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Financing democracy

tackling illicit financial flows

EVENT REPORT



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Illicit financial flows may be worth as much as 5% of global economic output, representing a trillion-dollar problem that has spread from the realm of organised crime to pose a real threat to democracy, development and the rule of law, a *Friends of Europe* expert panel heard on 30 September 2021.

“Illicit flows have overflowed the system and are flooding the whole of society,” said one participant. “What started ... as just a technical problem for juries and policemen and judges and prosecutors to deal with, has now flowed into mainstream society.”

The online event was part of *Friends of Europe*'s 'security briefing series' of invitation-only discussions seeking solutions to pressing contemporary challenges. It looked at defining the dimension of the problem, its evolution from a criminal to a security threat and the various levels of institutional response to illicit money movements.

“Without money there is no organised crime and illicit financial flows certainly are a major issue when we come to looking at some of the ills of our modern society, whether it be the trafficking of human beings, whether it be the drugs trade or the arms trade or counterfeit currency,” the event heard.

Experts are increasingly asking to what extent the problem is moving from organised crime into a form of hybrid warfare that is starting to affect “the stability of our democracy, the health of our society, respect for the rule of law”.

One basic problem is that there is no internationally agreed definition of what constitutes illicit financial flows. The closest definitions come from the World Bank, International Monetary Fund and G7's Financial Action Task Force (FATF).

Papers from the FATF suggest an approximate definition that would consider illicit financial flows to include: “types of cross-border movements of funds that are derived from criminal activity, on one hand, or cross-border movements of funds that are derived from licit activity, but with a criminal intent.” A further category would include funding with apparently legitimate sources and intent, but which undermine aspects of global security, such as financing weapons of mass destruction.

Speakers were clear that the problem has spread from 'hardcore criminality' to include white collar crime and corruption with an impact at the leadership level within societies, linked to other tenacious problems such as fake news and attempts to influence democratic decisions.

Revelations, such as those of the Panama Papers, have underscored the complexity of the challenge, with layers of shell companies, cyclical ownership and networks of lawyers and accountants working to facilitate illicit flows. With enforcement agencies frequently hampered by lack of resources and insufficient international cooperation, unbuckling these complex structures can take years.

Nevertheless, there has been significant improvement at the national and international levels, through the FATF, the Group of States against Corruption (GRECO) at the Council of Europe, as well as efforts within the United Nations and Organisation for Economic Co-operation and Development (OECD), for example.

The European Union was praised for its progress in tackling the issue, yet it still has major room for improvement. One expert outlined serious problems in Europe, including a lack of harmonisation and cooperation among member states; failings in

transparency and information exchange; and a shortfall in resources for enforcement agencies and other institutions.

“The EU has the best framework available, so you can imagine what the rest of the world has,” said one discussant. The global response to the problem is still “very early on in the process”, they added, meaning that “the return on investment is not there as much as we would want it to be”.

Europe needs to develop solutions for situations where outside jurisdictions refuse to cooperate with law enforcement efforts, the meeting was told. Participants called for more consolidated global supervision and coordination between national supervisors, and considered the need for new international structures, or conventions, to coordinate action.

One suggested measure would be basing assessments less on countries’ legal frameworks, which are often excellent, and more on application of the rules, using the number of procedures launched, convictions obtained or assets recovered, for example.

Currently, just 0.7% of illicit assets are recovered, and international enforcement agencies are looking at setting targets at much higher levels of up to 5%.

Participants highlighted how illicit financial flows are particularly harmful for developing countries, causing a ‘catastrophic impact’ as they syphon out money, aid corruption and contribute to tax avoidance that drains nations of financial resources and undermines government stability.

“We really have to join forces ... not only on big criminality, but on the new criminality that really weakens democracy, weakens institutions and is really dangerous for the rest of the world,” said one development specialist.

Although illicit flows often suck money from the global south to the north, one discussant complained, international enforcement efforts are often focused on blacklisting small jurisdictions rather than looking inward at problems with major countries in the north.

Others agreed that major countries need to be more active in identifying flows, confiscating illicit funds and returning them to low-income countries. Greater emphasis is also necessary to improve corporate governance and verification within the private sector.

Care is needed to strike a balance between more efficient and far-reaching regulation and the maintenance of basic freedoms, and speakers stressed the importance of not allowing enforcement measures to infringe on the operations of legitimate companies and non-profit civil society organisations.

“We need to find this new balance between democracy and efficiency in protecting our democracy,” said one expert. However, one insider insisted: “I don’t see any risk of over-regulation, totally the opposite, there is a lack of regulation.”

With new technological innovations - such as crypto-currencies - impacting illicit flows, the need to make “technology work for us and not just for the bad guys” was underscored.

Participants looked at how technological advances are expanding the scale and impact of illicit financial flows and asked what can be done to stop the pace of technology outstripping authorities' ability to detect and stop illicit financial flows.

"Financial intelligence units ... are not really forwarding or tackling the information that they are receiving from banks and other financial institutions in a manner that is timely and in a manner that actually brings about confiscation of those criminal proceeds," said one contributor. "They get a lot of information, millions of transactions from banks, but unfortunately they don't have the possibility to deal with that."

In response, artificial intelligence could help unpick the complex networks used in the flow of illicit finance and analyse the huge amounts of fast-moving financial data that could help uncover unlawful activity.

