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STOPPING THE KLEPTOCRATS: A STRATEGY FOR THE UNITED STATES AND EUROPE TO ADDRESS WEAPONIZED CORRUPTION

A report by Francis Shin and Ben Judah

Atlantic Council

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Preface

Democratic forces, not just in the transatlantic community but worldwide, are coming under increasingly intense assault from authoritarian kleptocracies. From the streets of Minsk to the squares of Astana to the battlefields of Ukraine, the kleptocrats have repeatedly shown their willingness to use deadly force to retain and expand their power. Meanwhile, in our own capitals and financial centers, these forces have found not only willing enablers but entire systems and structures so poorly regulated that they have fueled the kleptocrats' rise. For this reason, we welcome this report's central recommendation for a renewed joint effort by the United States, the United Kingdom, and the European Union to tackle the growing sophistication of authoritarian kleptocracy in weaponizing corruption to harm democracy. Only by standing firm against corruption at home and abroad, and by refusing to accept the institutional failure and poor governance which has characterized this issue for so long, can we hope to adequately defend our democracies from illicit finance.

- Jeanne Shaheen, United States Senator from New Hampshire, member of the Senate Foreign Relations Committee and Chair of the Subcommittee on Europe and Regional Security Cooperation

- Sheldon Whitehouse, United States Senator from Rhode Island, member of the Senate Committee on the Judiciary and Helsinki Commission

- Steve Cohen, United States Representative from Tennessee's 9th District, Co-Chair of the Helsinki Commission and member of the House Committee on the Judiciary

- Congresswoman María Elvira Salazar

- Katarina Barley, member of the European Parliament, vice president of the European Parliament

- David McAllister, member of the European Parliament, chair of the Committee on Foreign Affairs and vice president of the European People's Party

- Nathalie Loiseau, member of the European Parliament, chair of the Subcommittee on Security and Defence and chair of the Delegation to the EU-UK Parliamentary Partnership Assembly

- Raphaël Glucksmann, member of the European Parliament, chair of the Special Committee on foreign interference in all democratic processes in the European Union, including disinformation; vice chair of the Subcommittee on Human Rights; and member of the Committee on Foreign Affairs and Committee on International Trade

- Daniel Freund, member of the European Parliament, co-chair of the Anti-Corruption Intergroup

- Lara Wolters, member of the European Parliament, vice chair of the Committee on Legal Affairs, member of the Anti-Corruption Intergroup

- Sergey Lagodinsky, member of the European Parliament, vice chair of the Committee on Legal Affairs

- Katalin Cseh, member of the European Parliament, member of the Committee on Foreign Affairs and Delegation for relations with the United States; member of the Anti-Corruption Integroup

- Delara Burkhardt, member of the European Parliament, substitute member of the Committee on Foreign Affairs

- Margaret Hodge, member of Parliament, United Kingdom; chair of the UK All-Party Parliamentary Group on Anti-Corruption & Responsible Tax and member of the Economic Crime and Corporate Transparency Bill Committee

- Alicia Kearns, member of Parliament, United Kingdom; chair of the UK House of Commons Foreign Affairs Committee and member of the Joint Committee on the National Security Strategy

U.S. President Joe Biden and U.S Secretary of State Antony Blinken attend a virtual summit with leaders from democratic nations at the State Department's Summit for Democracy, at the White House, in Washington, U.S. December 9, 2021. REUTERS/Leah Millis

- Chris Bryant, member of Parliament, United Kingdom; chair of the UK House of Commons Standards Committee and member of the UK House of Commons Foreign Affairs Committee
- Liam Byrne, member of Parliament, United Kingdom; and member of the UK House of Commons Economic Crime and Corporate Transparency Bill Committee and UK House of Commons Foreign Affairs Committee
- Bob Seely, member of Parliament, United Kingdom; and member of the UK House of Commons Foreign Affairs Committee
- Stewart McDonald, member of Parliament, United Kingdom; member of the UK House of Commons Foreign Affairs Committee

Executive Summary: Rethinking Kleptocracy

A hidden web of power revealed itself to Internet users in early 2022. Following a brutal government crackdown in January, investigators, activists, journalists, and citizens in Kazakhstan were able to use open-source flight-tracking websites to watch kleptocratic elites flee the country on private jets. A little more than a month later, Russia's invasion of Ukraine brought a new spectacle: social media users were able to track various oligarchs' superyachts as they jumped from port to port to evade Western sanctions. These feeds captured a national security problem in near real time: In Eurasia and beyond, kleptocratic elites with deep ties to the West were able to move themselves and their assets freely despite a host of speeches by senior officials, sanctions, and structures designed to stop them.

Foreign corruption continues its assault on Euro-Atlantic democratic institutions. Kleptocratic regimes have exploited the lax and uneven regulatory environments of the global financial system to hide their ill-gotten gains and interfere in politics abroad, especially in the United States, the United Kingdom, and the European Union (EU). They are aided in this task by a large cast of professional enablers within these jurisdictions. By manipulating the very global financial system originally constructed by Western powers, the kleptocrats' continued success threatens the national security of these countries. The stronger these forces get, the more they erode the principles of democracy and the rule of law. Furthermore, the international sanctions regime imposed on Russia in response to its invasion of Ukraine has little hope of long-term success if the global financial system itself continues to weaken.

Since its emergence in the last quarter of the twentieth century, modern transnational kleptocracy has risen dramatically in the political consciousness of transatlantic policy makers. The Russian invasion of Ukraine in 2022 has turbocharged the view in the Western strategic community that corruption and kleptocracy must no longer be allowed to thrive within the global financial system, and that corrupt foreign governments must no longer be allowed to wield political influence in the United States and its allies. Debates about foreign weaponized corruption increased dramatically after reports of Russian inference in the 2016 US presidential election, and today the US government treats it as a top-ranked threat. US President Joe Biden has personally identified weaponized corruption as a national security threat.[1] There is also a growing consensus among experts, policy makers, and practitioners that combating corruption and kleptocracy must begin at home.

The result has been an awakening of not only words, but also policies and actions. Initially spurred by Russia's annexation of Crimea in 2014, the United States and its allies have started to close off their financial institutions to Kremlin-linked kleptocrats. Meanwhile, Western governments have acted against dark money networks connected to the Kremlin and implicated in sanctions evasion and electoral interference.[2] There has been a long buildup here. The US government has also cracked down on corrupt schemes involving luxury real estate with Geographic Targeting Orders (GTOs) since January 2016, passed a bill mandating a beneficial ownership registry in January 2021, and requested increased funding for the Financial Crimes Enforcement Network (FinCEN) in April 2021.[3] The crowning achievement of this new activity has been the US national anti-corruption strategy, unveiled just before the December 2021 Summit for Democracy.[4] The Biden administration also took particular care to note that the United States is itself a haven for kleptocratic assets, and to point out how this is undermining the national security of the United States and its allies.

The anti-kleptocratic policy revolution has also swept through Europe. The UK and the EU have similarly identified the ways that corruption is harming them. Like the United States, both are now increasingly identifying corruption as a security concern. The United States, UK, and EU sought to overhaul existing anti-corruption policies, particularly after supporting the most stringent set of sanctions on Russia to date, including those against the Central Bank of Russia. Both the UK and the EU have mandated beneficial ownership registries (in 2016 and 2018, respectively) to create greater transparency about the people who really own, control, and financially benefit from a company.[5] However, a recent ruling by the Court of Justice of the European Union (CJEU) has ended public access to these registries.[6] After the United States implemented the Global Magnitsky Act in 2016, the UK and the EU passed their own versions of the law in 2020.[7] These laws enabled the United States, the UK, and the EU to begin implementing sanctions against kleptocrats and prolific human rights abusers.

Europe has also passed its own anti-kleptocratic policy innovations. In the UK, for example, the National Crime Agency now has the authority to issue unexplained wealth orders to wealthy individuals whose income or inheritance are insufficient to account for the legitimacy of their wealth. With the AML Authority Regulation, AML Regulation, and 6th Anti-Money Laundering Directive (6AMLD), the EU has taken significant steps toward reducing regulatory mismatches between member states. 6AMLD includes a commitment to establishing an EU-level anti-money laundering authority (AMLA), which would directly supervise obligated financial institutions and coordinate with the financial intelligence units of EU member states to identify transnational money-laundering operations.

All of the above measures were bolstered by the unprecedented scale and coordination of the Group of Seven's effort with the rest of the anti-invasion coalition to implement sanctions against the Central Bank of Russia and other Russian government entities.

