being laundered and a lack of general consensus as to how this should be done, it thus does not come as a surprise that the estimates of IFFs affecting developing countries vary and are heavily debated. However, this does not mean that the problem of IFFs does not exist or that it is only of minor importance. On the contrary, there is a general agreement that IFFs from the developing world are

[487] P. Reuter and E.M. Truman, *Chasing Dirty Money – The Fight against Money Laundering*, Washington, Institute for International Economics, 2004, p. 12.

[488] P. Reuter, *Illicit Financial Flows*, Perspective Paper for the Project Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda: Post-2015 Consensus, p. 1.

[489] Such an approach was used, for example, to estimate money laundering in the Netherlands. See, for example, J. Meloen , R. Landman, H. de Miranda, J. van Eekelen J. and S. van Soest, *Buit en Bestendig: Een empirisch onderzoek naar de omvang, de kenmerken en de besteding van misdaadgeld*, Den Haag, Reed Business Information, 2003.

substantial.[490] In fact, each year huge sums of money are transferred out of developing countries illegally. The most authoritative and up-to-date data on IFFs from developing countries available so far come from the GFI.[491] Even though the data presented below may not be precise, it does give an indication of the scale and dynamics of IFFs affecting such countries.

According to the latest study published by the GFI in December 2015, from 2004 to 2013 the developing world as a whole lost $7.8 trillion on IFFs, averaging 4 percent of developing countries' GDP over the ten-year period.[492] What is more, these flows increased at 6.5% per annum. In 2013, IFFs from developing and emerging economies hit $1.1 trillion, marking a dramatic increase from 2004, when illicit outflows totalled just $465.3 billion.

These figures are based on two sources: (1) deliberate goods trade misinvoicing; and (2) leakages in the country's external accounts. According to the GFI, an average of 83.4% of illicit financial flows was due to the misinvoicing of trade in goods alone. While services are not included in the studies by the GFI,[493], they may nevertheless also significantly contribute to IFFs as they constitute a growing component of international trade, meaning that the estimates produced by the GFI may rather be understated than overstated. The increasing misinvoicing of services and intangibles, such as intra-group loans, intellectual property and management fees, has been signalled, for example, by the High Level Panel on Illicit Financial Flows from Africa which argues that such practices increasingly contribute to IFFs from Africa.[494]

This may indicate that nowadays trade-based money laundering (or 'money-laundering through the back door') serves as an important (if not the major) means for transferring funds out of developing countries illicitly. Money laundering by making use of the financial sector (or 'money laundering through the front door') may thus no longer be the main channel for the IFFs. At the same time, the GFI's study shows that there is also a noticeable growth in the HMN estimate of balance of payment leakages over 2003-2014. While initially only accounting for 6.9% of illicit outflows in 2004, the hot money narrow estimate rose to 19.4% of illicit flows by 2013.

It is also striking that, while, as mentioned above, $1.1 trillion flowed illicitly out of developing countries in 2013, in the same year these countries received $99.3 billion in official development

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[490] P. Reuter, 'Policy and Research Implications of Illicit Flows', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, Washington, World Bank, 2012, p. 483, at 484.

[491] Though its methodology for estimating IFFs has also been criticised in the academic literature. See, for example, P. Reuter, *Illicit Financial Flows*, Perspective Paper for the Project *Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda: Post-2015 Consensus*, p. 1.

[492] D. Kar and J. Spanjers, *Illicit Financial Flows from Developing Countries: 2004-2013*, Global Financial Integrity, December 2015, p. 23.

[493] This is due to a lack of bilateral trade data on services.

[494] High Level Panel on Illicit Financial Flows from Africa, *Illicit Financial Flows: Track It! Stop It! Get It!*, p. 28.

aid. This means that '[f]or every development-targeted dollar entering the developing world in 2013, over $10 exited illicitly'.[495]

What is particularly notable in the context of the present study is that, according to the GFI, Mexico and South Africa, with which the EU has concluded free trade agreements, are in the *top ten* of 149 developing countries with largest average illicit financial flows in the period between 2003 and 2014 (Box 15 on the next page).

[495] Kar and Spanjers, p. 15.

Table 5 Illicit Financial Outflows from the top ten source economies, 2004-2013 (in millions of nominal U.S. dollars)

Rank	Country	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative	Average
1	**China, Mainland**	81,517	82,537	88,381	107,435	104,980	138,864	172,367	133,788	223,767	258,640	1,392,276	139,228
2	**Russian Federation**	46,064	53,322	66,333	81,237	107,756	125,062	136,622	183,501	129,545	120,331	1,049,772	104,977
3	**Mexico**	**34,239**	**35,352**	**40,421**	**46,443**	**51,505**	**38,438**	**67,450**	**63,299**	**73,709**	**77,583**	**528,439**	**52,844**
4	**India**	19,447	20,253	27,791	34,513	47,221	29,247	70,337	85,584	92,879	83,014	510,286	51,029
5	**Malaysia**	26,591	35,255	36,554	36,525	40,779	34,416	62,154	50,211	47,804	48,251	418,542	41,854
6	**Brazil**	15,741	17,171	10,599	16,430	21,926	22,061	30,770	31,057	32,727	28,185	226,667	22,667
7	**South Africa**	**12,137**	**13,599**	**12,864**	**27,292**	**22,539**	**29,589**	**24,613**	**23,028**	**26,138**	**17,421**	**209,219**	**20,922**
8	**Thailand**	7,113	11,920	11,429	10,348	20,486	14,687	24,100	27,442	31,271	32,971	191,768	19,177
9	**Indonesia**	18,466	13,290	15,995	18,354	27,237	20,547	14,646	18,292	19,248	14,633	180,710	18,071
10	**Nigeria**	1,680	17,867	19,160	19,335	24,192	26,377	19,376	18,321	4,998	26,735	178,040	17,804

Source: D. Kar and J. Spanjers, *Illicit Financial Flows from Developing Countries: 2004-2013*, Global Financial Integrity, December 2015, p. 8.

According to this data, Mexico occupies the 3rd position after China and Russian Federation in the list of the top ten developing countries most affected by IFFs, having lost $528,439 million between 2004 and 2013.[652] What is also striking is that the amount of IFFs from this country in 2013 – estimated at $77,583 million – almost doubled compared to that in 2002 when it stood at $34,239 million. South Africa comes in 7th in the top ten group, having lost $209,219 million over the period from 2004 to 2013. A sharp increase in the IFFs out of this country took place between 2006 and 2007, averaging at $20,922 million per annum.

The study by the GFI also contains some relevant data on the other three developing countries in question with which the EU also concluded the EU FTAs, i.e. Peru, Colombia and Serbia.[653] Peru occupies the 33rd position in the ranking of 149 countries by the largest average illicit financial flow, with $4,284 million on average having left the country between 2004 and 2013. It is closely followed by Serbia, which has been placed on the 35th position with $4,083 million of IFFs on average in the same period. Colombia comes in 63rd with an average of $1,495 million per annum.[654]

Given that several developing countries in question – Mexico, Colombia and Peru – are associated with the illegal drug industry and cross-border criminal activities, the recent findings of the UNODC concerning the magnitude of illicit funds generated by drug trafficking and other transnational organised crime also deserve mentioning in the present context.[655] Based on a meta-analysis of the results from various studies, the UNDOC estimated that all criminal proceeds in 2009 are likely to amount to some 3.6% of global GDP, equivalent to about $2.1 trillion. It also emerged from this analysis that the best estimate for laundering through the financial systems would be equivalent to 2.7% of global GDP or $1.6 trillion. What is more, the results of the study suggest that '[e]xpressed as a proportion of national GDP, all crime proceeds appear to be generally higher in developing countries and tend to be laundered abroad more frequently'.[656]

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[652] See also D. Kar, *Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy, Global Financial Integrity*, January 2012.

[653] D. Kar and J. Spanjers, *Illicit Financial Flows from Developing Countries: 2004-2013*, Global Financial Integrity, December 2015, available at:, Appendix Table 2. Country Rankings by Largest Average Illicit Financial Flows, 2004-2013 (HMN+GER).

[654] As discussed in section 3.4 below, the major problem for Colombia is not outflows but inflows of illicit capital.

[655] United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crime: Research Report*, UNODC, 2011.

[656] United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crime: Research Report*, UNODC, 2011, p. 7.

3.3.3 A causal link between illicit financial flows and the EU FTAs?

While there is no doubt that developing countries, in particular Mexico and South Africa, are substantially affected by IFFs, the statistical data discussed above does not provide any direct evidence of a causal link between (an increase in) the IFFs from these countries and the liberalisation of trade in goods and services, in particular financial services, with the EU. For example, the statistics on Mexico generally show a steady increase in IFFs in the period from 2003 to 2014 when the free trade agreement between this country and the EU was fully operational.[657] Such an increase, however, might be (chiefly) caused by other factors, such as the parallel operation of NAFTA with the United States and Canada which also liberalised trade in goods and services, including financial services. In fact, an increase in IFFs from Mexico has been largely attributed to the conclusion of NAFTA by the GFI. The study published by this organisation in 2012 shows that, as a percentage of GDP, IFFs from Mexico increased from an average of 4.5% of the GDP in the period before NAFTA came into effect in January 1994 to an average of 6.3% of the GDP in the 17 years that followed.[658] According to Kar who authored this study:[659]

'While entering into NAFTA had many advantages for Mexico, it also provided incentives for many to transfer illicit capital abroad. Between 1994 and 2010, NAFTA seems to have facilitated illicit outflows totalling at least US$561 billion through export under-invoicing and import over-invoicing.'

In addition, while trade-based money laundering appears to be the largest source of IFFs from developing countries, it is important to remember that the data on misinvoicing presented by the GFI only covers goods and not (financial) services. This data, therefore, does not tell us anything about the extent of money laundering by mispricing (financial) services, let alone about a possible role of the EU FTAs in this context.

Likewise, no conclusive statistical evidence of a causal link between the EU FTAs and IFFs can be found in the data produced by the FIUs. For instance, while the free trade agreement between the EU and Peru became operational on 1 March 2013, the data obtained from the FIU of Peru show a noteworthy development – compared to the two previous years, in 2014 the financial institutions' reporting of suspicious transactions from Peru to a number of the EU countries almost doubled (see Box 16). Although this increase in the reported suspicious transactions may point to an increase in IFFs between Peru and the EU (in particular Spain which figures most prominently in the FIU Peru's report) after the trade agreement came into effect, it may equally result from the improvement in reporting by financial institutions operating in Peru. Moreover, in the absence of follow-up criminal

[657] The EU-Mexico Economic Partnership, Political Coordination and Cooperation Agreement signed in December 1997 entered into force in October 2000 for the part related to goods and in March 2001 for the part related to services.

[658] D. Kar, *Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy*, Global Financial Integrity, January 2012, p. 61.

[659] D. Kar, Mexico: Illicit Financial Flows, Macroeconomic Imbalances, and the Underground Economy, Global Financial Integrity, January 2012, p. 33.

investigations and convictions for money laundering, the reported suspicious transactions as such cannot be seen as hard proof of illegality.

Table 6 Suspicious transactions between Peru and the EU as reported by financial institutions to the Peru FIU over 2010-2015

	2010	2011	2012	2013	2014	2015	Total	EU Country mentioned in STR	Number of STR
STR which mention any EU country	54	47	36	3	61	36	265	Austria	1
Total of STR	932	1199	1843	2425	3097	2830	12326	Belgium	2
Annual participation %	6%	4%	2%	1%	2%	1%	2%	Cyprus	5
Total evolution rate STR involving EU countries		-13%	-23%	-14%	97%	-41%		Czech Republic	2
Total evolution rate STR		29%	54%	32%	28%	-9%		Denmark	3
								Finland	2
								France	19
								Germany	35
								Greece	1
								Ireland	3
								Italy	33
								Latvia	3
								Lithuania	5
								Luxembourg	5
								Malta	1
								Netherlands	14
								Poland	1
								Portugal	14
								Spain	**107**
								Sweden	7
								United Kingdom	21
								Total	265

*Suspicious Transaction Reports (STR) data

Source: Peru FIU, unpublished data on file with the authors.

Despite the lack of conclusive statistical evidence of a causal link between the EU FTAs and (an increase in) IFFs, the data available at present provides a strong indication that the liberalisation of trade between the EU and developing countries increases the threat of money laundering in such countries and is therefore likely to contribute to an increase in IFFs. Given the far-reaching commitments under the EU FTAs in question of both the EU and developing countries regarding access to each other's markets for goods and services, including in the financial services sector, such agreements significantly increase trade openness. Hence, they also increase the threat of money laundering facing developing countries, considering that the IFFs from such jurisdictions are not only already substantial but are also on the rise, and that some countries in the EU are an attractive destination for

money launderers from the developing world. The operation of the EU FTAs is therefore likely to contribute to an increase in IFFs from the developing countries to the EU.

A similar argument has been made, for example, with regard to the free trade agreement between the EU and Colombia/Peru.[660] In light of the susceptibility of Colombia and Peru to IFFs, the far-reaching liberalisation of financial services between the EU and these countries and their weak obligations under the free trade agreement to fight money laundering and tax evasion, the author concludes that the risk of the mentioned malpractices will increase.

Several respondents in this study also shared this assumption, in particular with regard to trade-based money laundering. In the words of three different respondents:

'You could say that as soon as trade flows increase, the ability to hide in a bigger flow becomes greater.'

'There is always a claim that there is a lot of trade-based money laundering. And to the extent that the free trade agreement increases Mexico/EU-trade, you can say almost mechanically that there will be an increase in illicit financial flows between Mexico and the EU, just as the result of the expansion of the trade.'

'What we find in our econometric studies … is the relationship between trade openness (i.e. exports plus imports over GDP) [and trade misinvoicing]. So, as trade openness increases, misinvoicing increases. We find that link, i.e. the larger volume of trade in goods (…) causes more misinvoicing, other things remaining the same [like weak governance in developing countries]… In fact, services are easier to misinvoice [than goods] (…) You can always make the case that your services are somehow distinct. Services are intangibles. They don't go through customs (…) It is settled through payments.'

An important caveat should be made here. As has been noted above, this study has primarily focused on the effects of the liberalisation of *financial* services on money laundering. However, the findings concerning trade-based money laundering presented above, point to the fact that financial services may not necessarily be the only (or even the major factor) contributing to an increase in IFFs from developing countries. While the trade in financial services is certainly likely to lead to such an increase, the operation of the EU FTAs considerably increases the risk of mispricing of goods and services in general – an important (if not the main) channel of money laundering from the developing world today.[661]

[660] M. Vander Stichele, *Free Trade Agreement EU–Colombia & Peru: Deregulation, Illicit Financial Flows And Money Laundering*, Commissioned by GUE/NGL Group (German Delegation), Stichting Onderzoek Multinationale Ondernemingen (SOMO), Amsterdam, 2012.

[661] In fact, as the WTO dispute between Panama and Colombia shows, similar problems can also occur when trade between developing countries is liberalised. For more information on this case see https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds461_e.htm ..

Therefore, it can be concluded that the increasing volume of trade in goods and services in general, and in financial services in particular, between the EU and the developing countries in question is likely to facilitate IFFs, further aggravating the problem.

Finally, it should also be emphasised that this conclusion applies only with respect to the developing countries considered in this study, i.e. South Africa, Colombia, Peru, Mexico, and Serbia. This means that the arguments developed above are not applicable with regard to Korea. The research team has not found any statistical evidence concerning the negative effects of the EU FTAs on money laundering in this country. No conceptual argument supporting such a conclusion can, in our view, be made either, in particular given the absence of data concerning the IFFs between Korea and the EU.

