TRANSPARENCY AND INTEGRITY IN **CROSS-BORDER FINANCIAL FLOWS**

CHALLENGES AND EXAMPLES OF INSTITUTIONAL COORDINATION TO PREVENT, DETECT AND COMBAT CROSS-BORDER MONEY LAUNDERING: FINANCIAL, MERCHANDISE AND SERVICES FLOWS.

IDB

Transparency and Integrity in Cross-Border Financial Flows

Challenges and Examples of Institutional Coordination to Prevent, Detect and Combat Cross-Border Money Laundering: Financial, Merchandise and Services Flows.

During September 2021, the IDB held the Webinar "Transparency and Integrity in Cross-Border Activities: Challenges and Examples of Institutional Coordination to Prevent Illicit Activities". The objectives and contents of the seminar were the result of a cross-cutting effort that includes the Investment and Trade Division (INT), the Fiscal Management Division (FMM), as well as the Innovation for Citizen Services Division (ICS). The audience included senior officials from customs, tax administration, financial intelligence units, and think tanks. The main objective was to discuss and identify policy actions, public and private reforms that promote transparency and integrity in cross-border flows of money, goods and services, with emphasis on the use of technological tools, as well as collaboration and cooperation between public agencies. The seminar had a great response and participation from each of the IDB member countries. On average, 130 participants attended the seminar. Moreover, the expressions of interest after the seminar reflect the interest of member countries to seek the assistance of the IDB, especially when there is a transversal vision to address complex problems, such these kinds of illicit cross-border activities.

The webinar aimed at discussing some paths towards tackling money laundering from cross-border illicit flows. On the one hand, it addressed the relevance of inter-institutional collaboration at the national level and across borders to effectively tackle such flows. For example, is clear for all that Financial Intelligence Units (FIUs), prosecutors, and the judiciary must work together effectively to tackle what will end up being money laundering. However, there is often a lack of collaboration between authorities, locally as well as internationally, which limits the effectiveness of investigations. On the other hand, how capable government agencies are to use data effectively to tackle illicit flows is already a critical issue. Myriad data collection happens every day. Due to increasing volume of data flows from multiple sources, neither law enforcement nor private companies can continue to monitor suspicious behavior using traditional tools. Thus, rethinking how *Big Data* tools can be implemented and used by governments is part of the new issues to consider when discussing strengthening of institutional capacities.

Overall, the webinar offered interesting takeaways that policymakers and practitioner should reflect onwards. Moreover, the lessons and experiences shared in the webinar suggest that institutional strengthening should focus in at least three key elements: 1) due to the nature of cross border activities, legal frameworks play a crucial role to make data exploitation and interagency coordination and country-to-country cooperation an effective tool to tackle financial, tax, and customs related illicit activities; 2) beyond formal agreements, promote complementary actions to improve collaboration and coordination between government agencies (financial intelligence, fiscal, customs). In addition, collaboration alliances with the reliable or certified private sector should be used, such as the case of Trusted Traders or authorized economic operators; 3) enhance technological capabilities to collect and use data to identify and trace money flows linked to such illegal activities. More generally speaking, take actions for upskilling the exploitation of data in order to provide FIUs and enforcement agencies better tools for investigation.

Collaboration, Coordination, and Cross-Border Cooperation

The presentations agreed in a necessary condition towards attaining effective work against money laundering through cross-border financial, merchandise or service flows: construct and feed good collaborative relationships, both, between the foreign agencies and the local authorities but also among domestic authorities. The latter can be achieved by establishing joint working groups and providing platforms for systematic dialogue and information sharing. Creating and strengthen inter-institutional cooperation is a challenge but it is necessary to overcome institutional silos in order to effectively tackle the problem of Illicit Financial Flows (IFFs), which naturally cut across competences of different institutions.

The European Union (EU) is a particular case to exemplify some best practices. For instance, as Alfonso Diez Garcia -Deputy Regional Head of Customs and Excises Government of Spain- pointed out, each country within the EU is abide to the same the rules regarding cooperation. This is the case as there is a free flow of goods and people within the EU territory. Thus, such level of integration requires high standards of information sharing. From a policy standpoint, this means there can be no limitation or obstruction to these movements and correspondingly cooperation and information sharing should be frictionless. Because the EU legal framework prioritizes coordination and sharing of information among member countries, procedures for exchange of information are somewhat easy. The challenges for EU countries are related to the sparsity of cooperation agreements with countries outside the Union: while exchange of information with countries outside the EU does take place, there are increased time lags and delays specially when it is related to a criminal investigation.