Unfortunately, these measures are far from sufficient. Though Western governments are now better able to track illicit financial flows—much like the public can now track the kleptocrats' private jets and yachts fleeing to safe havens—they are still largely unable to stop them. The threat posed by illicit finance is far from being brought under control. Illicit financial networks are often linked to authoritarian regimes and aggression against neighboring states, thus exacting a high geopolitical cost. The recent eruption of a "ring of fire" around Russia—from the Russian invasion of Ukraine and the Armenia-Azerbaijan conflict to the popular uprisings in Belarus, Kyrgyzstan, and Kazakhstan—is directly linked to the fact that the United States and its allies are not systematically using their leverage over authoritarian regimes implicated in illicit finance and sufficiently reducing their potential war chests before such conflicts erupt.[8]

We need only to look to Ukraine's burning, looted, and destroyed cities to see how bad the situation has become. Existing anti-corruption procedures and the work of anti-kleptocracy experts have brought to light the corruption of the ruling classes in Russia and its neighbors, as well as the ways in which that corruption has spread into the global financial system through a variety of enabler networks.[9]

The West still has a long way to go to bring this problem under control. The strategies employed by authoritarian regimes across the former Soviet Union have proven more ruthless, systematic, and adaptable than was once assumed by the United States, the UK, and the EU in the more immediate aftermath of the Cold War. We need to rethink not just how we combat kleptocracy, but also how we define it. It is time for a fresh approach. Policy makers need to understand that authoritarian regimes that threaten transatlantic security are closely linked to illicit financial systems. As it stands, our thinking about how foreign corruption spreads is too constrained by stereotypes about kleptocratic goals and actions.

This report proposes that the transatlantic community begin to address this threat by understanding that there have been two kleptocratic waves in recent history: The first wave began during the Cold War, and the second wave was closely linked to the era of globalization. When considering methods to counter kleptocracy, most transatlantic policy makers have in mind the first wave of kleptocracy, which primarily flourished in the late twentieth century. In fact, it is the second wave of kleptocracy, which emerged since the 2000s, that is more sophisticated, authoritarian, and integrated into the global financial system than its predecessor. Chapter 1 of this report notes an important distinction between these two waves: The second wave features weaponized corruption as a new challenge to the transatlantic community. Chapter 1 argues that corruption is targeted at, and can indeed infiltrate, the political processes and financial markets of the United States and its allies, threatening their collective security and undermining principles of democracy and the integrity of government. Chapter 2 identifies, through a few case studies, the tools that second-wave kleptocrats use to spread and weaponize corruption. It concludes by noting that these kleptocrats are increasingly hard to disentangle as a specific phenomenon from contemporary authoritarianism and subject to far less transatlantic leverage and deterrence—with most of these kleptocrats viewing the transatlantic community more as a target. Russia is a key example.

The report then turns to rethinking how kleptocracy, and not just the kleptocrat, itself functions. Chapter 3 highlights how second-wave kleptocracy has increasingly come to use financial crime in the global private investment, real estate, cryptocurrency exchange, and arts trade industries to achieve its ends. This threat emerged because, compared to the kinds of financial institutions that are the more traditional targets of money-laundering schemes and other forms of illicit finance, these industries have received less regulatory attention and anti-money laundering (AML) supervision despite their growing role in transnational and weaponized corruption. The lack of urgency about closing these regulatory gaps owes much to the fact that policy makers still associate kleptocracy with more traditional forms of corruption, such as organized crime. As a result, institutions in these industries have flown under the radar of most financial regulatory reforms. Policy makers have not fully grasped that this is an urgent national security concern.

Chapter 3 also presents a more fine-grained understanding of the loopholes the authoritarian kleptocrats are exploiting, as well as an explanation of the regulatory gaps in the private investment, real estate, cryptocurrency exchange, and arts trade industries in the United States, the UK, and the EU. Overall, the primary problem for the United States is its lack of enabling legislation to better regulate and supervise these industries. The UK and the EU, meanwhile, have had more trouble implementing and enforcing existing regulations on these industries. Together, the transatlantic community needs to implement stricter beneficial ownership requirements, extend AML/Know Your Customer (KYC) compliance to all private investment firms regardless of their size, coordinate sanctions regimes more effectively, and share financial intelligence about kleptocrats who are abusing regulatory loopholes on both a strategic level and a case-by-case, tactical level.

Governments on both sides of the Atlantic are reaching the limits of what reactive, siloed, and national strategies can achieve. Authoritarian kleptocrats pass with ease through the web of sovereignties that frame transatlantic governance; a tighter, more coordinated web is needed. Thus, Chapter 4 discusses the need for a new platform to ensure that the transatlantic community harmonizes its regulatory environment, especially in the private investment industry. This report proposes that a Transatlantic Anti-Corruption Council (TACC), modeled on the US-EU Trade and Technology Council, be established as that platform for transatlantic anti-corruption coordination. The TACC would provide a forum for policy makers and experts on both sides of the Atlantic to discuss and strategize how to address this growing crisis of weaponized corruption in their jurisdictions. It would also enable policy makers to exchange anti-corruption best practices—such as how to improve beneficial ownership requirements and recover stolen assets—and enable more transatlantic financial intelligence sharing. This is the way to stop authoritarian kleptocrats who have thrived on the institutional dysfunction, regulatory failure, and bureaucratic weakness of the transatlantic community for far too long.

U.S. President Joe Biden, Britain's Prime Minister Boris Johnson, European Commission President Ursula von der Leyen and European Council President Charles Michel sit at a round table as Ukraine's President Volodymyr Zelenskiy addresses G7 leaders via video link during their working session, in the Bavarian Alps, Germany June 27, 2022. Kenny Holston/Pool via REUTERS

Chapter 1: The Kleptocratic Waves

Although the term kleptocracy, which means "rule by thieves," has existed since at least 1819, its relevance in the international security discourse has grown only recently.[10] Nevertheless, there have been many historical figures who deserve the moniker of kleptocrat, from Gaius Verres, the Ancient Roman governor of Sicily whom Cicero prosecuted for his notorious bribery and extortion schemes,[11] to Robert Clive, who cemented the British East India Company's presence in Bengal through incessant looting and drove many of its people into poverty.[12]

The rise of contemporary transnational kleptocracy is tied to the rise of post-Cold War globalization. The first wave of transnational kleptocracy emerged slowly in the third quarter of the twentieth century, intertwined with the rise of transatlantic offshore finance. Offshore finance's rise prompted a race to the bottom in terms of financial regulation and a rise in baroque forms of corruption across the post-independence "Third World."

Kleptocrats from this first wave likely match most people's preconceptions upon hearing the word "authoritarian dictator" or "corrupt bureaucrat." It was, after all, the corrupt autocrats of the Cold War era who flaunted the wealth they stole from their own people and harbored little to no geopolitical ambitions about changing or corrupting the democratic world in the process of amassing their great wealth. Although few used the term "kleptocrat" to describe these figures, their practices certainly fit today's definition. One by one, these figures flourished, from the Philippines' Ferdinand Marcos ($5–$10 billion) and Zaire's Mobutu Sese Seko ($5 billion) in the 1960s to Yugoslavia's Slobodan Milošević ($1 billion) up until the mid-2000s.[13]

Behaviorally, these figures fit a type. For example, dictators like Mobutu or dictators' relatives like Teodoro Nguema Obiang Mangue, nicknamed Teodorín, in Equatorial Guinea lavishly spent their ill-gotten gains in million-dollar shopping sprees to buy huge mansions, expensive art, and celebrity memorabilia.[14] To obscure tracking by law enforcement, a simplistic, first-generation series of shell companies normally conducted these illicit financial acquisitions. These kleptocrats, many of whom are still spending large today, usually did not weaponize their corruption to influence the foreign policies of the United States or its allies; rather, they were content to offshore their ill-gotten gains in US, UK, and EU jurisdictions with lax oversight over these types of transactions. Given the bipolar nature of the world during the Cold War, these kleptocrats at first only had the option of approaching Western enablers to offshore their stolen money. They found a system of weak regulation, much of it being cut in the so-called neoliberal moment and booming offshore finance gains.

Left: Robert Clive, 1st Baron Clive of Plassey, in a portrait by Nathaniel Dance, held at the National Portrait Gallery in London. Right: Teodoro "Teodorín" Nguema Obiang Mangue, Vice President of Equatorial Guinea and son of the country's president. REUTERS/Darren Ornitz

Table 1. Prominent First-Wave Kleptocrats

Name	Estimated Wealth	Period of Rule
Former Indonesian President Suharto	$15–$35 billion[15]	1967–98
Former Filipino President Ferdinand Marcos	$5–$10 billion[16]	1966–86
Former Zairian President Mobutu Sese Seko	$5 billion[17]	1965–97
Former Nigerian Head of State Sani Abacha	$3–$5 billion[18]	1993–98
Former Yugoslav President Slobodan Milošević	$1 billion[19]	1989–2000
Former Peruvian President Alberto Fujimori	$600 million[20]	1990–2000
Former Haitian President Jean-Claude Duvalier ("Baby Doc")	$200–$500 million[21]	1971–86
Former Ukrainian Prime Minister Pavlo Lazarenko	$114–$250 million[22]	1996–97
Former Nicaraguan President Arnoldo Alemán	$100 million[23]	1997–2002
Former Filipino President Joseph Estrada	$78–$85 million[24]	1998–2001

SOURCES: AUTHORS.