3.4 The Impact of Illicit Financial Flows

3.4.1 The effects of illicit financial outflows

As has been demonstrated above, each year substantial sums of money are transferred out of developing countries illegally. There is a general agreement that these illicit financial outflows have a profoundly negative impact on the development potential of such countries. Recently, concern about the adverse effects of such outflows has been expressed by a variety of important international actors, such as the UNODC,[662] the High Level Panel on Illicit Financial Flows from Africa,[663] the OECD,[664] the World Bank[665] and the GFI.[666] In addition, the devastating consequences of IFFs on developing countries have also been highlighted in the academic literature.[667] From the countries in question in this study, Mexico and South Africa are particularly heavily affected by the outflows of illicit money.

In general, substantial outflows of illicit money from developing countries severely undermine domestic resource mobilisation and can, as a result, seriously imperil sustainable development and economic growth in such countries. As the OECD has noted:[668]

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[662] United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crime: Research Report*, (UNODC, 2011), p. 99 *et seq*.

[663] High Level Panel on Illicit Financial Flows from Africa, *Illicit Financial Flows: Track It! Stop It! Get It!*, p. 52 *et seq*.

[664] OECD, *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*, (OECD, 2014), p. 15 *et seq*.

[665] See, for example, International Bank for Reconstruction and Development/World Bank, *The World Bank in the Global Fight against Money Laundering and Terrorist Financing*, 2003, p. 4 *et seq*.

[666] See, for example, Global Financial Integrity, *Illicit Financial Flows: The Most Damaging Economic Condition Facing the Developing World*, Global Financial Integrity, September 2015.

[667] See, in particular, P. Reuter (ed.), Draining Development? Controlling Flows of Illicit Funds from Developing Countries, Washington, World Bank, 2012.

[668] OECD, *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*, OECD, 2014, p. 15.

'These illicit financial flows strip resources from developing countries that could be used to finance much-needed public services, from security and justice to basic social services such as health and education, weakening their financial systems and economic potential. While such practices occur in all countries – and are damaging everywhere – the social and economic impact on developing countries is more severe given their smaller resource base and markets. Estimates vary greatly and are heavily debated, but there is a general consensus that illicit financial flows likely exceed aid flows and investment in volume.'

In particular, illicit financial outflows may have the following detrimental effects on developing countries:

- Reducing domestic expenditure, both public and private;
- Reducing foreign private investment;
- Damaging the reputation of financial institutions and the functioning of the financial sector more generally;
- Discouraging structural transformation and transparency of economies (continually relying, for example, on natural resources extraction);
- Weakening the rule of law, in particular by increasing crime and corruption;
- Threatening political and economic security; and
- Undermining international development cooperation.

3.4.2 The effects of illicit financial inflows

While many developing countries are primarily troubled by illicit financial outflows, in some illicit financial inflows resulting from the entry of the foreign revenues of the drug industry present much greater problems. This is the case, for example, in Colombia. As Thoumi and Anzola explain:[669]

'In Colombia, money laundering has mainly been associated with the illegal drug industry, in which criminal activities cross borders, and payments are commonly made abroad. The main concern for the recipients of these funds is not only to launder the money, but also to bring the money to their countries, including back to Colombia. In the case of kleptocrats, guerrillas, and common organised criminals, even though the illegal funds are, in some cases, sent abroad, they are invested or spent directly in Colombia in most cases. The amounts of funds that these actors wish to send abroad likely pale in comparison with the amounts that traffickers wish to bring back in.'

Substantial inflows of illicit money in developing countries generate their own problems for such countries. Obviously, such inflows strengthen organised crime and allow it to expand, which in turn undermines the rule of law. In addition, they also have major

[669] F.E. Thoumi and M. Anzola, 'Illicit Capital Flows and Money Laundering in Colombia', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, Washington, World Bank, 2012, pp. 145-146.

negative socio-economic effects on developing countries. According to the UNODC, these include in particular:[670]

- Distorting the resource allocation from high-yielding investments to investments that run a low risk of detection;
- Distorting prices, notably in the real estate sector;
- Distorting consumption and imports;
- Distorting exports and potential problems with investment and economic growth;
- Unfair competition;
- Risks of crowding out licit activities and negative impact on direct foreign investment;
- Facilitating corruption;
- Risks of real sector volatility;
- Strengthening skewed income and wealth distributions;
- Distorting economic statistics and thus potential errors in economic policy decision-making; and
- Undermining the credibility of legal institutions.

In Colombia, the revenues from the illicit drugs industry have created a particularly grave problem in rural and urban real estate, aggravating rural land concentration.[671] As drug money could not be easily invested in the modern economy, drug traffickers purchased large amounts of rural land. For this purpose, paramilitary groups within the country forced the large-scale displacements of peasants. As a result, today, except for Syria, Colombia has the largest number of internally displaced citizens in the world. The Internal Displacement Monitoring Centre estimates the number of displaced Colombians, as of December 2014, at more than 6 million[672] in a total population of 48.3 million.

3.5 Causes of Illicit Financial Flows

3.5.1 General

The above analysis has shown that IFFs affecting developing countries are substantial and that they have a profoundly negative impact on the development potential of such countries. From a policy point of view, however, it may be more important to focus not on the IFFs as such but on their causes.[673] After all, IFFs are primarily a result of much more fundamental problems.

[670] United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crime: Research Report*, UNODC, 2011,

p. 109 *et seq*.

[671] Thoumi and Anzola, pp. 145-152.

[672] Internal Displacement Monitor, *Colombia IDP Figures Analysis*, available at: http://www.internal-displacement.org/americas/colombia/figures-analysis.

[673] *Cf.* P. Reuter, 'Policy and Research Implications of Illicit Financial Flows', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, (Washington: World Bank, 2012), pp. 483-484.

While this study explores the effects of the EU FTAs on money laundering and tax evasion with a focus on third countries, there is an important caveat which needs to be considered when discussing the causes of IFFs affecting such countries. IFFs are *not* only the problem of the developing countries, but also of the developed countries, in particular in the EU.

For many years, western financial institutions have both intentionally and unintentionally facilitated the absorption of illicit money from the developing world. For example, in 2012 an EU based bank, HSBC (headquartered in the UK), was caught laundering hundreds of millions of U.S. dollars for two drug cartels – one each in Mexico and Colombia – and had to pay at least $1.92 billion in a settlement with U.S. authorities. According to the U.S. prosecutors:[674]

'So rampant was the practice that on some days drug traffickers deposited hundreds of thousands of dollars at HSBC Mexico accounts. To speed things along, the criminals even designed "specially shaped boxes" that fit the size of teller windows at HSBC branches, according to the documents.'

In response to this scandal, the UK Financial Services Authority,[675] as lead regulator for the HSBC Group globally, took action in respect of HSBC's compliance with AML legislation.[676] However, as one of our respondents observed when talking about the role of the developed world in generating IFFs:

'We have also been complicit in absorbing [the illicit financial flows]. From time to time you hear all these stories in the media (…) HSBC has been caught in this money laundering exercise (…) The HSBC and Mexico scandal (...) So from time to time, we get these media flashes that certain such banks have been fined (…) But, of course, nobody goes to jail. So business continues as usual. They just pay the fine and carry on as usual. So there is much to be said that we have all these instruments that are very hard to track (…) like financial derivatives (…) We don't have information on beneficial ownership: you don't know who the ultimate owner of the account is. We have shell companies. We have trust funds. We have all these tax havens that house hundreds of thousands of corporations in one building (…) And all of this is going on (…) Nobody seems to be willing to tackle these things.'

Effective AML controls are key to stopping IFFs. Designing and operationalising such controls, however, is the major challenge facing not only the developing world but also the developed world, including the EU.

Given the focus of this study, the authors will next explore the effectiveness of the AML system in the developing countries in question. The comparative legal analysis of the selected countries has demonstrated a generally high degree of formal compliance by these

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[674] C. Mollenkamp, 'HSBC Became Bank to Drug Cartels, Pays Big for Lapses', *Reuters*, 11 December 2012.

[675] In 2013, the Financial Services Authority was succeeded by the Financial Conduct Authority.

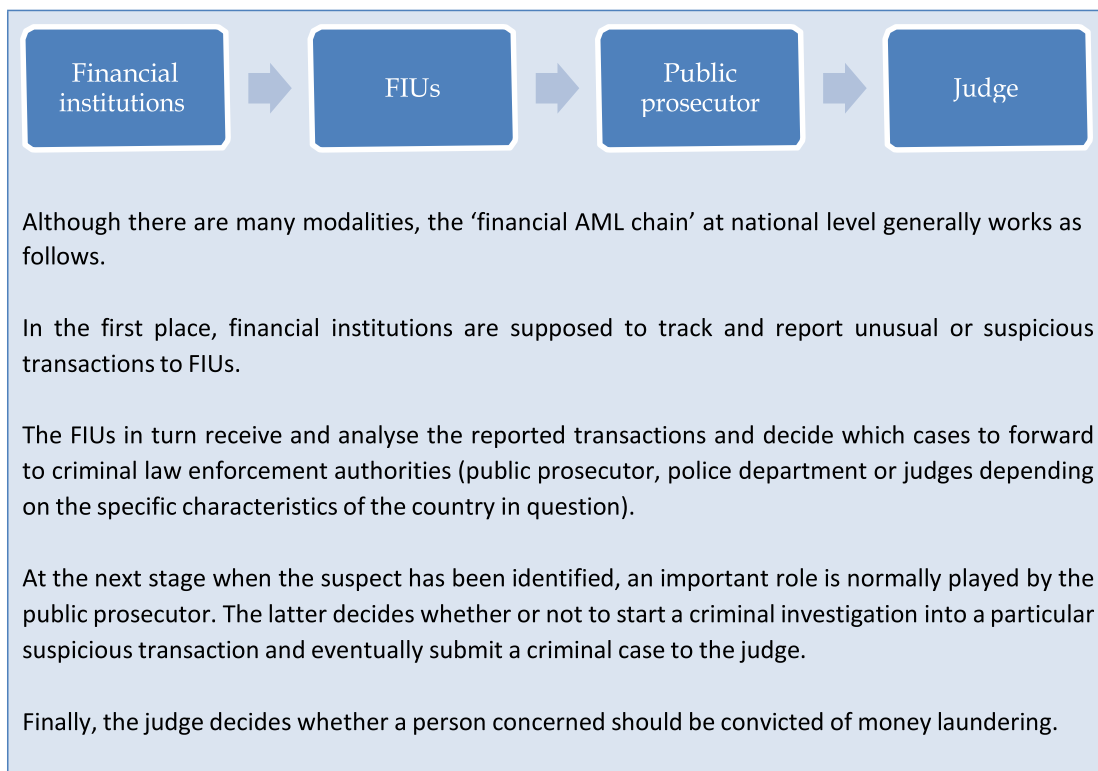
[676] FCA, '*FSA requires action of the HSBC Group*', March 2013.

countries with the international standards produced by the global standard-setter in the fight against money laundering – the FATF.

The major problem faced by the developing countries is a significant discrepancy between the AML law on the books and the AML law in action. Large IFFs affecting such countries are a striking manifestation of the extent of this problem. Moreover, according to the UNODC, it appears that globally much less than 1% (probably around 0,2%) of the proceeds of drug trafficking and other transnational organised crime laundered via the financial system are seized and frozen.[677]

Prior to analysing the major structural and functional weaknesses that undermine the well-functioning of the AML systems in developing countries, it should be emphasised that the effectiveness of such systems ultimately depends on the efforts of all actors involved therein. These include governments, FIUs, the police, public prosecutors, judges, reporting entities like banks, dealers in high value goods, notaries, accountants, lawyers and other groups in the private sector.[678] In the context of money laundering through the financial system, the proper functioning of the 'financial AML chain' at national level, as illustrated in Box 17, is particularly important.

Box 15 Financial AML chain' at national level '



Although there are many modalities, the 'financial AML chain' at national level generally works as follows.

In the first place, financial institutions are supposed to track and report unusual or suspicious transactions to FIUs.

The FIUs in turn receive and analyse the reported transactions and decide which cases to forward to criminal law enforcement authorities (public prosecutor, police department or judges depending on the specific characteristics of the country in question).

At the next stage when the suspect has been identified, an important role is normally played by the public prosecutor. The latter decides whether or not to start a criminal investigation into a particular suspicious transaction and eventually submit a criminal case to the judge.

Finally, the judge decides whether a person concerned should be convicted of money laundering.

[677] United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crime: Research Report*, UNODC, 2011, p. 7.

[678] *Cf.* Project 'ECOLEF' *The Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy* (led by B. Unger): Final Report, Utrecht, 2013, p. 28.

3.5.2 Structural weaknesses of developing countries

The well-functioning of the 'financial AML chain' described above in any country depends on the willingness and ability of all the actors involved therein to fight money laundering. The problem in one of the links may severally impair the effectiveness of the chain as a whole. In the case of developing countries, *structural* weaknesses caused by the weak rule of law and poor governance may severely distort incentives for some actors to do their work properly. Structural weaknesses that generally trouble developing countries include the following:

- Undue political influence, in particular on public prosecutors and judges either to prosecute regime opponents and financial institutions or not;
- Bribery;
- Corruption;
- Large-scale organised crime;
- Substantial informal economy; and
- Insufficient co-operation between various institutions involved in combating crime, in particular between anti-corruption and AML bodies.

The case of Mexico, for example, is particularly illustrative in this context. According to the 2015 U.S. government report:[679]

'Mexico is a major drug producing and transit country. Proceeds from the illicit drug trade leaving the United States are the principal source of funds laundered through the Mexican financial system. Other significant sources of laundered funds include corruption, kidnapping, extortion, intellectual property rights violations, human trafficking, and trafficking in firearms. Sophisticated and well-organised drug trafficking organisations based in Mexico take advantage of the extensive U.S.-Mexico border, the large flow of legitimate remittances, Mexico's proximity to Central American countries, and the high volume of legal commerce to conceal illicit transfers to Mexico (…) The combination of a sophisticated financial sector and a large cash-based informal sector complicates money laundering countermeasures (…) Corruption is the enabler of money laundering and its predicate offences. Corruption is endemic at all levels of Mexican society and government. The Government of Mexico should combat corruption.'

In general, the independence of the key actors involved in the 'financial AML chain' is crucial to its well-functioning. As Levi explains:[680]

'Unless the national financial intelligence unit (FIU) is believed to be both discreet and independent of the government, potential whistle-blowers might be afraid of exposure as sources of information. If suspicions are communicated to the FIU, what could the FIU plausibly do with the report [if investigators and prosecutors are not truly independent]?

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[679] Unites States Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *Money Laundering and Financial Crimes: Country Database*, June 2015, p. 297 *et seq.*

[680] M. Levi, 'How Well do Anti-Money Laundering Controls Work in Developing Countries?', in P. Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*, (Washington: World Bank, 2012), pp. 373-374.

This highlights the importance of the relationship between FIUs and effectively independent investigation and prosecutorial bodies, which may be needed if AML regimes in developing countries are to have a significant impact on domestic grand corruption.'