At country level, local agencies usually face reduced coordination and information sharing. Even in the EU, is not uncommon to observe a “silos” behavior. While not flawless, Spain seems to have a relatively well-structured system to tackle such “silos” behavior when addressing cross-border illegal activities. Diez Garcia discussed that while Spain has a prosecution agency responsible for organized crime and terrorism, this does not limit coordination and collaboration between them and other administrative agencies such as the customs and tax authority. In fact, is not uncommon for multiple agencies to work on one single investigation. They simply perform different tasks and regularly mutually report to each other. However, this is inbuilt and not mandated through formal agreements between agencies. Another key feature the Diez Garcia pointed out in the case of Spain is the presence of technical advisors appointed by the tax and customs agency. These advisors are specialized consultants through the life cycle of an investigation.

Whether they are detected or not, cross-border illicit activities will translate into money laundering. Unlike other areas of anti-money laundering, trade-based money laundering (TBML) traditionally has received little attention. John Cassara, former FinCEN special agent and INL specialist, explained that the main challenge to tackle TBML is that the individuals and institutions along the analysis and investigation chain don’t have access to the same information. TBML has a completely different dimension of complexity compared to other illicit activities. In this regard, Cassara discussed the main challenges that make TBML detection difficult, including:

- Poor communication between trade agencies and local tax-customs agencies for auditing purposes. Moreover, the audit tasks are not always coordinated with investigative tasks. Where possible, it is beneficial to tap into the trusted private sector or those with certifications to exchange information. An example of these are Trusted Traders or the Authorized Economic Operators.

- There is no uniform method on how to target contrabanded goods: This causes blind spots and reduced effectivity of risk-based approaches.
- In general, there is a poor recording of import, export, and re-exports, which leads to discrepancies between the information of the exporting country and the importing country. Moreover, few jurisdictions keep detailed records, these recording gaps create opportunities for illicit activities.
- There are still gaps towards a description of fair cross-border prices. This makes technical contraband difficult to systematically assess.
- Going forward, incipient knowledge of Cryptocurrencies by customs and tax administration agencies. New threats to transparent records and traceability of flows will undermine other compliance policies.

To face the above challenges, multilateral support should focus on strengthening institutional capacities to design and implement effective countermeasures. According to Cassara, the international standards should be more specific to TBML. For instance, FATF should undertake a deeper inspection for TMBL technical and effective compliance in their Mutual Evaluation Reports (MERs). Moreover, each jurisdiction should have comprehensive assessment or review of their trade finance ecosystem. Finally, MERs should pay more attention to actions that promote increased collaboration, cooperation, and data sharing between custom and other local agencies. In this regard, a straightforward first step is to ensure the existence of Customs to Customs Agreements. Cassara also pointed out that government should consider creating Trade Transparency Units (TTUs) as a specialized branch for data analysis and trade intelligence in order to better address cross-border illicit activities. TTUs would become the natural counterpart for Financial Intelligence Units (FIUs) and other enforcement agencies.

Financial Intelligence Units (FIUs) will continue to lead the way in terms of interinstitutional coordination to tackle Money Laundering. Yet, the degree of success in tackling money laundering due to policies promoting coordination, collaboration, and cooperation surely vary across countries. A remarkable example is the case of Peru. The experience in Peru has been that while the FATF instruments focus on co-operation between jurisdictions, real success has come from collaboration. Co-operation and collaboration are two similar words, but their differences are precisely what generates effectiveness. Peru has made significant changes through collaboration with overseas partners like the U.S., but also by working with different agencies and government departments within Peru itself. Sergio Espinosa head of Peru's FIU explained that to meet the expectations regarding effectiveness of AML policies there is a need to emphasize a *whole of government approach*.