Much of this world had passed into historical memory long before the Russian invasion of Ukraine on February 24, 2022. It is no longer a simple matter for first-wave kleptocrats to access the global financial system. Law enforcement in the United States and in allied states can track such behavior more easily, especially because these first-wave kleptocrats like showing off their wealth. The legal regime itself has been reformed—though it bears mentioning that these reforms were not initially designed to target first-wave kleptocrats. Law enforcement now has the authority to track and seize material purchases if there is clear evidence that the money used to make them was stolen.

Sanctions are now much more widespread as well, with the aim of countering both waves of kleptocracy. These legal authorities were partly developed under the Global Magnitsky Act in the United States and its equivalent legislation in the United Kingdom and the European Union (EU), US Geographic Targeting Orders, and the EU's Anti-Money Laundering Directives. Asset recovery is also much simpler. Although kleptocrats may try to move their assets away from the United States and its allied authorities, these assets can be recovered from allied jurisdictions. Additionally, many of the regulatory loopholes exploited by these classic kleptocrats have either already been addressed or are in the process of being closed. Above all, the United States and its allies have less patience for egregious kleptocratic allies in the mold of Suharto or Marcos than they did during the Cold War, when alignment against the Soviet Union was the top US strategic priority. These kinds of kleptocratic leaders are not extinct, but they are curtailed.

Notwithstanding these reforms, the threat posed by kleptocracy is greater than ever thanks to a second and more variegated wave of kleptocracy which is less well understood than the cruder kind that flourished during the Cold War and following the collapse of the Soviet Union. This remains the case even following the economic sanctions and anti-illicit finance reforms that the United States, the UK, and the EU have undertaken since the Russian invasion of Ukraine.[25]

Compared to first-wave kleptocrats, second-wave kleptocrats intend to use the global financial system for strategic gains—either for self-gain and/or to reshape it in their image—instead of just hiding or securing the money they have stolen. Most notably, this evolution accelerated in Russia under President Vladimir Putin before February 2022, with the agendas of oligarchs and kleptocrats being subordinated to and intertwined with the plans of an ambitious state authoritarian. The US State Department revealed that Putin's allies have invested at least $300 million to develop networks of illicit finance to fund political interference in more than two dozen countries since 2014.[26] This model is not confined to Putin's Russia either; it has since been attempted by post-Soviet authoritarians and others as well. A high-profile example of this is the Azerbaijani Laundromat used to bribe officials throughout the United States and the EU to secretly influence their foreign policies to benefit the regime of President Ilham Aliyev in Azerbaijan.[27]

Alongside this weaponized corruption, there has arisen in the West a coterie of enablers among the policy makers targeted by second-wave kleptocrats. In one emblematic case, an Al Jazeera undercover operation revealed high-ranking Cypriot politicians attempting to gain favor with a fictitious Chinese investor who had been convicted of money laundering by aiding the investor's citizenship-by-investment application.[28] Likewise, former German Chancellor Gerhard Schröder allegedly used his powers as chancellor to benefit the Russian state-owned energy giant Gazprom before joining the Gazprom-owned Nord Stream company after leaving office.[29] He has denied improper conduct, claiming to have "always served German interests," but such claims of enabling have become increasingly common as the second wave of kleptocracy has grown in scale and sophistication, outpacing the simultaneous drive for more regulation, law enforcement, and anti-corruption measures on both sides of the Atlantic.[30] More recently, a scandal in the European Parliament has implicated some of the most senior European politicians across the EU, including Eva Kaili, who was up until December 2022 one of the European Parliament's fourteen vice presidents. Ongoing investigations into bribes allegedly given by Qatar to senior European politicians are looking into whether Kaili was involved in this purported bribery. Although Qatar and Kaili have denied any wrongdoing, the lawmaker's colleagues voted to remove her from the vice presidency as the investigation into this purported corruption continues.[31]

Thinking Structurally

As the flurry of sanctions following the Russian invasion of Ukraine indicated, the Group of Seven (G7) and its allies were ill-prepared for the second wave of kleptocracy. Even though Russia has become the most sanctioned country in the world, these are merely stopgap measures and do not address the structural weaknesses in the West that the Kremlin has been exploiting.[32] The kleptocrats have benefited from the ways in which two structural conditions interact in globally connected political institutions: the nature of transnational finance and the rise of the enablers. Consequently, there must be a systemic step-up in structured cooperation, much in the same way that the G7 and its allies coordinated their invasion-related sanctions.

Since globalization accelerated after the end of the Cold War, it has been clear that illicit finance is increasingly an international phenomenon. When it comes to grand-scale corruption, it is now structurally a transnational and no longer a primarily national phenomenon, as it was throughout the Cold War. Meanwhile, the complexity of transnational finance has only grown. Kleptocrats have long parked their assets in transatlantic jurisdictions with lax regulations, but those assets likely had to cross several other transatlantic jurisdictions with lax oversight over transactions before reaching their final destination. For example, in many transnational money-laundering cases in which assets are offshored in the United States, those assets are highly likely to have transited through British and/or EU jurisdictions. The kleptocrats operate in this manner to make it more difficult for law enforcement agencies to track suspicious transactions, given the lack of financial intelligence sharing between law enforcement agencies in different jurisdictions.

However, Financial Intelligence Units (FIUs) and law enforcement agencies are increasingly aware of these practices. This was demonstrated in the global response to the Russian invasion of Ukraine, especially in the formation of the Russian Elites, Proxies, and Oligarchs (REPO) Task Force by the G7 and Australia in March 2022. REPO was specifically designed to facilitate easier financial intelligence sharing between the parties' relevant FIUs and law enforcement agencies to share typologies at the strategic level.[33] Yet REPO was designed in an ad hoc manner for the sanctions on the Kremlin, without focus on kleptocrats from other regimes. Even with this unprecedented level of financial intelligence sharing, financial law enforcement systems—structured nationally rather than internationally—are neither strong enough nor designed to tackle the second wave of kleptocracy.

This is not the only structural phenomenon in need of attention. In the domestic arena, it should now be clear that thinking of Western enablers as "bad apples" is unhelpful. In fact, the enabler class has emerged as a sustained, growing, and structured presence. Western enablers are essential tools for second-wave kleptocrats to offshore stolen money. In contrast to the first wave of kleptocracy, however, Western enablers today tend to be high-ranking politicians and bureaucrats. In the case of the Azerbaijani Laundromat, the Al Jazeera undercover investigation in Cyprus, and

Schröder's alleged connections to the Kremlin, high-ranking political figures were accused of sleaze, bribery, and/or enabling foreign corruption to enter and spread within their own jurisdictions. The role of the enabler has grown significantly, especially as anti-kleptocratic measures against first-wave kleptocrats have taken hold. Once again, however, the transatlantic community has failed to respond, and continues to view these actors as essentially national in their interests, rather than consider how their greed and self-interest may help foreign kleptocrats' bribery and influence schemes.

The failure to reformat anti-corruption systems around these consolidating realities means that the now-dominant second wave of kleptocracy is becoming much more difficult to track. This is happening for two primary reasons: first, because transatlantic authorities are so focused on countering smaller cases of more "conventional" forms of first-wave kleptocracy (usually without focusing on dictators themselves, unless they are pariah figures), and second, because the second wave of kleptocracy draws less attention by using new methods and strategies that are harder to track.

Central to both the failure of transatlantic regulation and the strategies of second-wave kleptocrats are chronically under-regulated financial industries. These include, but are not limited to, private investment firms, art dealerships, real estate agents, and luxury goods providers. These industries have never been strongly regulated compared to financial institutions, such as banks, which traditionally facilitated illicit financial activity. As regulations have caught up to the first wave of kleptocracy, foreign kleptocrats are increasingly switching to different channels for illicit finance. Compounding this problem, structurally, the current approach to corruption and kleptocracy in the transatlantic community is also too reactive and siloed by jurisdiction.

The broad strokes of what must be done on both sides of the Atlantic are already apparent.

Given the worsening circumstances, members of the transatlantic community must structurally reengineer their cooperation with each other to face the new wave of kleptocracy. But before we attempt to identify the loopholes used by kleptocrats and how to close them, we need to take a closer look at the different faces of second-wave kleptocracy —and dispense with some outmoded cliches. Only by building up a general picture from analysis of individual cases can we design a comprehensive response.