A first essential step in tackling structural weaknesses is to identify them. In this context, it is notable that some developing countries have been proactive and have come up with national money laundering risk assessments or national plans for combating money laundering in which structural weaknesses affecting them have been explicitly acknowledged. For example, the national plan for combating money laundering in Peru has identified the following structural problems affecting the effectiveness of its AML system:[681]

- A lack of mechanisms for inter-institutional coordination between the constituent components of the AML system;
- Corruption;
- Economic informality;
- Insufficient control over borders; and
- Underdevelopment of statistical databases affecting the entire AML system.

Indeed, as noted in the 2015 U.S. government report:[682]

'Peru's cash-based and heavily-dollarised economy, large informal sector (estimated to be 70% of GDP), and deficient regulatory supervision of designated non-financial businesses and professions (DNFBPs), such as informal money exchanges and wire transfer services, make the economy vulnerable to money laundering and other financial crimes.'

What struck us in the course of the empirical study is that the respondents from those developing countries that have publicly acknowledged their structural problems in fighting money laundering were more willing to cooperate with the research team and openly discuss such sensitive issues as compared to the (potential) respondents from those countries that have not done so (yet). The explicit recognition of fundamental domestic problems and the willingness to talk about them may be an indicator of whether or not there is a political will in a particular country to move away from purely formal compliance with the AML law towards substantive compliance.

A welcome development in this context is the adoption of the new approach to assessing compliance with its recommendations by the FATF. While in the past technical compliance with the black-letter rules was sufficient, the new methodology also includes the effectiveness test. According to the FATF:[683]

'The effectiveness assessment differs fundamentally from the assessment of technical compliance. It seeks to assess the adequacy of the implementation of the FATF

[681] Superintendent of Banking, Insurance and Private Pension Funds of Peru, *National Plan for Fighting Money Laundering and Terrorist Financing*, May 2011 (on file with authors), p. 20 *et seq*.

[682] U.S. Department of State, *Peru Investment Climate Statement 2015*, May 2015, p. 8.

[683] FATF, *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*, FATF, February 2015, updated October 2015, p. 5.

recommendations, and identifies the extent to which a country achieves a defined set of outcomes that are central to a robust AML/CFT [counter-terrorism financing] system. The focus of the effectiveness assessment is therefore on the extent to which the legal and institutional framework is producing the expected results.'

Such an outcome-focused approach has the potential to reduce the gap between the AML law on the books and the AML law in action in developing countries. The evaluations of the developing countries in question based on the new methodology are expected in the coming years. Thus, Serbia will be evaluated in 2016, followed by Mexico, Colombia and Peru in 2017, and South Africa in 2019.[684] The new evaluation reports drawn as a result could throw new light on the effectiveness of the AML legislation in these countries and ultimately prompt real improvements in their AML systems.

3.5.3 Functional weaknesses of the anti-money laundering systems in developing countries

In addition to structural weaknesses, the effectiveness of the AML systems in developing countries is also seriously undermined by the functional weaknesses of such systems themselves. As confirmed by our respondents, the functional problems affecting the AML systems in developing countries generally have to do with the capacity of the actors involved in the 'financial AML chain', as well as public authorities supervising compliance with the AML law, to properly identify, assess, and address money laundering risks. The three main capacity-related weaknesses affecting the 'financial AML chain' include:

- Shortage of resources;
- Insufficient knowledge and experience; and
- Little coordination between different actors.

These key problems are reflected, for example, in the above mentioned Peruvian plan for combating money laundering, which specifically mentions, *inter alia*, the following functional vulnerabilities:

- Problems with identification of beneficial ownership in the banking and securities sector;
- Overburdening of the supervisory capacity of the FIU;
- Poor quality of the strategic analysis of long term money laundering trends;
- Lack of experts with specialised skills needed to conduct complex money laundering investigations;
- No effective coordination between the FIUs, police and public prosecutor office; and
- Shortage of resources, work overload and lack of specific training in AML in the judiciary.

[684] FATF, Global Assessment Calender-July 2015.

These weaknesses seriously undermine the effectiveness of the Peruvian AML system. For example, according to the 2015 U.S. government report,[685] only 64 Financial Intelligence Reports totalling $214 million were submitted to the Public Ministry from January to September 2013, although 3,265 STRs, with a total value of $4.91 billion, were filed during the same period. Most STRs originate in Lima (59%); as of October 2013, there were 238 cases at various stages within the judicial system and approximately 797 cases in the investigative phase. According to the same U.S. report,[686] Peru made significant strides to continue the implementation of the national plan for combating money laundering. Both the appointed Prime Minister and the Superintendent of Banks, Insurance, and Pension Funds (SBS) expressed commitments to fully implement the National Plan. However, many problems still remain. In particular, the Peruvian FIU needs additional resources to deal with its expanded monitoring responsibilities.

Peru would also benefit from capacity building efforts in the prosecutorial system, including in: the conduct of investigations; the presentation and the use of clearer language when writing investigative reports for prosecutors; and the improvement of prosecutorial capacity. Prosecutors complain they cannot understand the format or language of many of the FIU's investigative results. In addition, the lack of financial experts to decode the FIU's reports makes it difficult for prosecutors to investigate the results within the required 120-day time frame. Compounding the problem, many judges lack adequate training to manage the technical elements of money laundering cases, and banks often delay providing information to judges and prosecutors. Convictions tend to be for lesser offences or predicate crimes, such as tax evasion or drug trafficking, which are easier offences to prosecute successfully.

The capacity-related problems also figure prominently in the national risk assessment on money laundering in Serbia:[687]

'One reason for the small number of judgments is (…) the insufficient level of education and information of prosecutors engaged in investigating [money laundering] offences and judges. Better coordination among all government authorities participating in this battle against money laundering is necessary in addition to training. Strengthening the prosecutor's role in all of these mechanisms is essential. The prosecutor should assume the role of coordinator and leader in the proceedings.'

In addition, the Serbian central financial intelligence unit – Money Laundering Prevention Administration (MLPA) – and the Tax Administration are understaffed, undertrained and underequipped for the performance of their statutory tasks in the manner envisaged by law.

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[685] U.S. Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *Money Laundering and Financial Crimes: Country Database*, June 2015, p. 340.

[686] U.S. Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *Money Laundering and Financial Crimes: Country Database*, June 2015, p. 338 *et seq.*

[687] E. Pantelić, *National Risk Assessment of Money Laundering in the Republic of Serbia*, Belgrade, April 2012.

In the same vein, in its 2015 South Africa financial sector assessment, the IMF stresses that structural capacity weaknesses frustrate the overall effectiveness of the efforts made by the South African law enforcement, and particularly prosecutorial authorities, to pursue complex money laundering cases, including those that involve foreign proceeds of crime.[688]

All in all, increasing the capacity of the AML systems in developing countries is key to ensuring the effectiveness of their AML legislation in practice. Several international actors, in particular the World Bank, have been involved in assisting developing countries in building such capacity. Regional actors may also play an important role in this area. In the case of Serbia, for example, support by the EU and the Council of Europe has proven essential for developing its capacity in the AML field. Similar efforts could also be made in relation to other developing countries.

3.6 Key Findings

- The concept of IFFs is central to the study into the effects of the EU FTAs on money laundering in the developing countries parties thereto. Such flows are most commonly defined as money (understood as funds or assets) illegally earned, transferred, or used. However, at present there is no general consensus on the precise meaning of this concept. Where to draw the line between *legal* and *illicit* flows has proved particularly controversial.
- Given the complexity involved in calculating how much money is being laundered and a lack of general consensus as to how this should be done, at present, there are no (exact) statistical estimates of IFFs from developing countries, in general, and IFFs resulting from the conclusion of the EU FTAs with such countries, in particular. At the same time, there is a general agreement that IFFs from the developing world are substantial and that they are on the increase. In particular, Mexico and South Africa are among the 10 biggest exporters of illicit money. The developing countries concerned thus face a significant threat of money laundering. In addition, it is widely acknowledged that IFFs are often going to developed countries, including those in the EU.
- Despite the lack of conclusive statistical evidence of a causal link between the operation of the EU FTAs and (an increase in) IFFs, the available data provides a strong indication that such a link is present as far as developing countries are concerned. Given (a) the significant degree of trade openness envisaged by the EU FTAs, (b) the already substantial and constantly rising IFFs from developing countries, and (c) the attractiveness of the EU as a destination for money launderers from such countries, the liberalisation of trade in goods and services, including financial services, between the EU and developing countries increases the threat of money laundering. The operation of the EU FTAs is therefore likely to contribute to an increase in IFFs from developing countries to the EU.
- An increase in illicit financial flows may not only (or even primarily) be due to the liberalisation of financial services. While traditionally illicit money has been

[688] IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 22.

laundered by making use of the international financial system, nowadays trade-based money laundering has become increasingly important as a means for transferring funds out of developing countries illicitly. By fraudulently manipulating the price, quantity, or quality of a good or service on an invoice, criminals can transfer significant amounts of money across international borders. Trade-based money laundering could therefore be an important (if not a major) source of illicit financial flows from the developing countries to the EU.

- IFFs can have a profoundly negative impact on developing countries. Such an impact can be caused not only by outflows of illicit money from developing countries but also by inflows of illicit money in such countries. Substantial outflows of illicit funds severely undermine domestic resource mobilisation, imperilling sustainable development and economic growth. Significant inflows of illicit funds in turn strengthen organised crime and have major and adverse socio-economic consequences.
- In view of a great deal of complexity presently involved in calculating IFFs, particularly as a result of the operation of the EU free trade agreements, no precise estimates of such flows can be expected in the near future. However, this fact should not undermine the efforts of the international community aimed at reducing IFFs from the developing world. Such efforts should primarily focus on studying and addressing the causes of such flows.
- The key problem faced by developing countries in combating IFFs is a significant discrepancy between the anti-money laundering (AML) law on the books and the AML law in action. The effectiveness of AML systems in such countries is undermined by: (a) structural weaknesses caused by poor implementation of good governance principles and deficiencies in the enforcement of the rule of law (e.g. corruption, large-scale organised crime, and a substantial informal economy); and (b) major functional weaknesses related to the insufficient capacity of the authorities in fighting money laundering (e.g. shortage of financial and human resources, insufficient knowledge and experience, and a lack of coordination between the competent authorities).

Part 4: Policy Recommendations

4.1 Objectives of Policy Recommendations

Since eliminating illicit financial flows contributes to the stability and credibility of the international financial system at large as well as to the sustainable development of the EU's trade partners, implementing the recommendations outlined below would help reduce the space for non-compliance and deviation from the intended goals of cooperation envisaged under EU FTAs. This would in turn create a better and more reliable environment for the fight against money laundering, tax evasion and tax elusion in EU external relations.

From this perspective, it is instructive for the EU to utilise its trade power as leverage to seek to establish closer working relationships with its trade partners. This could reduce friction and incentivise a smoother domestic implementation of the EU's FTAs. Hence, the new trade and investment strategy *Trade for All* should mention not only tax avoidance and the fight against corruption, but also illicit financial flows and AML efforts.

For greater clarity, our policy recommendations have been grouped into four categories that correspond to the four key queries of this study.

4.2 Groups of Policy Recommendations

Group A: Recommendations on the Extent of Coverage of Financial Services Provisions

- Although there is a significant degree of coherence concerning the definition and scope of financial services covered by EU FTAs, the discrepancies that exist with respect to the detail of specification of what financial services are covered by these FTAs make it necessary for the EU to *ensure greater coherence across FTAs* regarding these two elements. The EU could do so by striving to liberalise the same financial services with all trading partners. This is required in order to avoid gaps in the domestic implementation of international and European AML/CFT standards – such as those laid down in FATF recommendations and the EU's 4th AML Directive – in the financial sector. This would further contribute to preventing regional and global fragmentation that might arise from variable harmonisation.
- Notwithstanding this, the EU should *consider limiting the definition and/or scope of financial services to be liberalised where compelling reasons exist* in relation to the EU trading partner's failure to implement and enforce the application of the said international and European AML/CFT standards (e.g. EU-Colombia/Peru FTA).
- While most EU FTAs contain such provisions, the EU should *ensure that all FTAs contain provisions on tax cooperation and that such provisions guarantee cooperation at the bilateral level* in addition to any regional or international instruments or arrangements (e.g. this is missing in the EU FTA with South Africa). This recommendation should be in line with that under Group C below.
- Because illicit financial flows are to a great extent rooted in trade in both goods and services, the EU should seek to *include provisions combating the mispricing* of internationally traded goods and services.

Group B: Recommendations on the Effectiveness and Deficiencies of Safeguards on anti-money laundering/combatting the financing of terrorism

- Due to the sometimes rather general nature of FATF recommendations, it is necessary for the EU to strive to *reduce the room for discretion of administrative bodies* – such as central banks, financial intelligence units, tax administrations and financial inspectorates – when they exercise their powers in the process of applying and enforcing AML/CFT and tax law. This concerns notably administrative decisions on granting or revoking financial service providers' licences in case of linkages with AML/CFT activities or with the provision of mutual legal assistance and exchange of information. This is required in order to enable otherwise well-drafted legal rules to attain the AML/CFT objectives sought by the EU.
- To increase tax transparency and promote the reduction in tax evasion and elusion in its FTAs, the EU should seek to *include provisions on country-by-country reporting of corporate tax and the establishment of public registers of beneficial owners*. To facilitate this, the EU should also increase the responsibility of EU companies for its foreign activities.
- Given that a significant obstacle to the effectiveness of AML/CFT safeguards contained in EU FTAs lies in the deficient enforcement and insufficient operational capacity of the competent administrative bodies of the EU's trading partner countries, it is necessary for the EU to *provide further support to trading partners in terms of training and technical assistance*. The EU should therefore strive to transfer sector-specific expertise through person-to-person instruction and provide an adequate level of financial assistance to its trading partners. This is of particular importance in the case of FTAs with developing countries, which typically lack human, financial and technical resources to enforce domestic law and which may otherwise be compliant with international and European standards. These goals could be incorporated within the EU's Development Cooperation Instrument (DCI), particularly its focus area of good governance, rule of law and the fight against corruption. This recommendation is based on the EU's moral and legal duty (notably laid down in art. 3(5) and 21(2)(d) TEU) to exercise leadership in preventing money laundering and tax evasion from hindering the potential of developing countries to pursue and achieve sustainable development.
- In pursuing these goals and in order to achieve maximum impact, the EU is advised to *continue joint capacity-building actions* in the AML/CFT field, such as partnering with the Council of Europe or other FATF-Style Regional Bodies. Such projects have thus far yielded positive results in terms of raising the recipient country's capacity to act. However, the EU needs to make sure that any such assistance continues even after the completion of the project in order to sustain the momentum of reform.
- Because there is a high risk of some developing countries being disconnected from global initiatives, there is a need for the EU to *insist on the involvement of its trading partners in the work of international AML/CFT and anti-tax evasion networks*, such as those operating under the auspices of the FATF, the Basel Committee, the IMF and the OECD. Failing to do so is likely to reduce the transparency and effectiveness of the efforts of domestic and EU authorities in combating illicit financial flows and financial crimes. Where EU trading partners are already connected to such networks, we recommend building on the work of these networks further so as to improve the former's enforcement capacities.

- The EU should *insist on the establishment of well-functioning channels of information exchange between domestic AML/CFT and tax authorities;* the lack of such channels seriously impedes the fight against money laundering and tax evasion.