In Peru, a change of particular significance, though controversial at the time, was a regulatory reform that allowed prosecutors to come directly to the FIU to receive a report about an ongoing investigation. While the FIU was not pleased with this dissemination of information, it helped instill greater trust and co-operation between judges, prosecutors, and the FIU. This in turn created stronger cases to prosecute. Espinosa commented that expanding information sharing and working in teams through task forces has contributed to strengthen enforcement. That being said, the head of Peru's FIU mentioned that much of recent Peruvian success has come from co-operation and collaboration that exist beyond laws and international instruments designed to foster it. It has been about developing relationships nationally and internationally on key issue areas.

Digital Technologies, Big Data, and Cross-Border Illicit Financial Flows

Some years ago, the key challenge when trying to investigate cross-border illicit financial flows was about finding information and converting it into data to further use it for intelligence purposes. Back then, such task entailed a tedious work requiring hours and hours of data processing. Nowadays, technologies are available to enhance such processes and automate data collection to conform what is called a Big Data approach. Big Data analytics tools can use structured and unstructured raw data from different sources, such as administrative registries, public property registries, tax and customs declarations, financial statements, geolocation data and those from mobile devices or social media, to detect fraudulent activities, unearth hidden connections between accounts, and track the relationship between the sources and beneficiaries.

However, the human factor is especially important given the danger of making decisions with wrong or misleading data. Even if there is good quality data, the risk of incorrectly interpreting data is still a possibility. It is critical, thus, to ensure the quality, authenticity, and integrity of data before implementing data analytics, thus, minimizing errors due to the human factor. Even if these factors are under control mistakes can occur due to human error. Therefore, control and law enforcement agencies must work on capacity building and developing specialized knowledge in advanced data analytics to better ensure that the data being analysed is sound and that the analysts can interpret results correctly.

Sergio Espinosa agreed with the above. The Peruvian FIU in the last ten years has experienced a data revolution which has strengthened the capacity of the FIU to prosecute financial crimes. When the FIU started the process 10 years ago there was a clear paucity in information. Today the FIU is in a position where they are inundated with information and have to identify tools to filter out the *excess* information. The growth of big data has really empowered the work of the FIU in a way that was not possible even a few years ago. According to Espinosa, as much as technology is useful, to maximize value you need appropriate communication between different agencies. Otherwise, you have a situation where a database or system meets only the needs of one government agency/department

Data in the EU ecosystem is no longer the main challenge either. Diez Garcia explains that in Spain, as it may be the case for any other country within the Eurozone, from a regulatory standpoint, there can be no limitation of or obstruction to information and data sharing. Therefore, to effectively support organized and financial crime enforcement, technology and data analytics become imperative. This is especially true when discussing cross-border activities of Eastern European Organized Criminal Groups in Northern Europe. Electronic alert systems are critical to keep an eye on all cargo entering and exiting the EU. Here is where technology meets data. Yet, unlike other countries within the EU, Spain has developed normative procedures to gather specific data. In fact, in a cross-border related audit or investigation, whenever a government agency is unable or does not have access to certain valuable information, the Customs agency has the latitude to turn to the private sector to gain access.

A similar conclusion was presented by Cassara when discussing the role of data, technology, and TBML. While recognizing that data exists, he assesses that unlike tax or financial data, trade related data has not experience scrutiny in depth. In order to be able to exploit trade data better countries should i) use standardized accounting in a more disaggregated fashion to keep track of each trade transaction, ii) use price determination tool, iii) access and adopt distributed ledger technology/blockchain, and iv) gradually converge into smart shipping containers standards. But above all technology, Cassara reflects that

experience shows that there is no replacement for enforcement and training personnel and, thus, is very important to ensure financial resources for enforcement.