People hang a banner during a protest against corruption outside the Filoxenia Conference Center, currently hosting the Cypriot parliament, in Nicosia, Cyprus October 14, 2020. REUTERS/Yiannis Kourtoglou

Chapter 2: Case Studies of Weaponized Corruption

Russian businessman Boris Berezovsky (L) looks pensive at a Federation Council session July 7, 2000, as President Vladimir Putin's plans to trim the influence of regional leaders over their vociferous objections edged closer to becoming law on the eve of a major address by the Kremlin leader. CVI/CLH/

What is a kleptocrat? Though our understanding of the threat posed by illicit finance has grown ever more sophisticated, our conception of a kleptocrat remains frozen in the mid-to-late 2000s: halfway between David Cronenberg's 2007 London Russian gangster movie *Eastern Promises*, which depicted ties between the Russian state and overseas mafia groups, and the 2011 case of Teodoro Nguema Obiang Mangue, vice president of Equatorial Guinea, in which the US Justice Department seized a Gulfstream jet, yachts, cars, and Michael Jackson memorabilia. Both depictions—one fictional, one real—describe the world of ten years ago, when the second wave of kleptocracy was still relatively new.

The golden age of the first wave of kleptocracy ended approximately in the late 1990s, after the end of the Cold War and the bipolar contest between the United States and the Soviet Union. During that time, the idea that corruption was "just another way of doing business" became increasingly unpopular in global governance. These sentiments and newfound consensus culminated in the 1996 Inter-American Convention Against Corruption, 1997 OECD Anti-Bribery Convention, and the 2003 United Nations Convention against Corruption.[34]

Today's second-wave kleptocrats are much more complicated actors, sometimes using corruption as a means of achieving power, rather than power as a means of achieving kleptocratic ends. The second wave has not spread evenly across the world, which is partly why some first-wave kleptocrats, such as members of the Obiang dynasty in Equatorial Guinea, have retained their wealth and power up to present times. Russian kleptocrats are the primary engineers of the tools of the second wave, which is why much of this new form of kleptocracy has emerged from the former Soviet Union.

Second-wave kleptocracy symbolically arrived in November 2000, when Boris Berezovsky, a Russian oligarch, fled to the United Kingdom after losing favor with then-newly elected Russian president Vladimir Putin. Berezovsky had previously been a close Putin ally, enjoying exclusive access to his inner circle. However, following his self-exile, Berezovsky's wealth, valued at $3 billion by *Forbes* in 1997 ($5.54 billion by today's conversion), was seized by Russian authorities. The seizure of Berezovsky's wealth and his flight demonstrated a new relationship between kleptocrats and the Kremlin. When Berezovsky became a potential obstacle to the consolidation of Putin's regime, his wealth and influence, which had been acquired through kleptocratic means, was rebranded as a threat to the rule of law in Russia.[35] Meanwhile, back at home, Russian corruption was increasingly leveraged to achieve strategic goals and project power, such as regime consolidation domestically and abroad.

Despite the whirlwind of sanctions against Russian oligarchs following the Russian invasion of Ukraine on February 24, 2022, Western policy makers still do not fully understand these new kinds of kleptocrats, as sanctions were imposed on them because of their association with the Kremlin, not because of their financial crimes. Policy makers will be better served by a richer understanding of kleptocracy in action: one which more accurately reflects both the political realities they flow from and their differing objectives in a world subtly changed from the one depicted in Cronenberg's film. Today, kleptocrats exploit the following seven vulnerabilities:

1. Offshore accounts in jurisdictions with less oversight
2. Shell companies that do not list beneficial ownership
3. Lack of enforcement of existing rules
4. Not enough financial intelligence sharing
5. Sanctions misalignment
6. Lack of anti-money laundering (AML) compliance in the private investment, real estate, cryptocurrency exchange, and arts trade industries
7. Presence of enablers

Focusing more intently on the motives and methods behind weaponized corruption enables us not only to better understand the distinct reasons and strategies animating kleptocrats, it also gives us a more up-to-date picture of how and why they use the global financial system to achieve their ends and of the failures of existing enforcement and regulatory regimes. One of the greatest threats to emerge with the second wave of kleptocracy is "lawfare"—that is, litigation to discourage or prevent public discussion of the full extent of criminal kleptocratic activities in the United States, the UK, and the European Union (EU). Due to such legal concerns, this report has had to limit its own analysis of specific cases of weaponized corruption. This report aims instead to examine three typologies of kleptocrats and entities acting as vehicles for kleptocracy: the kleptocrat as natural resources tycoon, the corporation as vector for weaponized corruption, and the kleptocrat as legislative enabler.

The Kleptocrat as Natural Resources Tycoon

The kleptocrat as natural resources tycoon is a figure who has "assimilated" into the global financial system and has been recognized as a legitimate businessperson because they provide a consistent source of fossil fuels to the United States and its allies. The typical tycoon has a relatively strong reputation despite their questionable business practices. Their primary source of wealth is therefore not illicit finance, but they use such means to further their business objectives. The kleptocrat as natural resources tycoon views the transatlantic world above all as a market, but due to the fixed nature of resource extraction, they cannot deviate too far from loyalty to the regime in the country where this extraction takes place. As a result, the kleptocrat as natural resources tycoon has a strongly supportive relationship with the regime, which turns a blind eye to their criminal techniques. Because of that support, the tycoon hews to the regime even at the cost of losing legitimacy as business leaders within the transatlantic world. To guarantee the regime's support for continued extraction, these tycoons often "donate" parts of their revenue to leadership figures. Several Russian oligarchs would seem to fit this typology, such as Gennady Timchenko, if many of the allegations against him are true.[36]

In the case of Russian natural resource tycoons, given that their wealth is heavily reliant on the extraction of natural resources from Russian territory, they cannot deviate too far from loyalty to the Kremlin. Furthermore, the Kremlin may ask individual tycoons to leverage their existing businesses to facilitate financial crimes, such as sanctions evasion. Tycoon kleptocrats' continuing loyalty to the Kremlin following Russia's invasion of Ukraine has cost them their legitimacy as business leaders in the transatlantic community. Natural resource kleptocrats thus demonstrate the limits of Russia's integration in the global financial system.

Tycoon Kleptocrats' Illicit Financial Practices

On the surface, the integration of Russian natural resource tycoons into the global financial system was a success story of capitalist transition in post-communist Russia. Even though most of their wealth had been acquired through the corrupt way many oil and natural gas corporations were privatized in the 1990s, they were able to gain favor with Western politicians and business leaders by setting up some of the first post-Soviet Russian exports of oil. Many tycoon kleptocrats built upon their initial business successes and began investing large sums of their wealth outside Russia, successfully breaking into the global financial system. In fact, some were successful enough to make large-scale fossil fuel investments in the United States itself. A few were able to do this because they had successfully cultivated images of themselves as reliable partners of the transatlantic community.[37]

The tycoon kleptocrats' relationship with the transatlantic community only began to fray after accusations that their oil-trading enterprises had engaged in insider trading with Russian state-owned oil companies. However, most of the sanctions placed on Russia's natural resource tycoons before February 2022 were the result of US intelligence agencies' assessments that they were "donating" their revenue to provide material support to the Kremlin's pre-invasion aggression against Ukraine and its annexation of Crimea in 2014. Following the commencement of the Russian invasion of Ukraine on February 24, 2022, members of the transatlantic community imposed more sanctions on the tycoons.[38]

Because most Russian natural resource tycoons enjoyed public images as conventional businesspersons with many operations in Europe, their designation under Ukraine-related sanctions by the Department of the Treasury was more difficult to justify, even though most have been key members of Putin's inner circle since at least the 1990s. This may be partly why the UK and the EU did not impose sanctions on some of them until February 2022, even though at least one had voiced support for an aggressive Russian foreign policy toward Ukraine, and despite the aforementioned US intelligence assessments. Consequently, the United States sometimes had to rely on leveraging sanctions in an extraterritorial manner to restrict these Russian tycoons' financial activities, limiting their impact.

Implications of the Natural Resource Tycoons' Corruption

The business practices of the typical natural resource tycoon reveal how a failed transatlantic regulatory and information-sharing regime, coupled with sanctions misalignment, has resulted in the United States' struggles to sanction them and close their companies.

The typical tycoon kleptocrat relies heavily on shell companies. The weaknesses in the US Treasury's extraterritorial approach, necessitated by the UK and the EU not always following the same sanctions, is apparent in one case involving a venture fund that was originally registered in the British Virgin Islands. US Treasury authorities discovered a designated tycoon kleptocrat's control over the shell company and imposed sanctions on it in 2015, forcing him to give his shares of the company to his associate, another member of Putin's inner circle. Here, the failures of the sanctions regime become apparent, given that these moves did not hide the shell company's continued connections to the tycoon kleptocrat. Following further investigation, the US Treasury directly sanctioned the shell company. After this designation, a Panamanian law firm that provided legal services to the shell company flagged the company's activities as suspicious to British Virgin Islands authorities, citing the designation as evidence of potential criminal behavior.