Group C: Recommendations on Drafting and Implementing Financial Services Provisions

- The EU should *avoid agreeing on overly general, imprecise and vague commitments* and reduce the use of 'best endeavour' clauses in the AML/CFT and anti-tax evasion area. Such provisions are more likely to be ignored and neglected, and less likely to induce legal reform and effective enforcement because they leave a wide margin for interpretation to the authorities of the trading partner. This can dilute both the legal and the actual effect of the FTA. Therefore, the EU should strive for a greater degree of specification of the AML/CFT and tax-related requirements in its FTAs, for instance by specifying what 'cooperation' amounts to and by laying down concrete procedures for its operationalisation.
- The EU should *analyse the effects of liberalisation of financial services (and of trade in goods and services in general) on money laundering, tax evasion and tax elusion in Trade Sustainability Impact Assessments (Trade SIAs) and in general Impact Assessments (IAs)*. The tendency to produce Trade SIAs when negotiations are almost finalised should be reversed because the purpose of these SIAs is to influence the outcome of negotiations, and this is only possible if the expected effects and options are debated – including with the European Parliament – at a stage when the negotiations can still be influenced.

Group D: Recommendations on the 'Fitness' and Effectiveness of Existing Compliance Monitoring Mechanisms

- In future FTAs, the EU should seek to *include provisions on the establishment of mechanisms for monitoring* the trading partner's compliance with the commitments undertaken in FTAs. This can be done through regular or periodic follow-ups of the implementation of FTAs' AML/CFT and tax provisions. This is in line with EU Treaty obligations and the new EU strategy *Trade for All: Towards a More Responsible Trade and Investment Policy* (see point 2.2.2 thereof, p. 15).
- Taking a step further, the EU should also consider including provisions that would *make FTAs conditional on sufficient progress in the implementation and enforcement of the AML/CFT duties*, notably in line with FATF standards. The FATF country evaluations based on the new outcome-based approach that combines the assessment of technical compliance (the law on the books) with the assessment of effectiveness of the application of the law in practice may provide a useful benchmark.
- The EU should *adopt a systemic approach to devising its trade strategy* because the realisation of its trade goals is often jeopardised, not by legal shortcomings, but by the trade partner's poor adherence to the principles of good governance and insufficient enforcement of the rule of law, both of which are unrelated to whether financial services provisions are well-formulated in FTAs. Through a systemic approach, countries experiencing problems with enforcing the rule of law will be required to provide guarantees or submit plans to tackle these problems in at least the medium term.
- To this end, the EU should *pursue the strategy of imposing a measure of conditionality* during trade negotiations where structural weaknesses in the enforcement of the

rule of law, mainly due to corruption, organised crime and shadow economy, undermine the EU's trade goals and the trading partner's legislative and administrative endeavours in combating money laundering and tax evasion. The conditionality policy that the EU applies towards the states that are candidates for EU membership can be used as a basis on which to shape such a mechanism of conditionality. The mechanism would seek to strike a balance between giving trade benefits to the trading partner and effecting systemic domestic reforms.

- With respect to conditionality and monitoring, it should be recalled that following the enhancement of the European Parliament's foreign affairs powers after the entry into force of the Lisbon Treaty, the European Parliament, led by the INTA Committee, is well placed to *request concrete arrangements to be set up in EU FTAs and may use its right of consent to affect them*.
- Correspondingly, where this is not foreseen, the EU should seek to *ensure the participation of MEPs in the bodies set up by EU FTAs* in order to enable the European Parliament to have direct access to the policy discussions and negotiations within these bodies. This could also reduce the information asymmetry that arises from executive dominance in diplomatic negotiations, which is crucial for the success of AML/CFT and anti-tax evasion efforts.
- The European Parliament should *use its delegations for relations with third countries, regions and international organisations (e.g. with South Africa or MERCOSUR) as vehicles for discussing legal and political problems encountered in the area of AML/CFT and tax law*. This can be done by establishing working groups or appointing EU and regional rapporteurs on AML/CFT and tax matters within the bodies in which these delegations operate, such as joint parliamentary committees (e.g. with Mexico) or international parliamentary assemblies (e.g. Euro-Latin American Parliamentary Assembly). This would help the European Parliament bolster the achievement of the EU's AML/CFT and tax goals through the use of existing institutional capacities.

Annex 1: Comparative Overview of Financial Services Provisions in EU FTAs, FATF Membership and Selected Statistics

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
Scope of financial services covered	**Article 11** **Implementing Decision No 2/2001 of the EU-Mexico Joint Council** All insurance and insurance-related services; Banking and other financial services (excluding insurance); Others (Holding companies, Guarantee institutions)	**Article 63** **Services** The Parties agree to foster cooperation in the services sector in general and in the area of banking, insurance and other financial services in particular, through, *inter alia*: (a)) encouraging trade in services; (b)) exchanging, where appropriate, information on rules, laws and regulations governing the services sector in the Parties; (c) improving accounting, auditing, supervision and regulation of financial services and financial monitoring, for example through the facilitation of training schemes.	**Annex VI** **Establishment: Financial Services** All insurance and insurance-related services; Banking and other financial services (excluding insurance)	**Article 7.37** **Scope and definitions** Banking and other financial services (excluding insurance); Insurance and insurance-related services	**Article 152** **Definitions** Insurance and insurance-related services; banking and other financial services (excluding insurance);

	Me: ico	South-Africa	Serbia	Korea	Peru/Colombia
Exceptions/ exemptions	**Article 18** **Regulatory carve-out** Each Party may regulate the supply of financial services, in so far as regulations do not discriminate against financial service or financial service suppliers of the other Party in comparison 3. If a Party enters into an agreement of the type referred to its own like financial services and financial service suppliers. **Article 19** **Prudential carve-out** 1. Nothing in this Chapter shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: a) the protection of investors, depositors, financial market		**Annex VI** **Establishment: Financial Services** (a) Activities carried out by central banks or by any other public institution in pursuit of monetary and exchange rate policies; (b) activities conducted by central banks, government agencies or departments, or public institutions, for the account or with the guarantee of the government, except when those activities may be carried out by financial service providers in competition with such public entities; (c) activities forming part of a statutory system of social security or public retirement plans, except when those activities may be carried by financial service providers in competition with public entities or private institutions.	**Article 7.38** **Prudential carve-out** Each Party may adopt or maintain measures for prudential reasons, including: (a) the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier; and; (b)) ensuring the integrity and stability of the Party's financial system. **Article 7.44** **Specific exceptions** Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services forming part of a public retirement plan or statutory system of social security, except when those activities may be	**Article 159** **Specific Exceptions** 1. Nothing in this Title shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing, in its territory, activities or services forming part of a public retirement plan or statutory system of social security, except when those activities may be carried out, as provided by the domestic regulation of that Party, by financial service suppliers in competition with public entities or private institutions. 2. Nothing in this Agreement applies to activities or measures conducted or adopted by a central bank or monetary, exchange rate or credit authority or by any other public entity in pursuit of monetary and related credit or exchange rate policies.

Mexico	South-Africa	Serbia	Korea	Peru/Colombia
participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial service (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial service suppliers; or (c)) ensuring the integrity and stability of a Party's financial system. **Article 26** **Specific exceptions** 1. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting of a public retirement plan or statutory system of social security, except when those activities may be carried out by			carried out, as provided by its domestic regulations, by financial service suppliers in competition with public entities or private institutions. 2. Nothing in this Agreement shall apply to activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies. 3. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services for the account or with the guarantee or using the financial resources of the Party, including its public entities except when those activities may be carried out, as provided by its domestic regulations, by financial service suppliers	3. Nothing in this Title shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services for the account or with the guarantee or using the financial resources of the Party, or its public entities. **Article 154** **Prudential Carve-Out** 1. Notwithstanding other provisions of this Title or Title V (Current Payments and Movements of Capital), a Party may adopt or maintain for prudential reasons, measures such as: (a) the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier; (b)) ensuring the integrity and stability of its financial system.

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
	financial service suppliers in competition with public entities or private institutions. 2. Nothing in this Chapter applies to activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies. 3. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting Consultations or providing in its territory activities or services for the account or with the guarantee or using the financial resources of the Party, or its public entities.			in competition with public entities or private institutions.	

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
Current payments	**Article 29** **Payments related to investment** 1. Without prejudice to Articles 30 and 31, restrictions on payments related to investment between the Parties shall be Balance of payments difficulties progressively eliminated. The Parties undertake not to introduce any new restrictions on payments related to direct investment from the entry into force of this Decision.	**Article 32** **Current payments** 1. Subject to the provisions of Article 34, the Parties undertake to allow all payments for current transactions between residents of the Community and of South Africa to be made in freely convertible currency. 2. South Africa may take the necessary measures to ensure that the provisions of paragraph 1, which liberalise current payments, are not used by its residents to make unauthorised capital outflows.	**Chapter III: Supply of Services** **Article 62** The Parties undertake to authorise, in freely convertible currency, in accordance with the provisions of Article VIII of the Articles of the Agreement of the International Monetary Fund, any payments and transfers on the current account of balance of payments between the Community and Serbia.	**Article 8.1** **Current payments** The Parties undertake to impose no restrictions on, and to allow, all payments and transfers on the current account of balance of payments between residents of the Parties to be made in freely convertible currency, in accordance with the Articles of Agreement of the International Monetary Fund.	**Article 168** **Current Account** The Parties shall authorise, in freely convertible currency and in accordance with the provisions of Article VIII of the Articles of Agreement of the International Monetary Fund, any payments and transfers on the current account of balance of payments between the Parties.
Capital movement	**Article 8** **Capital movements and payments** The objective of this Title is to establish a framework to encourage the progressive and reciprocal liberalisation of capital movements	**Article 33** **Capital movements** 1. With regard to transactions on the capital account of balance of payments, the Community and South Africa shall ensure, from the entry into force of this Agreement, that capital relating to direct investments in South Africa in	**Chapter III: Supply of Services** **Article 63** 1. With regard to transactions on the capital and financial account of balance of payments, from the entry into force of this Agreement, the Parties shall	**Article 8.2** **Capital movements** 1. With regard to transactions on the capital and financial account of balance of payments, the Parties undertake to impose no restrictions on the free movement of capital relating to direct	**Article 169** **Capital Account** With regard to transactions on the capital and financial account of balance of payments, following the entry into force of this Agreement, the Parties shall ensure the free movement of capital relating to direct

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
	and payments between Mexico and the Community, without prejudice to other provisions in this Agreement and further obligations under other international agreements that are applicable between the Parties.	companies formed in accordance with current laws can move freely, and that such investment and any profit stemming therefrom can be liquidated and repatriated. 2. The Parties shall consult each other with a view to facilitating and eventually achieving full liberalisation of the movement of capital between the Community and South Africa.	ensure the free movement of capital relating to direct investments made in companies formed in accordance with the laws of the host country and investments made in accordance with the provisions of Chapter II of Title V, and the liquidation or repatriation of these investments and of any profit stemming there from. 2. With regard to transactions on the capital and financial account of balance of payments, from the entry into force of this Agreement, the Parties shall ensure the free movement of capital relating to credits related to commercial transactions or to the provision of services in which a resident of one of the Parties is participating, and to financial loans and credits, with maturity longer than a year.	investments made in accordance with the laws of the host country, to investments and other transactions liberalised in accordance with Chapter Seven (Trade in Services, Establishment and Electronic Commerce) and to the liquidation and repatriation of such invested capital and of any profit generated therefrom.	investments56 made in juridical persons constituted in accordance with the laws of the host country and investments and other transactions made in accordance with the provisions of Title IV (Trade in Services, Establishment, and Electronic Commerce), as well as the liquidation and repatriation of these investments and of any profit stemming therefrom.

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
Wording of money laundering provision	**Article 28** **Cooperation on combating drug trafficking, money laundering and chemical precursors** 1. The Parties shall take the appropriate measures for cooperation and liaison, that they consider appropriate, to intensify their actions for the prevention and reduction of production, distribution and illegal consumption of drugs, in conformity with their respective internal legal regulations. 2. Relying on the competent bodies in this field, such cooperation shall involve in particular: […] (c) exchange of information regarding	**Article 90** **Fight against drugs and money laundering** The Parties undertake to cooperate in the fight against drugs and money laundering by: (a)) promoting the South African drugs control master plan and enhancing the effectiveness of South African and southern African regional programmes to counter the illegal abuse of narcotic drugs and psychotropic substances as well as the production, supply and trafficking of these substances, based on the relevant international UN Drugs Control Conventions; (b)) preventing the use of their financial institutions to launder capital arising from criminal activities in general and from drugs trafficking in particular on the basis of standards equivalent to those adopted by international bodies, in particular the	**Article 84** **Money laundering and financing of terrorism** 1. The Parties shall cooperate in order to prevent the use of their financial systems and relevant non-financial sectors for laundering of proceeds from criminal activities in general and drug offences in particular, as well as for the purpose of financing terrorism. 2. Cooperation in this area may include administrative and technical assistance with the purpose of developing the implementation of regulations and efficient functioning of the suitable standards and mechanisms to combat money laundering and financing of terrorism equivalent to those adopted by the Community and international fora in this field, in particular the Financial Action Task Force (FATF).	**Article 7.24** **Governance** Each Party shall, to the extent practicable, ensure that internationally agreed standards for regulation and supervision in the financial services sector and for the fight against tax evasion and avoidance are implemented and applied in its territory. Such internationally agreed standards are, *inter alia*, the Core Principle for Effective Banking Supervision of the Basel Committee on Banking Supervision, the Insurance Core Principles and Methodology, approved in Singapore on 3 October 2003 of the International Association of Insurance Supervisors, the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions, the Agreement on	**Article 155** **Effective and Transparent Regulation** […] 4. Each Party shall make its best endeavours to ensure that international standards for regulation and supervision in the financial services sector and for the fight against money laundering and the financing of terrorism are implemented and applied in its territory. Such international standards are the Core Principle for Effective Banking Supervision of the Basel Committee, the Insurance Core Principles and Methodology of the International Association of Insurance Supervisors, the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions, the Forty Recommendations on Money Laundering, and

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
	legislative and administrative treatment and the adoption of appropriate measures on the control of drugs and on combating money-laundering, including measures adopted by the Community and international bodies active in this field; […]	Financial Action Task Force (FATF), […]		Exchange of Information on Tax Matters of the Organisation for Economic Cooperation and Development (hereinafter referred to as the 'OECD'), the Statement on Transparency and Exchange of Information for Tax Purposes of the G20, and the Forty recommendations on Money Laundering and Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force.	the Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force. 5. The Parties also take note of the "Ten Key Principles for Information Sharing" promulgated by the Finance Ministers of the G7 Nations and the Agreement on Exchange of Information on Tax Matters of the Organisation on Economic Cooperation and Development's (hereinafter referred to as ("OECD") and the Statement on Transparency and exchange of information for tax purposes of the G20. […]
FATF Member/ Regional organisation	Yes / GAFILAT	Yes / ESAAMLG	No / Moneyval	Yes / APG	No / GAFILAT
Number of prosecutions for money laundering	162 (Sep 2009-Jul 2010); 54 (Jan-Oct 2011); 155 (Nov 2011-Nov 2012);	21 (2010); 38 (2011); 29 (2012);	255 (pending as of May 2011); 4 (2012); 2 (2013)	153 (2010); 249 (2011); 248 (2012);	*Colombia*: 115 (2010); 97 (2012); 67 (2013); 46 (2014)

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
activities 2010-2014[689]	84 (2013)[690]	37 (2013)[691]		350 (2013)[692]	*Peru*: 0 (up to 2012); 238 (2013); 158 (2014);
Reported convictions for money laundering activities 2010-2014	17 (Sep 2009-Jul 2010);[693] 13 (Jan-Jul 2011); 160 (Nov 2011-Nov 2012); 15 (2013)[694]	0 (2010); 8(2011); 13 (2012); 11 (2013)[695]	19 (as of May 2011); 15 (2012); 0 (2013)	62 (2010); 84 (2011); 79 (2012); 141 (2013)[696]	*Colombia*: 95 (2010); 80 (2012); 8 (2013); 57 (2014) *Peru*: 0 (up to 2013); 2 (2014)

[689] Unless otherwise provided, information based on the U.S. Department of State's Narcotic Control Reports 2011-2015, available at: http://www.state.gov/j/inl/rls/nrcrpt/index.htm.