On the other hand, many countries in Latin America and the Caribbean (LAC) must first undertake other institutional efforts to be able to exploit all the available information. Galo Maldonado, Legal Director of Ecuador Revenue Service (IRS), discussed the case of Ecuador which is similar to many LAC countries. Ecuador is still at the stage of data collection. Right now, the data is allowing Ecuador to expand the horizon of their audit work and better connect data sources. Maldonado explicitly says that Ecuador is not yet at the stage where the data is overwhelming, but at the point where such influx of information is improving the understanding within the audit and investigation procedures. However, the experience of Ecuador's IRS has shown the value that technology can have in getting information that is necessary to carry out enforcement and address tax crimes. The use of data has definitely allowed for greater precision of audits and investigations. Interestingly, an unintended positive externality has been the tackling of information leaks. The Ecuador IRS has utilized data not just to enhance operational aspects of investigations but to also to improve data protection and security which by enhancing access protocols. Similarly, in terms of financial crimes, Ecuador is still in a place where it is not inundated with data for financial intelligence. But even in this earlier stage, data has enhanced the capacity and capabilities of Ecuador FIU and IRS to fulfil their mandate. Another key insight provided by Galo Maldonado suggests that Ecuador's data revolution and sharing did not happen only through a national financing but also through technical and financial assistance from multilateral and bilateral partners.

Ecuador case study shows that strengthening human and technological capacities required a strong political mandate from within the government. Moreover, other reforms where needed alongside this data revolution, including:

1. Regulatory adjustments for the presence of specialized investigative teams. Multiple professionals make up the team for tax crimes. Because most of tax crimes are investigated as money laundering, a different specialized team is created for that purpose. Thus, both teams collaborate to tackle the issue as both money laundering and as a tax crime.
2. Normative provisions so that the SRI can work on tax related crime issues connected to trade. Tax crimes are intrinsically connected to trade; the SRI has formal cooperation agreements with customs, but the two agencies also work together through participation in joint committees to coordinate responses and share resources.
3. A significant legal reform within Ecuador to ensure that the SRI has the necessary resources but also the legal mandate to carry out tax crime investigations. Critical to this has been the legislative reform in 2014 that recognized tax fraud as a major crime.

Final Remarks

Inter-institutional collaboration at the national level and across borders are key to effectively tackle such illicit flows. Countries in LAC must continue to catch up with the modus operandi and sophistication of activities that lead to money laundering through cross-border financial, merchandise or service flows. Strengthening of institutional capacities to deter illicit flows must be part of public policies. Where there is a lack of collaboration between authorities, criminal groups will find an opportunity to undertake their illegal activities. Thus, regulatory frameworks need to evolve to facilitate cooperation and coordination, both, locally as well as internationally: this is the way towards effectiveness of investigations and ultimately compliance. Likewise, the authorities can take advantage of agreements with the private

sector, especially those certified such as Trusted Traders or Authorized Economic Operators. Technology and data are part of the available toolkit. However, the major challenge is the readiness of government agencies to use data effectively and through them contribute to stronger investigations. Finally, rethinking how big data and other technologies involving machine learning/artificial intelligence or distributes ledgers/blockchains can be implemented and used by governments will be part of the new issues to consider when discussing the pending tasks regarding the strengthening of institutional capacities.

About the rapporteur: The Seminar and the rapporteur were organized with the support of the IDB Transparency Fund. This recount compiles the contributions of the panelists made by Lakshmi Kumar (Director of Policy at Global Financial Integrity) and Guillermo Lagarda (IDB Specialist in the Transparency and Integrity Cluster). The document had additional contributions from Jaime Granados (Head of the Trade and Investment Division of the Integration and Trade Sector at the IDB), Sandra Corcuera (Specialist of the Trade and Investment Division of the Integration and Trade Sector at the IDB), Ubaldo Gonzalez (Specialist of the Fiscal Policy and Management Division at the IDB), Francesco De Simone and Maria Cecilia Alvarez both part of the Transparency and Integrity Cluster at the IDB. The panelists, in order of appearance, were Alfonso Diez García (Regional Deputy Director of Customs and Special Taxes of the Government of Spain), John Cassara (Expert Consultant in TBML), Sergio Espinosa (Director of the Financial Intelligence Unit of Peru), and Galo Maldonado (Legal Director of the Internal Revenue Service of Ecuador). The seminar also featured Ubaldo Gonzalez (Specialist of the Fiscal Policy and Management Division at the IDB), Jaime Granados (Head of the Trade and Investment Division of the Integration and Trade Sector at the IDB), Roberto de Michele (Head of the Transparency and Integrity Cluster at the IDB), and Emilio Pineda (Head of the Division of Fiscal Policy and Management at the IDB), each one as a panel moderator.