The regulatory system is so weak that the same shell company was able to avoid compliance with the legal actions taken against it. When the company was faced with increased scrutiny from the British Virgin Islands authorities, it moved out of that jurisdiction, eventually reappearing in Cyprus in 2017—leaving authorities flatfooted. As of September 2022, the company remains operational in Cyprus under the control of the kleptocratic associate's daughter, despite the ongoing presence of US sanctions against it. The continued operation of the company in the face of these sanctions aligns with US concerns about sanctions evasion in Cyprus, as Financial Crimes Enforcement Network (FinCEN) Files indicate that the US Treasury views Cyprus as a "higher-risk jurisdiction."[39] This is a clear example of the consequences of the tycoon kleptocrats' effective buildup and US weaknesses when it comes to curtailing it without the assistance of allies.

Clearly, one of the main consequences of the tycoon kleptocrats' cat-and-mouse play with the authorities is that it undermines the overall effectiveness of the US sanctions regime on the Kremlin's inner circle. This in turn blunts the effectiveness of economic measures intended to dissuade the Kremlin from undertaking aggressive actions against Ukraine. The February 2022 Russian invasion of Ukraine was not deterred by such sanctions on Putin's inner circle, many analysts believe, partly because transatlantic sanctions have been unable to fully dissuade the Kremlin from this course of action. The tycoon kleptocrats' abilities are a case in point.

How the Tycoons' Practices Reflect on the Global Financial System

Once again, we see how a mixture of offshore finance, shell companies, weak law enforcement coordination, and misalignment of sanctions allows kleptocrats to move with ease throughout the global financial system. Their ability to do so owes, in part, to their identity as national resource tycoons. Many of these tycoons already have a long history of private business operations in the United States, the UK, and the EU, giving them insight into how financial regulations work in each of these jurisdictions, as well as the loopholes therein. The tycoons also operate several large-scale businesses in jurisdictions known to be more lax in financial regulation (such as Cyprus, Switzerland, and Luxembourg), likely providing them cover for some of their more suspicious activities, until the United States imposed sanctions on them.

The global financial system as currently configured allowed Russia to threaten the international rules-based order through its invasion of Ukraine while retaining some foreign sources of income, even from British and EU jurisdictions. Russia's threat to Ukraine extends to the rest of Europe, and US intelligence analysts believe that Russia's natural resource tycoon kleptocrats are materially contributing to it. Seen from Washington, both the UK and EU jurisdictions' regulatory gaps have enabled Russia to continue funding the aggression against Ukraine and the disruption of the rest of Europe. The threat to European security was clear in this case, demonstrating how essential it was for the UK and the EU to coordinate more closely with the United States on restricting the activities of Putin's inner circle before February 2022. Although the UK and the EU have since imposed sanctions on many of these natural resource tycoon kleptocrats, the fact that many could operate without much fear of British and EU authorities between 2014, when Russia annexed Crimea, and 2022 raises the question of how Putin prepared for this eventuality given his plans for invading Ukraine.

Why Transatlantic Coordination Was Necessary to Address Natural Resource Tycoons' Corruption Sooner

Until its allies can be brought on board, US reliance on extraterritorial action prevents the imposition of a comprehensive sanctions regime against Putin's inner circle, blunting the impact of sanctions and keeping avenues for Russian aggression open. The current state of play allows the tycoon kleptocrats' shell companies to evade detection by transatlantic financial law enforcement agencies because there is not enough intelligence sharing between them. Without similar sanctions regimes on Russian tycoon kleptocrats by the UK and EU member states, transatlantic financial law enforcement agencies do not have the legal authority to curtail the tycoons' financial activities. In fact, the shell company highlighted in the example above likely would have gone unnoticed by the British Virgin Islands authorities had the law firm not flagged it for suspicious activity, and its operations went unhindered in Cyprus, even after the EU became more proactive in imposing sanctions against Russia following its invasion of Ukraine.[40] This reveals a chronic financial intelligence-sharing failure, although the formation of the Russian Elites, Proxies, and Oligarchs (REPO) Task Force does partially address this shortcoming.

While the United States has successfully curtailed the overseas activities of many of Russia's natural resource tycoon kleptocrats, the US Treasury can only impose so many secondary sanctions (economic restrictions on foreign trade with sanctioned entities). The Russian tycoon kleptocrats remain a potential threat primarily because the UK and the EU were late in taking proactive action against their offshore accounts. Natural resource tycoon kleptocrats expose the limits of what the United States can achieve with an extraterritorial approach. Given the threat that Russia poses to European security, the transatlantic community must have more consensus on sanctions standards.

Private Corporations Subordinated to Authoritarian Objectives

Even private companies can be vectors for state-sponsored weaponized corruption, especially if the state is controlled by a one-party authoritarian regime at odds with the United States, its allies, and the liberal international order. Large Chinese corporations exemplify this dynamic, as they are sometimes alleged to be working on behalf of the Chinese Communist Party (CCP). Some technology corporations are described as being arms of the CCP, usually because they are players in China's policy of Military-Civil Fusion (MCF), linking dual-use technological innovations with military capabilities. In this capacity, some Chinese private companies have allegedly been linked to weaponized corruption campaigns, developing means of spreading the CCP's influence through both official channels and networks of shell companies. Under this scheme, Chinese technology corporations have allegedly been involved in promoting digital authoritarianism, primarily through surveillance, and extending the interests of the CCP.

One Private Corporation's Alleged Financial Malpractices

In 2018, a senior official of a Chinese corporation was arrested for allegedly overseeing engagement in US sanctions evasion with North Korea and Iran through a shell company and for engaging in bank fraud. In 2013, this official claimed to US banks that had invested in the corporation that it had sold its shares in a Hong Kong-based shell company. According to US law enforcement, the shares had in fact been sold to another shell company owned by the same private corporation. The senior official was eventually released the following year upon reaching an agreement with the Department of Justice and returned to China. The deferred prosecution agreement stipulated that the senior official must publicly admit to not always telling the truth to US investigators, but it effectively let the official deny the government's charges.

Though the official was released back to China, the United States remains suspicious of the private corporation's connections to the CCP. Even though the corporation is officially privately owned, there are more allegations that the CCP retains strong influence, if not outright control, over the company. Today, 98.99 percent of this corporation's stock is officially owned by a trade union committee representing employees (with the remainder held by the corporation's founder). However, all trade unions in China are required to be part of a CCP-run labor federation. Furthermore, the corporation's founder worked as a military engineer in the People's Liberation Army before founding the corporation and maintains strong ties to the CCP. Even if the CCP does not directly influence this specific corporation, all Chinese private corporations are obligated to assist in Beijing's intelligence-gathering operations under the National Intelligence Law. A British parliamentary inquiry into the potential security risks of Chinese technology companies noted that, even if they were not directly led by the CCP, they tended to maintain very strong links, including receiving billions of dollars' worth of funding from the Chinese government.[41]

The Chinese private corporation has additionally been accused of directly engaging in corruption by using offshore firms to bribe foreign officials. The Pandora Papers revealed that the corporation used offshore firms to make suspicious payments to two persons associated with a Serbian state-owned company as it was negotiating a deal to upgrade part of Serbia's technological infrastructure. A former executive in the Serbian company received over $1 million in assets, including an apartment, from a British Virgin Islands-based front for consulting with the corporation. He and a lawyer organized meetings between the Chinese private corporation and the Serbian state-owned company officials and assisted the corporation in securing approvals and licenses. Not long after, the Chinese private corporation landed a nine-figure contract to upgrade Serbia's technology infrastructure.

Implications of the Chinese Private Corporation's Alleged Corruption

The Chinese private corporation has been accused of engaging in financial crimes like evasion of US sanctions and bribery through the repeated usage of shell companies. A lot of the private corporation's alleged illicit trade is with authoritarian states under sanction by the United States and its allies, such as North Korea and Iran. Critics of the corporation argue that the CCP develops and exports surveillance technology through it, enabling the spread of digital authoritarianism. Therefore, the private corporation's technologies have allegedly played a role in repressive actions against dissidents and increased the repressiveness of authoritarian regimes.

Furthermore, the corporation's technology has been repeatedly flagged as potentially offering backdoor access to Chinese intelligence agencies. This could partly explain why it has such a large presence in China's MCF policy, as it actively enables China to engage in a more aggressive foreign policy. The United States and its allies have repeatedly voiced concerns about the corporation's potential advantage in infiltrating networks to collect information on people connected to them, which is why the United States and its allies have restricted or outright banned the presence of some Chinese telecommunications equipment in their jurisdictions. If the corporation has indeed engaged in financial crime to expand its presence around the world, then the CCP has far greater reach in its signals-intelligence gathering thanks to the corporation's global presence.

How These Alleged Malpractices Reflect on the Global Financial System

The case of the Chinese private corporation shows the limits of the United States' power in the global financial system and its inability to enforce its extraterritorial sanctions regime. A combination of shell companies and the failure to manage the politics of extradition saw the corporation's senior official slip through the US net.