[690] Figures over 2013 based on the FATF's 7th Follow-up *Report, Mutual Evaluation of Mexico*, February 2014, available at: http://www.fatf-gafi.org/media/fatf/documents/reports/mer/Follow-up-report-Mexico-2014.pdf. complete the reference and add link in the title

[691] Figures of South Africa based on: IMF, *South Africa Financial Sector Assessment Program, Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT) - Technical Note*, IMF Country Report No. 15/51, February 2015, p. 19.

[692] Figures of Korea based on: FATF, 8th Follow-up Report, Mutual Evaluation of Korea, June 2014.

[693] 37 Individuals.

[694] *Supra* footnote 538.

[695] *Supra* footnote 691, p. 20.

[696] *Supra* footnote 692, p. 23.

	Mexico	South-Africa	Serbia	Korea	Peru/Colombia
Suspicious transactions reported 2010-2014	34,511 (Jan-Sep 2010); 36,040 (Jan-Sep 2011); 44,591 (Jan-Oct 2012); 117,731 (Oct 2012-Nov 2013); 86,293 (Jan- Sep 2014)	36,990 (Apr 2010- Mar 2011); 53,506 (Apr 2011-Mar 2012) ; 147,744 (Apr 2012- Mar 2013); 355,369 (Apr 2013-Mar 2014)	3,854 (Jan-Oct 2010); 2,257 (Jan-Oct 2011); 811 (2012); 634 (2013)	27 (2009); 101 (2010); 96 (2011); 116 (2012); 295 (2013)[697]	*Colombia*: 9,600 (2010) 4,904 (Jan-Aug 2011); 4,842 (Jan-Aug 2012); 5,224 (Jan-Sep 2013); 6,943 (Jan-Nov 2014) Peru: 2,337 (2010); 1,650 (Jan-Sep 2011); 2,605 (Jan-Sep 2012); 3,265 (Jan-Sep 2013); 4,624 (Jan-Sep 2014)[698]

[697] *Supra* footnote 6920, p. 16.

[698] Note that these figures are different from those provided in Box 16, which draws from the Peruvian Financial Intelligence Unit and moreover covers a different timeframe.

Annex 2: Provisions relevant to Financial Services, Money Laundering and Tax Evasion in selected EU FTAs

EU-Mexico Economic Partnership, Political Coordination and Cooperation Agreement

Article 28 - Cooperation on combating drug trafficking, money- laundering and chemical precursors

1. The Parties shall take the appropriate measures for cooperation and liaison, that they consider appropriate, to intensify their actions for the prevention and reduction of production, distribution and illegal consumption of drugs, in conformity with their respective internal legal regulations.
2. Relying on the competent bodies in this field, such cooperation shall involve in particular:

a) developing coordinated programmes and measures regarding the prevention of drug abuse and the treatment and rehabilitation of drug addicts, including technical assistance programmes. These efforts may also include research and measures designed to reduce drug production by means of regional development of areas inclined to be used to produce illegal crops;
b) developing coordinated research programmes and projects on drug control;
c) exchange of information regarding legislative and administrative treatment and the adoption of appropriate measures on the control of drugs and on combating money-laundering, including measures adopted by the Community and international bodies active in this field;
d) preventing the diversion of chemical precursors and other substances used in the illegal production of drugs and psychotropic substances, in accordance with the 'Agreement on the Control of Drugs Precursors and Chemical Substances' signed by the Parties on 13 December 1996, and in the 1988 United Nations Vienna Convention.

Article 54 (does not have a title)

2. Nothing in this Agreement, or in any arrangements adopted under this Agreement, may be construed to prevent the adoption or enforcement by the Member States or Mexico of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation

'Provisions of implementing Decision (2001/152/EC) no. 2/2001 of the EU-Mexico Joint Council of 27 February 2001', *OJ* L70/7 relevant to financial services, money laundering and tax evasion.

Article 12 – Establishment of financial service suppliers

1. Each party shall allow the financial service suppliers of the other party to establish a commercial presence in its territory.
2. Each Party may require a financial service supplier of the other Party to incorporate under its own law or impose terms and conditions on establishment that are consistent with the other provisions of this Chapter.
3. No Party may adopt new measures as regards to the establishment and operation of financial service suppliers of the other Party, which are more discriminatory than those applied on the date of entry into force of this Decision.
4. No Party shall maintain or adopt the following measures:
a) limitations on the number of financial service suppliers whether in the form of numerical quotas, monopolies, exclusive financial service suppliers or the requirements of an economic needs test;
b) limitations on the total value of financial service trans- actions or assets in the form of numerical quotas or the requirement of an economic test;
c) limitations on the total number of service operations or on the total quantity of service output expressed in the terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
d) limitations on the total number of natural persons that may be employed in a particular financial service sector or that a financial service supplier may employ and who are necessary for, and directly related to, the supply of a specific financial service in the form of numerical quotas or a requirement of an economic needs test; and
e) limitations on the participation of foreign capital in the terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

Article 13 – Cross border provision of financial services
1. Each party shall allow the cross-border provision of financial services.
2. No Party may adopt new measures as regards to the cross-border provision of financial services by financial service suppliers of the other Party which are more discriminatory as compared to those applied on the date of entry into force of this Decision.
3. Without prejudice to other means of prudential regulation of the cross-border provision of financial services, a Party may require the registration of cross-border financial service suppliers of the other Party.
4. Each Party shall permit persons located in its territory to purchase financial services from financial service suppliers of the other Party located in the territory of that other Party. This obligation does not require a Party to permit such suppliers to do business or carry on commercial operations; or to solicit, market or advertise their activities in its territory. Each Party may define the meaning of ‘doing business’, ‘carry on commercial operations’, ‘solicit’, ‘market’ and ‘advertise’ for purposes of this obligation.

Article 14 - National treatment
1. Each Party shall grant to the financial service suppliers of the other Party, including those already established in its territory on the date of entry into force of this Decision, treatment no less favourable than that it accords to its own like financial service suppliers with respect to the establishment, acquisition, expansion, management, conduct, operation and

sale or other disposition of commercial operations of financial service suppliers in its territory.
2. Where a Party permits the cross-border provision of a financial service it shall accord to the financial service suppliers of the other Party treatment no less favourable than that it accords to its own like financial service suppliers with respect to the provision of such a service.

Article 15 – Most favoured nation treatment
1. Each Party shall accord to financial service suppliers of the other Party treatment no less favourable than it accords to the like financial service suppliers of a non-Party.
2. Treatment granted under other agreements concluded by one of the Parties with a third country which have been notified under Article V of GATS shall be excluded from this provision.
3. If a Party enters into an agreement of the type referred to in paragraph 2, it shall afford adequate opportunity to the other Party to negotiate the benefits granted therein.
Article 20 – Effective and transparent regulation
4. Each Party shall make its best endeavours to ensure that the Basle Committee's 'Core Principles for Effective Banking Supervision', the International Association of Insurance Super- visors' 'Key Standards for Insurance Supervision' and the International Organisation of Securities Commissions' 'Objectives and Principles of Securities Regulation' are implemented and applied in its territory.
5. The Parties also take note of the 'Ten Key Principles for Information Exchange' promulgated by the Finance Ministers of the G7 Nations, and undertake to consider to what extent they may be applied in bilateral contacts.

EU-South Africa Trade and Development Cooperation Agreement

Article 29
Reconfirmation of GATS obligations
1. In recognition of the growing importance of services for the development of their economies, the Parties underline the importance of strict observance of the General Agreement on Trade in Services (GATS), in particular its principle on most-favoured-nation treatment, and including its applicable protocols with annexed commitments.
2. In accordance with the GATS, this treatment shall not apply to:
(a) advantages accorded by either Party under the provisions of an agreement as defined in Article V of the GATS or under measures adopted on the basis of such an agreement;
(b) other advantages accorded pursuant to the list of most-favoured-nation exemptions annexed by either Party to the GATS.
3. The Parties reaffirm their respective commitments as annexed to the fourth Protocol to the GATS concerning basic telecoms and the fifth Protocol concerning financial services.

Article 30
Further liberalisation of supply of services
1. The Parties will endeavour to extend the scope of the Agreement with a view to further liberalising trade in services between the Parties. In the event of such an extension, the liberalisation process shall provide for the absence or elimination of substantially all discrimination between the Parties in the services sectors covered and should cover all modes of supply including the supply of a service:
(a) from the territory of one Party into the territory of the other;
(b) in the territory of one Party to the service consumer of the other;
(c) by a service supplier of one Party, through commercial presence in the territory of the other;
(d) by a service supplier of one Party, through presence of natural persons of that Party in the territory of the other.
2. The Cooperation Council shall make the necessary recommendations for the implementation of the objective set out in paragraph 1.
3. When formulating these recommendations, the Cooperation Council shall take into account the experience gained by the implementation of the obligations of each Party under the GATS, with particular reference to Article V generally and especially paragraph 3(a) thereof covering the participation of developing countries in liberalization agreements.
4. The objective set out in paragraph 1 shall be subject to a first examination by the Cooperation Council at the latest five years after the entry into force of this Agreement.

Article 32
Current payments
1. Subject to the provisions of Article 34, the Parties undertake to allow all payments for current transactions between residents of the Community and of South Africa to be made in freely convertible currency.
2. South Africa may take the necessary measures to ensure that the provisions of paragraph 1, which liberalise current payments, are not used by its residents to make unauthorised capital outflows.

Article 33
Capital movements
1. With regard to transactions on the capital account of balance of payments, the Community and South Africa shall ensure, from the entry into force of this Agreement, that capital relating to direct investments in South Africa in companies formed in accordance with current laws can move freely, and that such investment and any profit stemming therefrom can be liquidated and repatriated.
2. The Parties shall consult each other with a view to facilitating and eventually achieving full liberalisation of the movement of capital between the Community and South Africa.

Article 52
Investment promotion and protection
Cooperation between the Parties shall aim to establish a climate which favours and promotes mutually beneficial investment, both domestic and foreign, especially through improved conditions for investment protection, investment promotion, the transfer of capital and the exchange of information on investment opportunities. The aims of cooperation shall be, *inter alia*, to facilitate and encourage:
(a) the conclusion, where appropriate, between the Member States and South Africa of agreements for the promotion and protection of investment;
(b) the conclusion, where appropriate, between the Member States and South Africa of agreements to avoid double taxation;
(c) the exchange of information on investment opportunities;
(d) work towards harmonised and simplified procedures and administrative practices in the field of investment;
(e) support, through appropriate instruments, the promotion and encouragement of investment in South Africa and in the Southern African region.

Article 63
Services
The Parties agree to foster cooperation in the services sector in general and in the area of banking, insurance and other financial services in particular, through, *inter alia*:
(a) encouraging trade in services;
(b) exchanging, where appropriate, information on rules, laws and regulations governing the services sector in the Parties;
(c) improving accounting, auditing, supervision and regulation of financial services and financial monitoring, for example through the facilitation of training schemes.

Article 90
Fight against drugs and money laundering
The Parties undertake to cooperate in the fight against drugs and money laundering by:
(a) promoting the South African drugs control master plan and enhancing the effectiveness of South African and southern African regional programmes to counter the illegal abuse of narcotic drugs and psychotropic substances as well as the production, supply and trafficking of these substances, based on the relevant international UN Drugs Control Conventions;

(b) preventing the use of their financial institutions to launder capital arising from criminal activities in general and from drugs trafficking in particular on the basis of standards equivalent to those adopted by international bodies, in particular the Financial Action Task Force (FATF), and
(c) preventing the diversion of precursor chemicals and other essential substances used for the illicit production of narcotic drugs and psychotropic substances on the basis of the standards adopted by international authorities concerned, notably those of the Chemical Action Task Force (CATF).

Article 91
Data protection
1. The Parties shall cooperate to improve the level of protection to the processing of personal data, taking into account international standards.
2. Cooperation on personal data protection may include technical assistance in the form of exchanges of information and experts and the establishment of joint programmes and projects.
3. The Cooperation Council shall periodically review the progress made in this regard.

Article 97
Institutional set-up
1. The Parties agree on the establishment of a Cooperation Council which will perform the following functions:
(a) to ensure the proper functioning and implementation of the Agreement and the dialogue between the Parties;
(b) to study the development of trade and cooperation between the Parties;
(c) to seek appropriate methods of forestalling problems which might arise in areas covered by the Agreement;
(d) to exchange opinions and make suggestions on any issue of mutual interest relating to trade and cooperation, including future action and the resources available to carry it out.
2. The composition, frequency, agenda and venue of Cooperation Council meetings shall be agreed on through consultation between the Parties.
3. The Cooperation Council referred to above shall have the power to take decisions in respect of all matters covered by this Agreement.
4. The Parties agree to encourage and facilitate regular contacts between their respective Parliaments on the various areas of cooperation covered by the Agreement.
5. The Parties will also encourage contacts between other similar and relevant institutions in South Africa and the European Union such as the Economic and Social Committee of the European Community and the National Economic Development and Labour Council (NEDLAC) of South Africa.

Article 98
Tax carve-out clause
2. Nothing in this Agreement, or in any arrangements adopted under this Agreement, may be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements, or domestic fiscal legislation.

EU-Serbia Stabilisation and Association Agreement

Chapter II : Establishment

Article 53
1. Serbia shall facilitate the setting-up of operations on its territory by Community companies and nationals. To that end, Serbia shall grant, upon entry into force of this Agreement:
(a) as regards the establishment of Community companies on the territory of Serbia, treatment no less favourable than that accorded to its own companies or to any third country company, whichever is the better;
(b) as regards the operation of subsidiaries and branches of Community companies on the territory of Serbia once established, treatment no less favourable than that accorded to its own companies and branches or to any subsidiary and branch of any third country company, whichever is the better.
2. The Community and its Member States shall grant, from the entry into force of this Agreement:
(a) as regards the establishment of Serbian companies treatment no less favourable than that accorded by Member States to their own companies or to any company of any third country, whichever is the better;
(b) as regards the operation of subsidiaries and branches of Serbian companies, established in its territory, treatment no less favourable than that accorded by Member States to their own companies and branches, or to any subsidiary and branch of any third country company, established in their territory, whichever is the better.
3. The Parties shall not adopt any new regulations or measures which introduce discrimination as regards the establishment of any other Party's companies on their territory or in respect of their operation, once established, by comparison with their own companies.
4. Four years after the entry into force of this Agreement, the Stabilisation and Association Council shall establish the detailed arrangements to extend the above provisions to the establishment of Community nationals and nationals of Serbia to take up economic activities as self-employed persons.
5. Notwithstanding the provisions of this Article:
(a) Subsidiaries and branches of Community companies shall have, from the entry into force of this Agreement, the right to use and rent real property in Serbia;
(b) Subsidiaries of Community companies shall, from the entry into force of this Agreement, have the right to acquire and enjoy ownership rights over real property as Serbian companies and as regards public goods/goods of common interest, the same rights as enjoyed by Serbian companies respectively where these rights are necessary for the conduct of the economic activities for which they are established.
(c) Four years after the entry into force of this Agreement, the Stabilisation and Association Council shall examine the possibility of extending the rights mentioned under point (b) to branches of the Community companies.

Article 54
1. Subject to the provisions of Article 56, with the exception of financial services described in Annex VI, the Parties may regulate the establishment and operation of companies and

nationals on their territory, insofar as these regulations do not discriminate against companies and nationals of the other Parties in comparison with its own companies and nationals.
2. In respect of financial services, notwithstanding any other provisions of this Agreement, a Party shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Such measures shall not be used as a means of avoiding the Party's obligations under this Agreement.
3. Nothing in this Agreement shall be construed to require a Party to disclose information relating to the affairs and accounts of individual customers or any confidential or proprietary information in the possession of public entities.

Article 58
1. A Community company established in the territory of Serbia or a Serbian company established in the Community shall be entitled to employ, or have employed by one of its subsidiaries or branches, in accordance with the legislation in force in the host territory of establishment, in the territory of the Republic of Serbia and the Community respectively, employees who are nationals of the Member States or nationals from Serbia respectively, provided that such employees are key personnel as defined in paragraph 2 and that they are employed exclusively by companies, subsidiaries or branches. The residence and work permits of such employees shall cover only the period of such employment. (...)

Chapter III: Supply of Services

Article 60
1. The Parties shall not take any measures or actions which render the conditions for the supply of services by Community and Serbia nationals or companies which are established in a Party other than that of the person for whom the services are intended significantly more restrictive as compared to the situation existing on the day preceding the day of entry into force of this Agreement.
2. If one Party is of the view that measures introduced by the other Party since the entry into force of this Agreement result in a situation which is significantly more restrictive in respect of supply of services as compared with the situation existing at the date of entry into force of this Agreement, such first Party may request the other Party to enter into consultations.

Chapter IV: Current Payments and Movement of Capital

Article 62
The Parties undertake to authorise, in freely convertible currency, in accordance with the provisions of Article VIII of the Articles of the Agreement of the International Monetary Fund, any payments and transfers on the current account of balance of payments between the Community and Serbia.

Article 63

1. With regard to transactions on the capital and financial account of balance of payments, from the entry into force of this Agreement, the Parties shall ensure the free movement of capital relating to direct investments made in companies formed in accordance with the laws of the host country and investments made in accordance with the provisions of Chapter II of Title V, and the liquidation or repatriation of these investments and of any profit stemming there from.
2. With regard to transactions on the capital and financial account of balance of payments, from the entry into force of this Agreement, the Parties shall ensure the free movement of capital relating to credits related to commercial transactions or to the provision of services in which a resident of one of the Parties is participating, and to financial loans and credits, with maturity longer than a year.
3. As from the entry into force of this Agreement, Serbia shall authorise, by making full and expedient use of its existing procedures, the acquisition of real estate in Serbia by nationals of Member States of the European Union. Within four years from the entry into force of this Agreement, Serbia shall progressively adjust its legislation concerning the acquisition of real estate in its territory by nationals of the Member States of the European Union to ensure the same treatment as compared to its own nationals.
4. The Community and Serbia shall also ensure, as from four years after the entry into force of this Agreement, free movement of capital relating to portfolio investment and financial loans and credits with maturity shorter than a year.
5. Without prejudice to paragraph 1, the Parties shall not introduce any new restrictions on the movement of capital and current payments between residents of the Community and Serbia and shall not make the existing arrangements more restrictive.
6. Without prejudice to the provisions of Article 62 and of this Article, where, in exceptional circumstances, movements of capital between the Community and Serbia cause, or threaten to cause, serious difficulties for the operation of exchange rate policy or monetary policy in the Community or Serbia, the Community and Serbia, respectively, may take safeguard measures with regard to movements of capital between the Community and Serbia for a period not exceeding six months if such measures are strictly necessary.
7. Nothing in the above provisions shall be taken to limit the rights of economic operators of the Parties from benefiting from any more favourable treatment that may be provided for in any existing bilateral or multilateral Agreement involving Parties to this Agreement.
8. The Parties shall consult each other with a view to facilitating the movement of capital between the Community and Serbia in order to promote the objectives of this Agreement.

Chapter V: General Provisions

Article 68

1. The Most-Favoured-Nation treatment granted in accordance with the provisions of this Title shall not apply to the tax advantages that the Parties are providing or will provide in the future on the basis of Agreements designed to avoid double taxation or other tax arrangements.
2. None of the provisions of this Title shall be construed to prevent the adoption or enforcement by the Parties of any measure aimed at preventing the avoidance or evasion

of taxes pursuant to the tax provisions of Agreements to avoid double taxation and other tax arrangements or domestic fiscal legislation.
3. None of the provisions of this Title shall be construed to prevent Member States or Serbia from applying the relevant provisions of their fiscal legislation, from distinguishing between taxpayers who are not in identical situations, in particular as regards their place of residence.

Article 81
Protection of personal data
Serbia shall harmonise its legislation concerning personal data protection with Community law and other European and inter• national legislation on privacy upon the entry into force of this Agreement. Serbia shall establish one or more independent supervisory bodies with sufficient financial and human resources in order to efficiently monitor and guarantee the enforcement of national personal data protection legislation. The Parties shall cooperate to achieve this goal.

Article 84
Money laundering and financing of terrorism
1. The Parties shall cooperate in order to prevent the use of their financial systems and relevant non-financial sectors for laundering of proceeds from criminal activities in general and drug offences in particular, as well as for the purpose of financing terrorism.
2. Cooperation in this area may include administrative and technical assistance with the purpose of developing the implementation of regulations and efficient functioning of the suitable standards and mechanisms to combat money laundering and financing of terrorism equivalent to those adopted by the Community and international fora in this field, in particular the Financial Action Task Force (FATF).

Article 86
Preventing and combating organised crime and other illegal activities
The Parties shall cooperate on combating and preventing criminal and illegal activities, organised or otherwise, such as:
(a) smuggling and trafficking in human beings;
(b) illegal economic activities, and in particular counterfeiting of cash and non-cash means of payments, illegal transactions on products such as industrial waste, radioactive material and transactions involving illegal, counterfeit or pirated products;
(c) corruption, both in the private and public sector, in particular linked to non-transparent administrative practices;
(d) fiscal fraud; (e) identity theft; (f) illicit trafficking in drugs and psychotropic substances;
(g) illicit arms trafficking; (h) forging documents; (i) smuggling and illicit trafficking of goods, including cars; (j) cyber-crime.
Regional cooperation and compliance with recognised international standards in combating organised crime shall be promoted.

Article 87
Combating terrorism
In compliance with the international conventions to which they are Party and their respective laws and regulations, the Parties agree to cooperate in order to prevent and suppress acts of terrorism and their financing:
(a) in the framework of full implementation of United Nations Security Council Resolution 1373 (2001) and other relevant UN resolutions, international conventions and instruments;
(b) by exchanging information on terrorist groups and their support networks in accordance with international and national law;
(c) by exchanging experiences with regard to means and methods of combating terrorism and in technical areas and training, and by exchanging experience in respect of the prevention of terrorism.
(this Article is of indirect relevance)

Article 91
Banking, insurance and other financial services
Cooperation between Serbia and the Community shall focus on priority areas related to the Community *acquis* in the fields of banking, insurance and financial services. The Parties shall cooperate with the aim of establishing and developing a suitable framework for the encouragement of the banking, insurance and financial services sectors in Serbia based on fair competition practices and ensuring the necessary level playing field.

Article 93
Investment Promotion and Protection
Cooperation between the Parties, within the scope of their respective competencies, in the field of investment promotion and protection shall aim to bring about a favourable climate for private investment, both domestic and foreign, which is essential to economic and industrial revitalisation in Serbia. The particular aims of cooperation shall be for Serbia to improve the legal frameworks which favours and protects investment.

Article 100
Taxation
The Parties shall establish cooperation in the field of taxation including measures aiming at the further reform of Serbia's fiscal system and the restructuring of tax administration with a view to ensuring effectiveness of tax collection and the fight against fiscal fraud.
Cooperation shall take due account of priority areas related to the Community *acquis* in the field of taxation and in the fight against harmful tax competition. Elimination of harmful tax competition should be carried out on the basis of the principles of the Code of Conduct for business taxation agreed by the Council on 1 December 1997.
Cooperation shall also be geared to enhancing transparency and fighting corruption, and to include exchange of information with the Member States in an effort to facilitate the enforcement of measures preventing tax fraud, evasion and avoidance. Serbia shall also complete the network of bilateral Agreements with Member States, along the lines of the latest update of the OECD Model Tax Convention on Income and on Capital as well as on the basis of the OECD Model Agreement on Exchange of Information in Tax Matters, to the extent that the requesting Member State subscribes to these.

EU-Korea Free Trade Agreement

Article 7.3
The body supervising the implementation and application of the 'services'-component is the *Committee on Trade in Services, Establishment and Electronic Commerce*.

Article 1.1, Paragraph 2
The objectives of this Agreement are:
(b) to liberalise trade in services and investment between the Parties, in conformity with Article V of the General Agreement on Trade in Services (hereinafter referred to as 'GATS');
(d) to further liberalise, on a mutual basis, the government procurement markets of the Parties;
(f) to contribute, by removing barriers to trade and by developing an environment conducive to increased investment flows, to the harmonious development and expansion of world trade;
(h) to promote foreign direct investment without lowering or reducing environmental, labour or occupational health and safety standards in the application and enforcement of environmental and labour laws of the Parties.

Article 7.11
Market access
1. With respect to market access through establishment, each Party shall accord to establishments and investors of the other Party treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in the specific commitments contained in Annex 7-A.
2. In sectors where market access commitments are undertaken, the measures which a Party shall not adopt or maintain either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in Annex 7-A, are defined as: (a) limitations on the number of establishments whether in the form of numerical quotas, monopolies, exclusive rights or other establishment requirements such as economic needs test;(b) limitations on the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test;(c) limitations on the total number of operations or on the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test (18);(d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholdings or the total value of individual or aggregate foreign investment;(e) measures which restrict or require specific types of legal entity or joint ventures through which an investor of the other Party may perform an economic activity; and (f) limitations on the total number of natural persons, other than key personnel and graduate trainees as defined in Article 7.17, that may be employed in a particular sector or that an investor may employ and who are necessary for, and directly related to, the performance of the economic activity in the form of numerical quotas or the requirement of an economic needs test.

Article 7.12
National treatment (19)
1. In the sectors inscribed in Annex 7-A, and subject to any conditions and qualifications set out therein, with respect to all measures affecting establishment, each Party shall accord to establishments and investors of the other Party treatment no less favourable than that it accords to its own like establishments and investors.
2. A Party may meet the requirement of paragraph 1 by according to establishments and investors of the other Party, either formally identical treatment or formally different treatment to that it accords to its own like establishments and investors.
3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of establishments or investors of the Party compared to like establishments or investors of the other Party.
4. Specific commitments assumed under this Article shall not be construed to require any Party to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant establishments or investors.

Article 7.14
MFN treatment (20)
1. With respect to any measures covered by this Section affecting establishment, unless otherwise provided for in this Article, each Party shall accord to establishments and investors of the other Party treatment no less favourable than that it accords to like establishments and investors of any third country in the context of an economic integration agreement signed after the entry into force of this Agreement (21).
2. Treatment arising from a regional economic integration agreement granted by either Party to establishments and investors of a third party shall be excluded from the obligation in paragraph 1, only if this treatment is granted under sectoral or horizontal commitments for which the regional economic integration agreement stipulates a significantly higher level of obligations than those undertaken in the context of this Section as set out in Annex 7-B.
3. Notwithstanding paragraph 2, the obligations arising from paragraph 1 shall not apply to treatment granted: (a) under measures providing for recognition of qualifications, licences or prudential measures in accordance with Article VII of GATS or its Annex on Financial Services; (b) under any international agreement or arrangement relating wholly or mainly to taxation; or (c) under measures covered by an MFN exemption listed in Annex 7-C.

Article 7.16
Review of the investment legal framework
1. With a view to progressively liberalising investments, the Parties shall review the investment legal framework (22), the investment environment and the flow of investment between them consistently with their commitments in international agreements no later than three years after the entry into force of this Agreement and at regular intervals thereafter.
2. In the context of the review referred to in paragraph 1,the Parties shall assess any obstacles to investment that have been encountered and shall undertake negotiations to address such obstacles, with a view to deepening the provisions of this Chapter, including with respect to general principles of investment protection.

Article 7.24
Governance
Each Party shall, to the extent practicable, ensure that internationally agreed standards for regulation and supervision in the financial services sector and for the fight against tax evasion and avoidance are implemented and applied in its territory. Such internationally agreed standards are, *inter alia*, the Core Principle for Effective Banking Supervision of the Basel Committee on Banking Supervision, the Insurance Core Principles and Methodology, approved in Singapore on 3 October 2003 of the International Association of Insurance Supervisors, the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions, the Agreement on Exchange of Information on Tax Matters of the Organisation for Economic Cooperation and Development (hereinafter referred to as the 'OECD'), the Statement on Transparency and Exchange of Information for Tax Purposes of the G20, and the Forty Recommendations on Money Laundering and Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force.

Sub-section E on Financial services

Article 7.37
Scope and definitions
1. This Sub-section sets out the principles of the regulatory framework for all financial services liberalised pursuant to Sections B through D.
2. For the purposes of this Sub-section:
financial services means any service of a financial nature offered by a financial service supplier of a Party. Financial services include the following activities:
(a) Insurance and insurance-related services:
(i) direct insurance (including co-insurance): (A) life; (B) non-life;
(ii) reinsurance and retrocession;
(iii) insurance inter-mediation, such as brokerage and agency; and
(iv) services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services; and
(b) Banking and other financial services (excluding insurance):
(i) acceptance of deposits and other repayable funds from the public;
(ii) lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions;
(iii) financial leasing;
(iv) all payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;
(v) guarantees and commitments;
(vi) trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
(A) money market instruments (including cheques, bills and certificates of deposits);
(B) foreign exchange;
(C) derivative products including, but not limited to, futures and options;
(D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
(E) transferable securities; and

(F) other negotiable instruments and financial assets, including bullion;

(vii) participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;

(viii) money broking;

(ix) asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;

(x) settlement and clearing services for financial assets, including securities, derivative products and other negotiable instruments;

(xi) provision and transfer of financial information, and financial data processing and related software; and

(xii) advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (i) through (xi), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy;

financial service supplier means any natural person or juridical person of a Party that seeks to provide or provides financial services and does not include a public entity; public entity means:

(a) a government, a central bank or a monetary authority of a Party or an entity owned or controlled by a Party, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; or

(b) a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions; new financial service means a service of a financial nature, including services related to existing and new products or the manner in which a product is delivered, that is not supplied by any financial service supplier in the territory of a Party but which is supplied in the territory of the other Party.

Article 7.38
Prudential carve-out (39)

1. Each Party may adopt or maintain measures for prudential reasons (40), including: (a) the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier; and (b) ensuring the integrity and stability of the Party’s financial system.

2. These measures shall not be more burdensome than necessary to achieve their aim, and where they do not conform to the other provisions of this Agreement, they shall not be used as a means of avoiding each Party’s commitments or obligations under such provisions.