In addition to using shell companies, the corporation has worked with Chinese state-owned enterprises, or through its own official channels, to export censorship and surveillance technology to authoritarian states. The *Washington Post* reported that the corporation has partnered with a Chinese state-owned enterprise to export technology to North Korea, although it is unclear if the corporation continues to maintain a relationship with the Korean Workers' Party providing

North Korea with more advanced technology. The corporation has also been known to engage directly with authoritarian regimes globally, including in Uzbekistan, Tajikistan, Cuba, and Venezuela, providing them with technology for surveillance and censorship. In at least Cuba's case, the Internet software that the corporation provided to the Cuban Communist Party was used to identify and censor Cuban dissidents' websites.[42]

Much of the corporation's activities in support of overseas authoritarian regimes reflects China's intention to strengthen its relations with authoritarian states. The corporation's last publicly known contract in North Korea was in 2016, possibly mirroring China's dip in relations with North Korea the following year. Nonetheless, China remains an ally of North Korea, having restored stronger relations in recent years, and the corporation could very well have acquired new contracts since then.[43]

China and Iran likewise recently launched a twenty-five-year cooperation agreement, signed in 2021, which committed huge increases in Chinese investments into Iran's energy sector through the Belt and Road Initiative (BRI), increased security cooperation, and Chinese access to discounted Iranian oil, among other areas of economic and military cooperation.[44] Cuba has joined the BRI as well, with several Chinese surveillance technology and even artificial intelligence research projects now being based on the Caribbean isle.[45] Similar surveillance technology has appeared in Venezuela, complementing Chinese arms sales to Venezuelan President Nicolás Maduro's armed forces.[46]

This Chinese private corporation is not alone in being accused of relying on shell companies to evade sanctions; other Chinese private companies are accused of using shell companies to evade sanctions and to assist the CCP in shipping kleptocratic gains overseas. Notably, bribery payments for projects related to the BRI have used shell companies, much in the same way that the private corporation made suspicious payments in the Serbian case. The 2016 Panama Papers also revealed how senior apparatchiks and their relatives have used offshore companies, like Mossack Fonseca, to hide unexplained wealth. The problem is especially acute in the United States, where Chinese authorities claimed in 2014 that more than 150 Chinese kleptocrats have stored their wealth.[47]

The CCP's strategic agenda benefits from the opacity of the global financial system, the continued existence of shell

A surveillance camera is seen near a Chinese flag in Shanghai, China August 2, 2022. REUTERS/Aly Song companies, and the United States' difficulties in enforcing its extraterritorial sanctions regime.

Why Transatlantic Coordination Was and Is Necessary

The case of the private corporation exposes the weakness of financial intelligence sharing among the transatlantic community. It also reveals the failure of law enforcement agencies to identify shell companies, other patterns of financial crimes, sanctions evasion, and acts of bribery allegedly committed by Chinese private companies. A functioning system would have identified all these things sooner. This case shows that there has not been enough standardization in sanctions regimes across the transatlantic community through similar legislation and levels of enforcement. Now that several Chinese private companies are under sanction by the United States and have had some of their other activities restricted by US allies, it is likely that this private corporation has increased its reliance on shell companies to commit sanctions evasion and bribery, making it all the more essential to strengthen regulation to match the rise in financial crime.

We can look to the EU's backyard to see how these failures can compound one another. For example, in the case involving the upgrades to Serbian infrastructure, the United States, the UK, and the EU could have at least come to Serbian authorities in good faith with evidence of the suspected case of bribery as the agreement with the private corporation was being negotiated. However, this was not possible because authorities in the British Virgin Islands did not conduct sufficient due diligence on the suspicious transactions being made, nor on identifying the beneficial owners of the offshore accounts. The transatlantic community must be more vigilant when it comes to identifying Chinese private companies' shell companies to ensure that they do not spread China's malign influence, especially the digital authoritarianism that is closely associated with some of these companies. US and British Virgin Islands regulations throughout this case appeared inadequate when it came to identifying shell companies involved in sanctions evasion and bribery. These failures are not *sui generis*; they are reflective of a structural failure in transatlantic coordination.

The Enabling Policy Maker as Kleptocrat

One of the most important aspects of the second wave of kleptocracy is the degree to which enablers have catalyzed the spread of weaponized corruption. Authoritarian regimes will search for a person of high rank in the transatlantic world who wishes to benefit both from their own leadership role in democratic processes and from business or illicit finance in partnerships with these regimes. For the enabling policy makers, their position in the transatlantic community is a source of profit to be leveraged through collusion with foreign kleptocratic actors. While these enablers profess commitment to their national community and democratic values, they have no meaningful ideology and work for the highest bidder, with no concern for the transatlantic community itself. As a result, such policy makers have an inherently transactional relationship with any authoritarian regime.

The Enabler's Illicit Financial Practices

On the face of it, this case of an enabling kleptocrat involved a respected mainstream democratic politician. This politician was the leader of a major bloc in the Parliamentary Assembly of the Council of Europe (PACE). In this capacity, he led other PACE members to vote down a resolution based on a 2013 Council of Europe report that condemned Azerbaijan's human rights record. However, it was later revealed through the research of the European Stability Initiative (ESI) that the enabler's actions had been influenced by extravagant bribes from Ilham Aliyev's regime in Azerbaijan to obscure its authoritarian nature and to lobby on its behalf in various jurisdictions. Through this "caviar diplomacy," the Aliyev regime worried that the Council of Europe report would expose it to public scrutiny of its authoritarian repression and human rights abuses, and that it could also jeopardize several pipeline projects it wanted to negotiate with the EU. The enabler had successfully downplayed these repressive actions, making Azerbaijan look less authoritarian and securing a tidy profit for himself.[48]

The enabling kleptocrat was a target and vector of weaponized corruption. The bribery that the Aliyev regime engaged in was predicated on transnational illicit financial operations. Many of the bribes paid to the PACE enablers were channeled through the "Azerbaijani Laundromat," a money-laundering operation channeled from an Aliyev-controlled shell company associated with the International Bank of Azerbaijan (ABB), and then through European and British companies and banks, before reaching their final destination in the coffers of corrupt European politicians.[49] Arif Mammadov, an Azerbaijani dissident and former delegate to the Council of Europe, claimed that these politicians were chosen based on their age, as the Aliyev regime believed politicians closer to retirement were more likely to accept bribes. Mammadov alleges that a total €30 million (worth more than $27.5 million at the time) was spent on this corruption scheme.[50] Once the ESI publicized the growing corruption sponsored by the Aliyev regime within PACE, European law enforcement agencies opened several investigations into these politicians. This uncovered the scale and political influence of the Azerbaijani Laundromat money-laundering operation.

Although the enabler had attempted to hide the bribes received, the law eventually caught up. By 2016, law enforcement had accused the individual of money laundering and accepting bribes. The scale of this individual's corruption was revealed in more detail in 2017, when the Azerbaijani Laundromat money-laundering scheme was first publicly exposed.[51]

Implications of the Enabler's Corruption

The enabler leveraged his status as a democratic official to directly support an authoritarian regime to the disadvantage of democratic institutions and transatlantic policy. Once PACE voted down a resolution supporting the Council of Europe's own report on Azerbaijan's human rights record, repression in Azerbaijan dramatically intensified against civil society groups. Despite this escalation of authoritarian measures in Azerbaijan, the European Commission approved the construction of the Trans Adriatic Pipeline (TAP) to bring Azerbaijani natural gas to Europe. Taken together, Aliyev may have viewed the rejection of the PACE resolution and the increased business with the EU as a green light to increase repression without risking a serious loss of business opportunities or damaging Azerbaijan's international reputation. The credibility of the Council of Europe as a defender of human rights was called into question by the PACE vote to reject the resolution condemning the Aliyev regime's human rights record. The ability of the Council of Europe to encourage democratic governance and respect for human rights was diminished because of its damaged credibility.[52]

There have been a few legal developments since the revelations of the Azerbaijani Laundromat and the corruption and bribery of PACE representatives. The Council of Europe and European law enforcement acted against several PACE members alleged to have connections with the Azerbaijani Laundromat. In 2018, thirteen PACE members were suspended and barred from working in any of its constituent bodies after an internal PACE investigation flagged these politicians on suspicion of graft.[53] Still, the Council of Europe's reputation remains precarious due to its not having been more proactive in reducing corruption within its own ranks, even after the expulsion of Russia in March 2022 for its invasion of Ukraine.[54] This is to lasting authoritarian advantage.

The EU maintained a growing trade relationship with Azerbaijan even as the PACE officials came under investigation for accepting bribes. Construction of the TAP began in 2016 and was completed in late 2020. The pipeline delivered its first gas shipments to Italy on December 30, 2020.[55] Additionally, most of the money stolen from the Azerbaijani public and siphoned to the corrupt PACE officials has yet to be recovered. Many believe that this global-scale money-laundering operation remains partly operational.