3. Nothing in this Agreement shall be construed to require a Party to disclose information relating to the affairs and accounts of individual consumers or any confidential or proprietary information in the possession of public entities.

4. Without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments.

Article 7.39
Transparency
The Parties recognise that transparent regulations and policies governing the activities of financial service suppliers are important in facilitating access of foreign financial service suppliers to, and their operations in, each other's markets. Each Party commits to promoting regulatory transparency in financial services.

Article 7.42
New financial services
Each Party shall permit a financial service supplier of the other Party established in its territory to provide any new financial service that the Party would permit its own financial service suppliers to supply, in like circumstances, under its domestic law, provided that the introduction of the new financial service does not require a new law or modification of an existing law. A Party may determine the institutional and juridical form through which the service may be provided and may require authorisation for the provision of the service. Where such authorisation is required, a decision shall be made within a reasonable period of time and the authorisation may be refused only for prudential reasons.

Article 7.43
Data processing
No later than two years after the entry into force of this Agreement, and in no case later than the effective date of similar commitments stemming from other economic integration agreements:
(a) each Party shall permit a financial service supplier of the other Party established in its territory to transfer information in electronic or other form, into and out of its territory, for data processing where such processing is required in the ordinary course of business of such financial service supplier; and
(b) each Party, reaffirming its commitment (41) to protect fundamental rights and freedom of individuals, shall adopt adequate safeguards to the protection of privacy, in particular with regard to the transfer of personal data.

Article 7.44
Specific exceptions
1. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services forming part of a public retirement plan or statutory system of social security, except when those activities may be carried out, as provided by its domestic regulations, by financial service suppliers in competition with public entities or private institutions.
2. Nothing in this Agreement shall apply to activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies.
3. Nothing in this Chapter shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services for the account or with the guarantee or using the financial resources of the Party, including its public entities except when those activities may be carried out, as provided by its domestic regulations, by financial service suppliers in competition with public entities or private institutions.

Article 7.45
Dispute settlement

1. Chapter Fourteen (Dispute Settlement) shall apply to the settlement of disputes on financial services arising exclusively under this Chapter, except as otherwise provided in this Article.
2. The Trade Committee shall, no later than six months after the entry into force of this Agreement, establish a list of 15individuals. Each Party shall propose five individuals respectively and the Parties shall also select five individuals who are not nationals of either Party and who shall act as chairperson to the arbitration panel. Those individuals shall have expertise or experience in financial services law or practice, which may include the regulation of financial service suppliers, and shall comply with Annex 14-C (Code of Conduct for Members of Arbitration Panels and Mediators).
3. When panellists are selected by lot pursuant to Article 14.5.3 (Establishment of the Arbitration Panel),Article 14.9.3 (The Reasonable Period of Time for Compliance),Article 14.10.3 (Review of any Measure Taken to Comply with the Arbitration Panel Ruling), Article 14.11.4 (Temporary Remedies in case of Non-compliance), Article 14.12.3 (Review of any Measure Taken to Comply after the Suspension of Obligations),Articles 6.1, 6.3 and 6.4 (Replacement) of Annex 14-B(Rules of Procedure for Arbitration), the selection shall be made in the list established pursuant to paragraph 2.4. Notwithstanding Article 14.11, where a panel finds a measure to be inconsistent with this Agreement and the measure under dispute affects the financial services sector and any other sector, the complaining Party may suspend benefits in the financial services sector that have an effect equivalent to the effect of the measure in its financial services sector. Where such measure affects only a sector other than the financial services sector, the complaining Party may not suspend benefits in the financial services sector.

Annex 7 - The Additional Commitment on Financial Services
7. Financial Services

Headnotes: All financial services are subject to the following provisions.

1. To clarify the commitment of Korea with respect to Article 7.11, juridical persons supplying financial services and constituted under the laws of Korea are subject to non-discriminatory limitations on juridical form (35).
2. The commitments of Korea under Articles 7.11 and 7.12 are subject to the limitation that in order to establish or acquire a controlling interest in a financial service supplier in Korea, a foreign investor must own or control a financial service supplier that engages in supplying financial services within the same financial services sub-sector in its home country.
3. For greater certainty, nothing in this Agreement limits Korea’s ability to require the chief executive officer of a financial service supplier established under its laws to reside within its territory.
4. Even if Korea permits persons located in its territory, and its nationals wherever located, to purchase financial services from cross-border financial service suppliers of the other Party located in the territory of the other Party, such permission will not mean that Korea is required to permit such suppliers to do business or engage in solicitation in the territory of Korea. Korea may define ‘doing business’ and ‘solicitation’ for purposes of this obligation, provided that those definitions are not inconsistent with the commitments regarding cross-border supply of financial services undertaken by Korea.

5. Without prejudice to other means of prudential regulation on cross-border supply of financial services, Korea may require the registration or authorisation of cross-border financial service suppliers of the other Party and of financial instruments. Korea may require a cross-border financial service supplier of the other Party to provide information, solely for informational or statistical purposes, on the financial services it has supplied within the territory of Korea. Korea will protect such business information that is confidential from any disclosure that would prejudice the competitive position of the supplier.
6. The Parties confirm that the following entities, as currently structured, are covered by Chapter Seven, but that they shall not be considered financial service suppliers for purposes of that Chapter (36): Korea Deposit Insurance Corporation (KDIC), Resolution and Finance Corporation, Export-Import Bank of Korea, Korea Export Insurance Corporation, Korea Technology Credit Guarantee Fund, Credit Guarantee Fund, Korea Asset Management Corporation (KAMCO), Korea Investment Corporation (KIC), the National Agricultural Cooperative Federation, and the National Federation of Fisheries Cooperatives (37).
7. Korea may grant
(a) to one or more of the following financial service suppliers (collectively, Government-Sponsored Institutions or GSIs):
— The Korea Development Bank;
— Industrial Bank of Korea;
— Korea Housing Finance Corporation;
— The National Agricultural Cooperative Federation; and
— The National Federation of Fisheries Cooperatives.
(b) special treatment, including but not limited to the following:
— Guarantees of loans to or bonds issued by the GSIs;
— Permission to issue more bonds per capital than similarly-situated non-GSIs;
— Reimbursement of losses incurred by GSIs;
— Exemption from certain taxes on capital, surplus, profit, or assets.
8. Chief and deputy executive officers and all members of the Board of Directors of the Korea Housing Finance Corporation, the National Agricultural Cooperative Federation of Fisheries Cooperatives must be Korean nationals.
9. Korea reserves the right not to consider any ‘compulsory’ third-party insurance service supplied in the territory of a foreign country to a natural person in Korea or a juridical person established therein, in determining whether such a natural or juridical person has satisfied a legal obligation to purchase such ‘compulsory’ third party insurance service not listed in this Schedule. However, services supplied outside the territory of Korea may be considered in satisfaction of the legal obligation if the required insurance cannot be purchased from an insurer established in Korea.
10. In the context of privatising government-owned or government-controlled entities that supply financial services, Korea reserves the right to adopt or maintain any measure relating to the continued guarantee, or time-limited additional guarantee, of the obligations and liabilities of these entities.
11. Korea reserves the right to limit ownership by foreign investors of the Korea Exchange and the Korea Securities Depository. In the event of public offering of shares of the Korea Exchange or the Korea Securities Depository, Korea reserves the right to limit shareholding by foreign persons in the relevant institution, provided that Korea shall ensure that: (a) any

shareholding interests held by foreign persons at the time of the public offering shall be preserved; and (b) following the public offering, the Korea Exchange or the Korea Securities Depository shall assure access for financial service suppliers of the EU Party which are established in Korea's territory, and regulated or supervised under the laws of Korea.

Annex 7 - D The Additional Commitment on Financial Services

Transfer of information

1. The Parties recognise the importance of the cross-border transfer of information by financial service suppliers. Korea has expressed its intent to undertake modification to its regulatory regime that will result in its adoption of approaches that will permit the transfer of financial information across borders while addressing such areas as the protection of sensitive information of consumers, prohibitions on unauthorised reuse of the sensitive information, the ability of financial regulators to have access to records of financial service suppliers relating to the handling of such information, and requirements for the location of technology facilities (1).

Performance of functions

2. The Parties recognise the benefits of allowing a financial service supplier in a Party's territory to perform certain functions at its head office or affiliates located inside or outside the Party's territory. To the extent practicable, each Party should allow such an office or affiliate to perform these functions which generally include, but are not limited to: (a) trade and transaction processing functions, including confirmation and statement production;
(b) technology-related functions, such as data processing (2), programming and system development; (c) administrative services, including procurement, travel arrangements, mailing services, physical security, office space management and secretarial services; (d) human resource activities, including training and education; (e) accounting functions, including bank reconciliation, budgeting, payroll, tax, account reconciliation and customer and proprietary accounting; and (f) legal functions, including the provision of advice and litigation strategy.

3. Nothing in paragraph 2 prevents a Party from requiring a financial service supplier located in its territory to retain certain functions.

4. For greater certainty, a financial service supplier located in the territory of a Party retains ultimate responsibility for compliance with requirements applicable to those functions performed by its head office or affiliate.

Supply of insurance by the postal services to the public

5. The regulation of insurance services supplied by a Party's postal service supplier to the public should not accord to the Party's postal service supplier a competitive advantage over private service suppliers of like insurance services in the territory of the Party.

6. To this end, Korea should, to the extent practicable, provide that the Financial Services Commission (hereinafter referred to as the 'FSC') exercise regulatory oversight over the insurance underwriting services supplied by Korea Post to the public and that those services be subject to the same rules applicable to private suppliers supplying like insurance underwriting services in its territory (3).

Sectoral cooperatives selling insurance

7. The regulation of insurance services supplied by a sectoral cooperative should not provide the cooperative a competitive advantage over private suppliers of like insurance

services. To the extent practicable, a Party should apply the same rules to services supplied by such cooperatives that it applies to like services supplied by private insurers.
8. To this end, the FSC should exercise regulatory oversight over services supplied by sectoral cooperatives. At a minimum, Korea shall provide that no later than three years after the entry into force of this Agreement, solvency matters related to the sale of insurance by the National Agricultural Cooperative Federation, the National Federation of Fisheries Cooperatives, the Korea Federation of Community Credit Cooperatives and the National Credit Union Federation of Korea shall be subject to regulation by the FSC.
Self - Regulatory Organisations
9. The Korea Insurance Development Institute is subject to the discipline of Article 7.40. This confirmation is without prejudice to the status of any other organisation in this or any other financial services sub-sector.
10. For greater certainty, if each Party's financial regulatory authority delegates a function related to insurance to a self-regulatory organisation or other non-governmental body, the authority shall take reasonable steps to ensure compliance with Article 7.39 (Transparency) and Article 7.23.2 (Domestic Regulation) with regard to any actions taken by the organisation or other non-governmental body pursuant to the delegated function.

Points of the comparative part to work out: scope of liberalisation and exceptions; wording of the provisions on money laundering (best efforts); introduce/refer to goods-related/trade-based money laundering (perhaps relate this phenomenon to definitions, hint at need for further study, need for full empirical study); compare with more stringent environmental clauses; membership of the FATF or Regional Group; national implementation (money laundering and tax evasion and elusion); look into number of convictions (money laundering and tax evasion and elusion); discretion whether or not (to report by financial institutions or to investigate/prosecute by authorities); key points and conclusions from the comparative part (to be included later in the fourth part); capacity/effectiveness/structural weakness considerations;

EU-Colombia/Peru Trade Agreement

Article 107 Objective and Scope of Application
1. The Parties, reaffirming their commitments under the WTO Agreement, and with a view to facilitating their economic integration, sustainable development and continuous integration into the global economy, and considering the differences in the level of development of the Parties, hereby establish the necessary provisions for the progressive liberalisation of establishment and trade in services and for cooperation on electronic commerce.
2. Nothing in this Title shall be construed to require any Party to privatise public undertakings or to impose any obligation with respect to government procurement.
3. The provisions of this Title shall not apply to subsidies granted by a Party […].
4. The provisions of this Title shall not apply to services supplied in the exercise of governmental authority.
5. Subject to the provisions of this Title, each Party retains the right to exercise its powers and to regulate and introduce new regulations in order to meet legitimate public policy objectives.
6. This Title shall not apply to measures affecting natural persons seeking access to the employment market of a Party, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis.
7. Nothing in this Title shall prevent a Party from applying measures to regulate the entry of natural persons into, or their temporary stay in, its territory, including those measures necessary to protect the integrity of, and to ensure the orderly movement of natural persons across, its borders, provided that such measures are not applied in such a manner as to nullify or impair the benefits accruing to any Party under the terms of a specific commitment in this Title and its Annexes [16].

Article 108 Definitions
For the purposes of this Title:
- "economic integration agreement" means an agreement substantially liberalising trade in services and establishment pursuant to WTO rules;
- "juridical person of a Party" means a juridical person set up in accordance with the laws of that Party and having its registered office, central administration or principal place of business in the territory of that Party; in case a juridical person has only its registered office or central administration in the territory of a Party, it shall not be considered as a juridical person of that Party, unless its operations have a real and continuous link with the economy of that Party […];
- "measure" means any measure by a Party, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form;
- "measures adopted or maintained by a Party" means measures adopted or maintained by:
(a) central, regional or local governments and authorities; and
(b) non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;
- "natural person of a Party" means a natural person that has the nationality of a Member State of the European Union or of a signatory Andean Country according to their respective domestic legislation […];

- "services" includes any service in any sector, except services supplied in the exercise of governmental authority;
- "services supplied in the exercise of governmental authority" means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers;
- "service supplier of a Party" means any natural or juridical person of a Party that seeks to supply or supplies a service;
- "supply of a service" includes the production, distribution, marketing, sale and delivery of a service.

Article 151 Scope of Application

This Section establishes the principles of the regulatory framework for all financial services committed pursuant to Chapters 2 (Establishment), 3 (Cross-Border Supply of Services) and 4 (Temporary Presence of Natural Persons for Business Purposes) of this Title. This Section applies to measures affecting the supply of financial services.[699]

Article 152 Definitions

For the purposes of this Chapter and of Chapters 2 (Establishment), 3 (Cross-Border Supply of Services) and 4 (Temporary Presence of Natural Persons for Business Purposes) of this Title:

- "financial service" means any service of a financial nature offered by a financial service supplier of a Party. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance). Financial services include the following activities:

(a) insurance and insurance-related services:

(i) direct insurance (including co-insurance):

(A) life;

(B) non-life;

(ii) reinsurance and retrocession;

(iii) insurance inter-mediation, such as brokerage and agency; and

(iv) services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services;

(b) banking and other financial services (excluding insurance):

(i) acceptance of deposits and other repayable funds from the public;

(ii) lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions;

(iii) financial leasing;

(iv) all payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;

(v) guarantees and commitments;

(vi) trading, for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:

(A) money market instruments (including cheques, bills, certificates of deposits);

[699] Reference to the supply of a financial service in this Section shall mean the supply of a service as defined in Article 108.

(B) foreign exchange;
(C) derivative products including, but not limited to, futures and options;
(D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
(E) transferable securities; and
(F) other negotiable instruments and financial assets, including bullion;
(vii) participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;
(viii) money broking;
(ix) asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
(x) settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;
(xi) provision and transfer of financial information, and financial data processing and related software; and
(xii) advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (i) through (xi) above, including credit reference and analysis, investment and portfolio research and advice, and advice on acquisitions and on corporate restructuring and strategy;
- "financial service supplier" means any natural or juridical person of a Party that seeks to supply or supplies financial services. The term "financial service supplier" does not include a public entity;
- "new financial service" means a service of a financial nature, including services related to existing and new products or the manner in which a product is delivered, that is not supplied by any financial service supplier in the territory of a Party but which is supplied in the territory of another Party;
- "public entity" means:
(a) a government, a central bank or a monetary authority, of a Party, or an entity owned or controlled by a Party, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; or
(b) a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions;
- "self-regulatory organisation" means any non-governmental body, including any securities or futures exchange or market, clearing agency or other organisation or association that exercises its own or delegated regulatory or supervisory authority over financial service suppliers; for greater certainty, a self-regulatory organisation shall not be considered a designated monopoly for purposes of Title VIII (Competition);
- "services supplied in the exercise of governmental authority" for the purposes of Article 108, also includes:
(a) activities conducted by a central bank or a monetary authority or by any other public entity in pursuit of monetary or exchange rate policies;
(b) activities forming part of a statutory system of social security or public retirement plans; and
(c) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government;

for purposes of the definition of "services supplied in the exercise of governmental authority" in Article 108, if a Party allows any of the activities referred to in subparagraphs (b) or (c) above to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier, the definition of "services" as established in Article 108 shall include such activities.

Article 153 Clearing and Payment Systems
1. Under terms and conditions that accord national treatment, each Party shall grant to financial service suppliers of another Party established in its territory access to payment and clearing systems operated by public entities and to official funding and refinancing facilities available in the normal course of ordinary business. This paragraph is not intended to confer access to lender of last resort facilities of a Party.
2. Where a Party:
(a) requires, as a condition for financial service suppliers of another Party to supply financial services on an equal basis with domestic financial service suppliers, membership or participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any other organisation or association; or
(b) provides, directly or indirectly, such entities privileges or advantages in supplying financial services;
such Party shall ensure that such entities accord national treatment to financial service suppliers of another Party resident in its territory.

Article 154 Prudential Carve-Out
1. Notwithstanding other provisions of this Title or Title V (Current Payments and Movements of Capital), a Party may adopt or maintain for prudential reasons, measures such as:
(a) the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier;
(b) ensuring the integrity and stability of its financial system.
2. Measures referred to in paragraph 1 shall not be more burdensome than necessary to achieve their aim, and shall not discriminate against financial services or financial service suppliers of another Party in comparison to its own like financial services or like financial service suppliers.
3. Nothing in this Agreement shall be construed to require a Party to disclose information relating to the affairs and accounts of individual customers or any confidential or proprietary information in the possession of public entities.
4. Without prejudice to other means of prudential regulation of the cross-border supply of financial services, a Party may require the registration or authorisation of cross-border suppliers of financial services of another Party and of financial instruments.

Article 155 Effective and Transparent Regulation
1. Each Party shall make its best endeavours to provide in advance to all interested persons any measure of general application that that Party intends to adopt in order to give an opportunity for such persons to comment on the measure. Such measure shall be provided:
(a) by means of an official publication; or
(b) in other written or electronic form.

2. Each Party shall make available to interested persons its requirements for completing applications relating to the supply of financial services.
3. Upon request of an applicant, the Party concerned shall inform the applicant of the status of his/her application. Where the Party concerned requires additional information from the applicant, it shall notify the applicant without undue delay.
4. Each Party shall make its best endeavours to ensure that international standards for regulation and supervision in the financial services sector and for the fight against money laundering and the financing of terrorism are implemented and applied in its territory. Such international standards are the Core Principle for Effective Banking Supervision of the Basel Committee, the Insurance Core Principles and Methodology of the International Association of Insurance Supervisors, the Objectives and Principles of Securities Regulation of the International Organisation of Securities Commissions, the Forty Recommendations on Money Laundering, and the Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force.
5. The Parties also take note of the "Ten Key Principles for Information Sharing" promulgated by the Finance Ministers of the G7 Nations and the Agreement on Exchange of Information on Tax Matters of the Organisation on Economic Cooperation and Development's (hereinafter referred to as "OECD") and the Statement on Transparency and exchange of information for tax purposes of the G20.

Article 156 New Financial Services

Each Party shall permit a financial service supplier of another Party established in its territory to supply any new financial service of a type similar to those services which that Party permits its own financial service suppliers to supply under its domestic law in like circumstances. A Party may determine the institutional and juridical form through which the new financial service may be supplied and may require authorisation for the supply of such service. Where such authorisation is required, a decision shall be made within a reasonable period of time and the authorisation may only be refused for prudential reasons.

Article 157 Data Processing

1. Each Party shall permit a financial service supplier of another Party to transfer information in electronic or other form, into and out of its territory, for data processing where such processing is required in the ordinary course of business of such financial service supplier.
2. Each Party shall adopt adequate safeguards for the protection of the right to privacy and the freedom from interference with the privacy, family, home or correspondence of individuals, in particular with regard to the transfer of personal data.

Article 158 Recognition of Prudential Measures

1. A Party may recognise prudential measures of any other country in determining how the measures relating to financial services of that Party shall be applied. Such recognition, which may be achieved through harmonisation or otherwise, may be based upon an agreement or arrangement with the country concerned, or may be granted autonomously.
2. A Party that is a party to such an agreement or arrangement referred to in paragraph 1, whether future or existing, shall afford adequate opportunity for another Party to negotiate

its accession to such agreements or arrangements, or to negotiate comparable ones with such Party, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation and, if appropriate, procedures concerning the sharing of information between the Parties to the agreement or arrangement. Where a Party accords recognition autonomously, such Party shall afford adequate opportunity for another Party to demonstrate that those circumstances exist.

Article 159 Specific Exceptions

1. Nothing in this Title shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing, in its territory, activities or services forming part of a public retirement plan or statutory system of social security, except when those activities may be carried out, as provided by the domestic regulation of that Party, by financial service suppliers in competition with public entities or private institutions.
2. Nothing in this Agreement applies to activities or measures conducted or adopted by a central bank or monetary, exchange rate or credit authority or by any other public entity in pursuit of monetary and related credit or exchange rate policies.
3. Nothing in this Title shall be construed to prevent a Party, including its public entities, from exclusively conducting or providing in its territory activities or services for the account or with the guarantee or using the financial resources of the Party, or its public entities.

Annex 3: GAFILAT-EU Cooperation

GAFILAT (the Financial Action Task Force in Latin America) and the EU agreed on developing a project "Support to the fight against money laundering in the Latin America and the Caribbean countries" in December 2009. This project forms a part of the global action funded by the EU through its "Cocaine Route Programme: Combating Transnational Organised Crime."

The objective of the first stage of the EU-GAFILAT project was to support the fight against money laundering in the *non-banking* financial sector, in a 24 month term, later extended for 12 additional months. In 2011 a specific study a four sub-sectors was carried out: Exchange Market, Remittance, Transport of Securities and other Non-Banking Financial or Credit Agents. In 2012, the work was to focus on the Stock Market, credit cards, and new payment methods.[700]

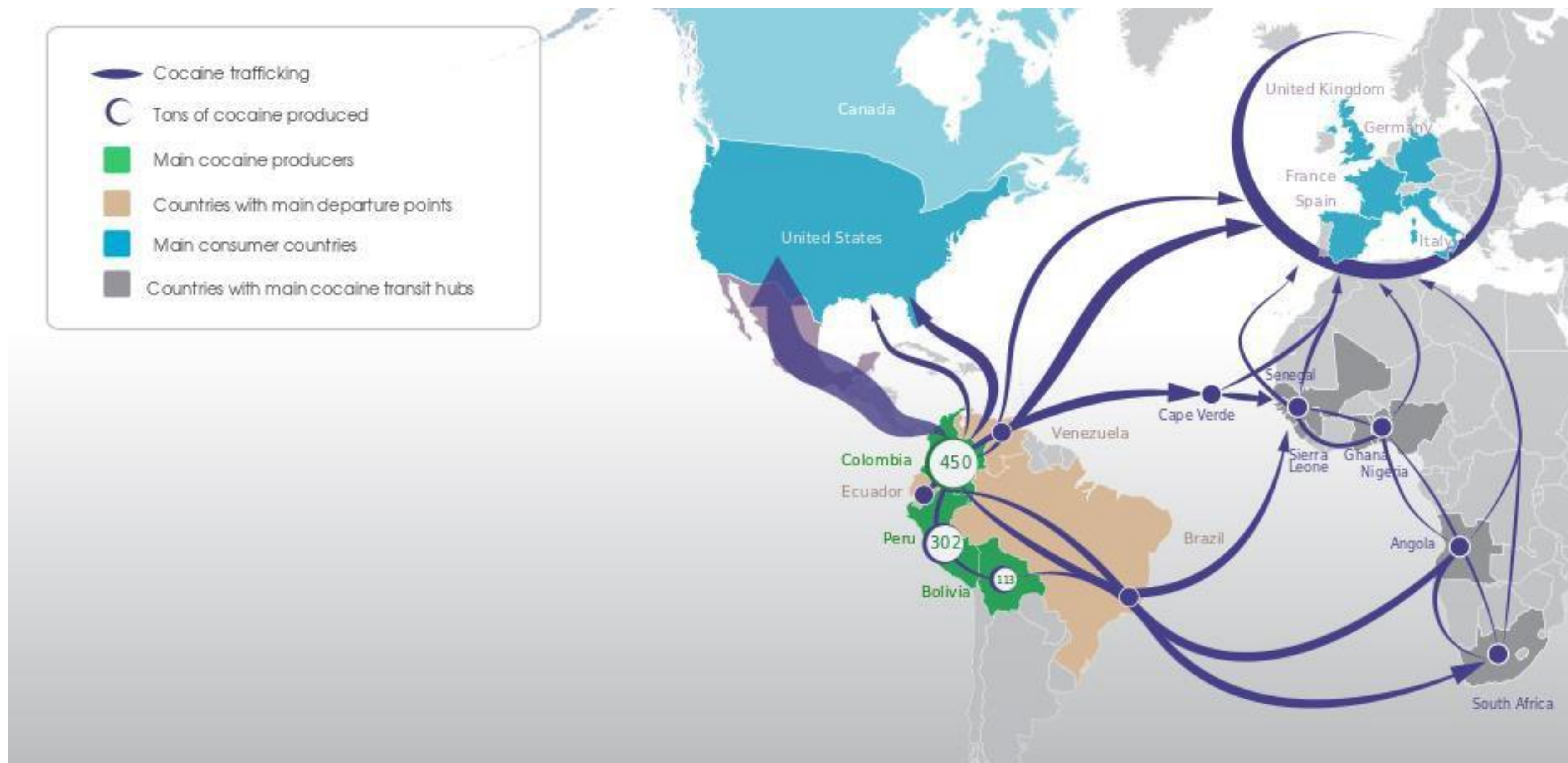
Much training has been carried out during these years (two regional typology seminars, two evaluator seminars, two advanced evaluator seminars, and one workshop on the prevention of money laundering in the transport of valuables sub-sector) and finally, it is expected to draft a regional risk analysis of money laundering through non-banking financial activities.

The agreement for the development of a second stage was signed in December 2011. It consists of four convergent objectives:

- To strengthen the money laundering investigation processes in GAFILAT member countries
- To promote coordination amongst the national actors in the investigation and criminalisation of money laundering cases
- To strengthen cooperation among GAFILAT countries at the administrative, police and legal level
- To promote cooperation in those levels with other FATF style regional bodies (like GAFIC and GIABA) and their member countries.

[700] Like telephone and internet banking and prepaid cards.

For further information, see http://www.cocaineroute.eu/gafisud/. This picture shows cocaine-routes from and through countries like Colombia, Peru, Mexico and South-Africa.



Source: *http://www.cocaineroute.eu*

Annex 4: Questionnaire for the Empirical Study

1. Background and exact role within the [institution x].

2. Trade in financial services between the EU and Mexico, South Africa, Serbia, Korea, and Colombia/Peru following the conclusion of the EU free trade agreements:

    - in which legal forms are financial services provided?
    - how are the financial institutions involved supervised?
    - volumes of trade in financial services (from the EU to third countries and from third countries to the EU).

3. Illicit financial flows resulting from money laundering, tax evasion and elusion:

    - the extent of / specific data on illicit financial flows between the EU and the above mentioned third countries (if available);
    - is there a causal link between (an increase in) such illicit financial flows and the liberalisation of financial services between the EU and third countries?
    - if the data on the illicit financial flows are too general or scarce, what are the main problems in obtaining them?
    - the role of the [institution X] and other relevant international/EU/national institutions involved in combating money-laundering, tax evasion and elusion;
    - major legal and regulatory difficulties involved in combating illicit financial flows between the EU and the above mentioned third countries.

4. Room for improvement in international/EU/national legal frameworks: e.g.

    - Harder obligations of third countries in the area of anti-money laundering, tax evasion and elusion under the EU free trade agreements?
    - Better AML regulation at international level, EU level, EU Member State level and/or third country level?
    - Better implementation and enforcement of AML regulation at EU Member State level and/or third country level?
    - Better governance in third countries?

5. Most important/relevant organisations/persons we should talk to.

Annex 5: List of Questionnaire and Interview Respondents

Institution	Name and position
Bank of Italy (*Banka d'Italia*), Italy	- Pierpaolo Fratangelo, Deputy Head of the Money Laundering Unit
Dutch Central Bank (*De Nederlandse Bank*), the Netherlands	- Juliëtte van Doorn, Head of the Department 'Expert Centre Integrity Strategy' - Maud Bökkering, Financial Supervisor (Anti-Money Laundering/ Counter Terrorist Financing), Department 'Expert Centre Integrity Strategy'
European Banking Authority	- Carolin Gardner, Policy Expert (Anti-Money Laundering)
European Commission, Directorate-General for Justice and Consumers	- David Schwander, Policy Officer Anti-money Laundering
Financial Action Task Force	- Valerie Schilling, Senior Policy Analyst
Financial Intelligence Centre, South Africa	- Kathy Nicolaou-Manias, Senior Policy Analyst
Financial Conduct Authority, United Kingdom	- James London, Manager of Financial Crime Policy and Risk Unit
Global Financial Integrity	- Dev Kar, Chief Economist
Financial Intelligence Unit of Peru (*Unidad de Inteligencia Financiera del Perú*), Peru	- Gonzalo Alvarado, Coordinator for Liaison and Cooperation at the Department for Prevention, Liaison & Cooperation - Miguel Flores Valdivia, Senior Analyst at the Strategic Analysis Department
Financial Intelligence Unit (*Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias*), Spain	- Rafael Abad Prieto, Legal Specialist (Anti-Money Laundering)
Korea Financial Intelligence Unit, Republic of Korea	- Koh Chol Soo, Deputy Director
Ministry of Finance (*Ministarstvo finansija*), Republic of Serbia	- Milovan Milovanovic, Director of the Administration for the Prevention of Money Laundering
National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*), Mexico	- Sandro García Rojas Castillo, General Director of the Anti-Money Laundering Unit
University of Maryland, United States	- Peter Reuter, Professor in the School of Public Policy and in the Department of Criminology
University of Saarland, Germany	- Marco Mansdörfer, Professor of Criminal Law, in particular Economic Criminal Law and Criminal Procedure
World Bank	- Emile van der Does de Willebois, Senior Financial Sector Specialist

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U.S.-Colombia Free Trade Agreement, https://ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text

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