How the Enabler's Corruption Reflects on the Global Financial System

The Azerbaijani Laundromat primarily managed to evade detection because it operated between several jurisdictions. The combination of poor transatlantic financial intelligence sharing and poor oversight over corporate structures enabled its growing operations.

Upon leaving the ABB, Azerbaijani dark money entered the Estonian branch of Danske Bank before being sent to four UK-based limited partnerships. (The Estonian branch of Danske Bank was later implicated for permitting a huge number of suspicious Russian-based transactions to the rest of Europe.) Two of the four UK-based limited partnerships were Scottish limited partnerships, which have less stringent regulations compared to other UK limited partnerships. (Despite the name, the regulation of Scottish limited partnerships is controlled by Westminster.) From the UK, the money would then be shifted to accounts held by the corrupt PACE members.[56]

Elaborate and large-scale illicit financial schemes like the Azerbaijani Laundromat have been implicated in corrupting other democratic institutions like PACE. The United States has faced similar threats from dark money networks. The Organized Crime and Corruption Reporting Project (OCCRP) has found evidence that the Azerbaijani Laundromat operates in the United States as well, with several shell companies associated with the Azerbaijani Laundromat found to be siphoning money to the BL&A lobbying firm through Baku-based Renaissance Associates.[57] However, because there was no formal link between Renaissance Associates and Elkhan Suleymanov, an Azerbaijani parliamentarian who is suspected of overseeing the Azerbaijani Laundromat's operation, BL&A's relationship with the Aliyev regime did not need to be registered under the terms of the Foreign Agents Registration Act (FARA).[58] Although this operation no longer seems to be active, this raises questions of whether illicit financial schemes like the Azerbaijani Laundromat have been corrupting transatlantic political structures, and whether they may be evading detection through regulatory asymmetries in the same way that the Azerbaijani Laundromat did.

Why Transatlantic Coordination Was Necessary to Address This Corruption Sooner

If anti-money laundering (AML) and Know Your Customer (KYC) compliance standards were shared more widely within the transatlantic world, it would have helped the jurisdictions involved detect the Azerbaijani Laundromat much faster. The Estonian branch of Danske Bank failed to conduct due diligence on the suspicious transfers Azerbaijani shell companies made to the UK-based private companies. If there had been greater coordination between Estonian and British financial authorities, these transfers would have been identified as suspicious. Likewise, British authorities would have been able to flag suspicious activity had there been stronger regulatory oversight on private corporate vehicles like the Scottish limited partnerships. Similar corporate vehicles, like private investment firms, are ripe for this type of abuse, as noted in other cases.

Absent greater financial intelligence sharing between transatlantic jurisdictions, the Azerbaijani Laundromat was able to operate unhindered until its existence was leaked to the public in 2017. Information sharing between financial institutions would have also implicated PACE members in bribery, as suspicious transfers made to accounts owned by these members would have raised red flags, especially if other jurisdictions became aware of where money linked to the Aliyev regime had previously gone.

The lack of a shared set of anti-corruption standards in the transatlantic community, especially for politicians accepting money and other gifts from kleptocratic and authoritarian regimes, was another vulnerability exploited by the Aliyev regime. Building upon the policies set out in the FARA, the United States and its allies should strengthen reporting requirements on foreign lobbying so that operations like the Azerbaijani Laundromat can be exposed sooner. It would also deter politicians from accepting bribes as the corrupt PACE members did by outlining penalties and other legal actions that may be taken against them.

Conclusion

These cases of second-wave kleptocracy show us why, despite a decade of transatlantic anti-corruption activism and the sanctions imposed on the Kremlin's cronies and war chest, the kleptocrats are still winning even as their objectives have evolved. Though the transatlantic community has significantly caught up with how classic first-wave kleptocracy operates by improving regulations on the financial institutions most likely to be exploited by them, it is largely failing to deal with the more variegated kleptocrats of the second wave, who view corruption as a means rather than an end. Despite their ideological and material differences, these second-wave kleptocrats from authoritarian states emphasize weaponized corruption, not personal corruption, as the primary factor in their relationship with transatlantic states. This has increased the security risk posed by the growth of a kleptocracy-enabling class among transatlantic policy makers.

Although transatlantic authorities have imposed sanctions against the Kremlin's associates, the ad hoc nature of these sanctions means that the structural flaws that were exploited by kleptocrats remain open. The pre-invasion evolution of transnational kleptocracy has undermined the leverage available to the United States, the UK, and the EU in dealing with this issue. When a kleptocrat prioritizes weaponized corruption with a strategic objective—namely, weakening the transatlantic community—the threat of sanctions and exclusion from these states no longer has the same bite.

A review of the claims/allegations of second-wave kleptocracy also shows us that this second wave is more varied in its methods. This is partly because the transatlantic community is approaching the problem with a reactive strategy based on outmoded Cold War-era concepts. As noted, these cases demonstrate how kleptocrats exploit the seven major vulnerabilities of the global financial system:

1. Offshore accounts in jurisdictions with less oversight
2. Shell companies that do not list beneficial ownership
3. Lack of enforcement of existing rules
4. Not enough financial intelligence sharing
5. Sanctions misalignment
6. Lack of AML compliance in the private investment, real estate, cryptocurrency exchange, and arts trade industries
7. Presence of enablers

Therefore, the transatlantic community must take a preventative stance or risk further infiltration by kleptocratic and authoritarian regimes.

Having looked at the problem from the point of view of kleptocrats, we shall now examine it from the point of view of transatlantic structures. This report focuses on the second wave of kleptocrats. The six problems identified are preexisting, from the very beginning of the first wave, and have been covered at length elsewhere. In the following chapter, which examines the United States, the UK, and the EU separately, we shall focus on the new frontier for kleptocrats: the private investment, real estate, cryptocurrency exchange, and arts trade industries. This is the largest and least-understood problem area—and a main reason the kleptocrats are still winning.

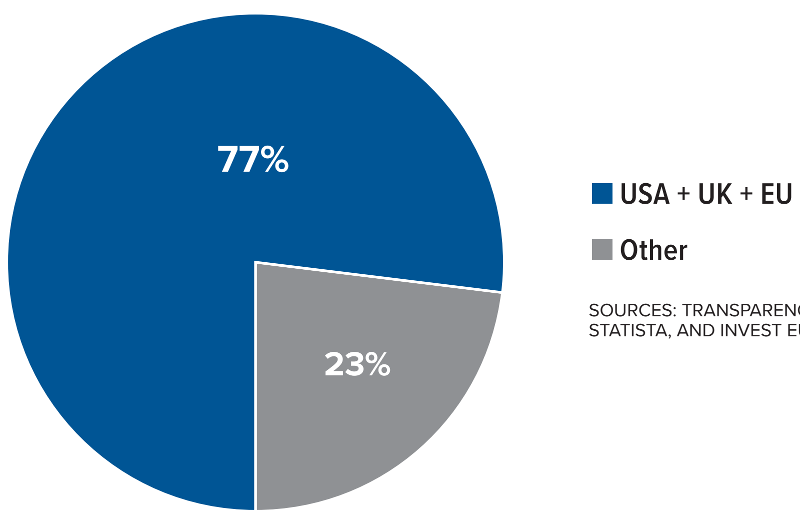
Chapter 3: Kleptocracy LLC

Extending regulation to financial industries beyond banks and other traditional platforms for kleptocracy is essential to the task of stopping second-wave kleptocrats. This is because determining who can interact with these industries is not simply a matter of accountability, but also of building and shaping Western societies through business. The broader financial world, which this report now turns its attention to, is both immense and weakly regulated. Furthermore, the regulatory problems stem from the very nature of the transatlantic community.

The 2021 United States Strategy on Countering Corruption identifies several underregulated industries. These include private investment, real estate, cryptocurrency exchange, and arts trade—all of which touch on issues involving shell companies and other proxies intended to hide the true benefactors of assets.[59] Although the strategy document was written primarily from a US perspective, there have also been issues with supervising and policing these industries in the United Kingdom and the European Union (EU). However, the UK and the EU's issues with regulation stem from implementation and poor regulatory design rather than from a lack of legal and regulatory backing for oversight, as much of the increased scrutiny of these industries comes from recently formulated and imposed regulations like the EU's 5th Anti-Money Laundering Directive (5AMLD), which the UK has adopted following its departure from the EU. The need to extend regulation to these industries has only grown since Russia's invasion of Ukraine on February 24, 2022, and the transatlantic community's commitment to fully enforcing the sanctions imposed on the Kremlin's allies, proxies, and war chest.[60]

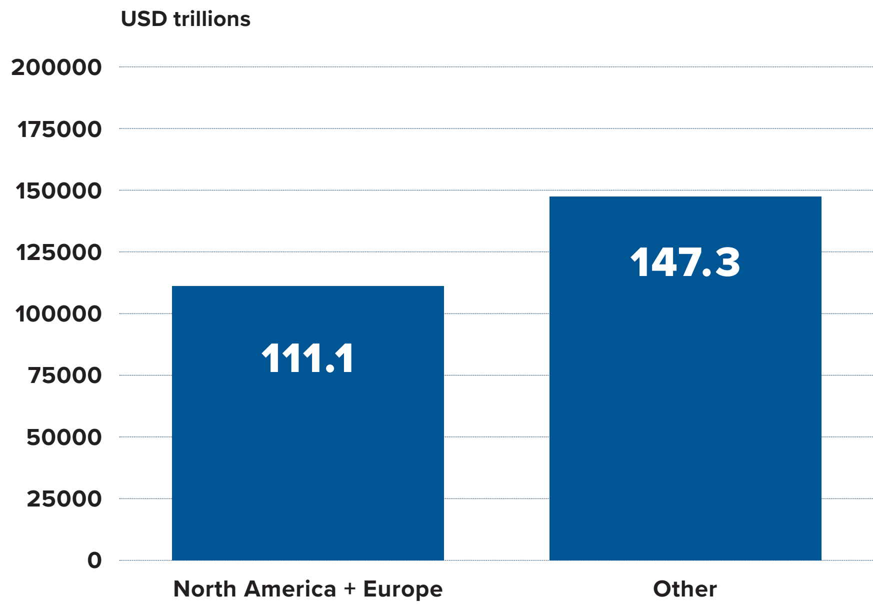
The scale of the private investment, real estate, cryptocurrency exchange, and arts trade industries is often underappreciated, even by industry analysts. As of 2020, the total value of assets under management in the global private investment industry was estimated at $115 trillion. Of this total, the United States, the UK, and the EU comprise the majority of the global industry, managing more than $89 trillion in total assets.[61] A similar dynamic appears in other financial industries as well. In 2020, the global value of residential real estate was an estimated $258.5 trillion, with North America and Europe together composing at least 43 percent of that value (approximately $111.155 trillion).[62]

Figure 1. Share of Private Asset Management Industry by Jurisdiction in 2020



SOURCES: TRANSPARENCY INTERNATIONAL US, STATISTA, AND INVEST EUROPE.

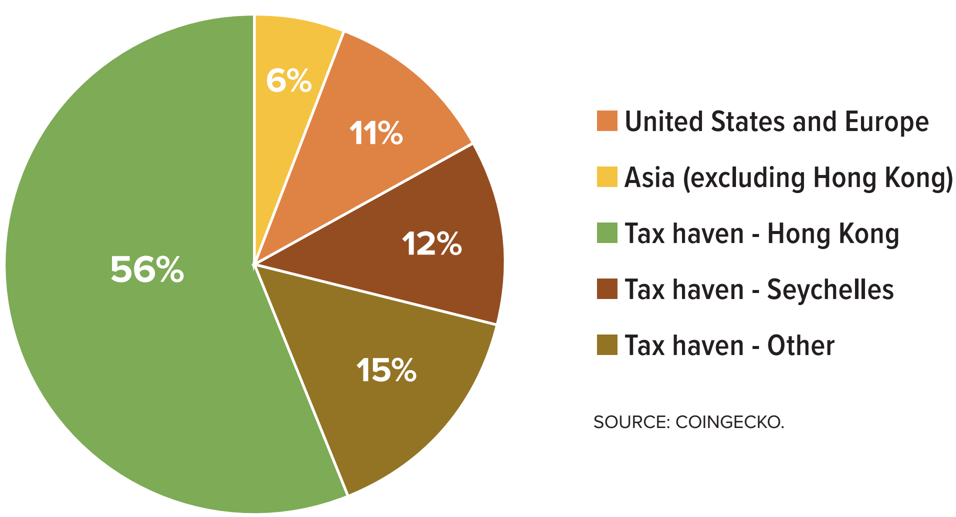
Figure 2. Value of Global Residential Real Estate Industry



SOURCE: SAVILLS.

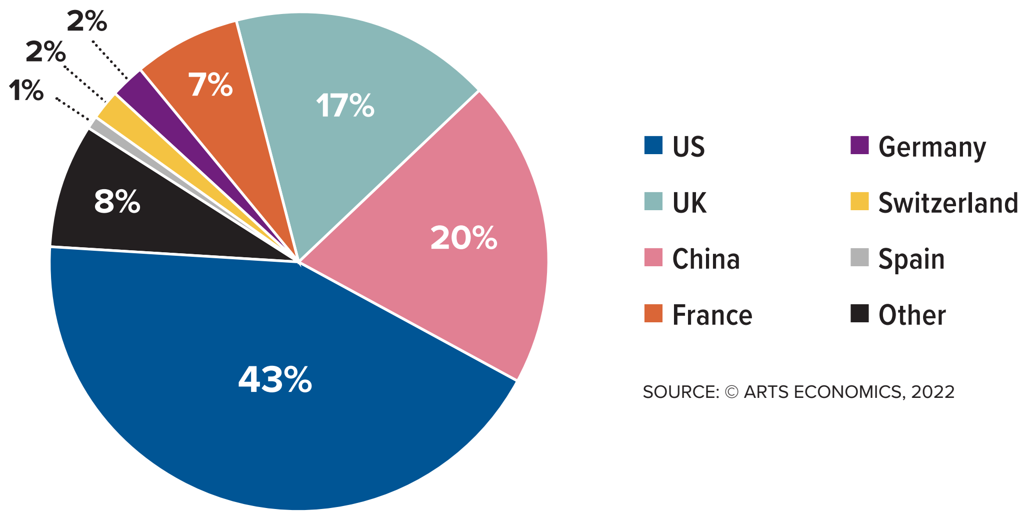
Out of the four financial industries that are the focus of this report, the global cryptocurrency market is the newest. At the end of 2020, total market value of digital assets was estimated at $771.9 billion. As the cryptocurrency exchange industry is less stable than other financial industries, its relative size and value fluctuates more dramatically. Cryptocurrency trade peaked at an estimated $3 trillion in value in November 2021, before falling to $900 billion in June 2022. Another area of divergence is the overall share of the United States, the UK, and the EU in the market. Compared to the other industries, their total volume of trade was much smaller in 2021, at approximately 11 percent, meaning they have a smaller impact on the global cryptocurrency market than they do on the other financial industries.[63]

Figure 3. Share of Cryptocurrency Exchange Industry by Jurisdiction in 2021



SOURCE: COINGECKO.

Figure 4. Share of Global Art Market by Jurisdiction in 2021



SOURCE: © ARTS ECONOMICS, 2022

The global arts trade industry is much smaller than the other global financial industries listed in this report. The global arts trade industry was estimated to be worth $65 billion in 2021, with the United States, the UK, and the EU accounting for at least 70 percent ($45.5 billion) of worldwide sales.[64] As is the case with the other industries, the issues in the arts market are not reflective of the entire trade, but rather a subsection of it.

The existing framework for global regulation on all these industries has flaws because of a lack of regulation, supervision, and/or execution from financial authorities, due either to there being no legal backing for such regulation or too weak enforcement power for existing regulatory and supervisory authorities. Importantly, the United States, the UK, and the EU are all members of the Financial Action Task Force (FATF), the Organisation for Economic Co-operation and Development (OECD), and the Group of Seven (G7). Through these organizations, all three have released official statements and commitments about improving anti-money laundering (AML), Know Your Customer (KYC), and customer due diligence (CDD) compliance in their respective private sectors.[65]

Nevertheless, the United States, the UK, and the EU all have deficiencies in regulating these industries. These three jurisdictions have had issues with implementing beneficial ownership registries and with ensuring that firms in the private investment, real estate, cryptocurrency exchange, and arts trade industries (as well as firms in other underregulated industries) properly enforce AML and KYC policies. All three jurisdictions have subsequently had public scandals over the presence of illicit financial operations in these industries. The FATF's recommendations for reducing risk in these industries clearly have not gone far enough.[66]

Despite their common AML struggles, each jurisdiction has failed to address the evolution of weaponized corruption and transnational kleptocracy in its own way. For instance, in the private investment industry, the United States lacks the executive direction and executive direction required to improve its regulation of private investment firms. UK and EU institutions, meanwhile, both have legislative backing for AML supervision and regulatory enforcement of private investment, but their enforcement of these regulations is inconsistent. Furthermore, the United States and the EU both directly regulate private investment firms that have a total asset value above a specific threshold, but the EU still registers and expects AML compliance with the smaller private investment firms, while the United States does not. Lastly, given the supranational nature of the EU, many of its enforcement problems are inherent in its less centralized nature compared to the United States and the UK, making its enforcement dependent on the degree to which EU member states' legislation is harmonized with existing EU institutional mandates. There are also issues with political will and enforcement capabilities in individual EU member states.

Similarly, the United States, the UK, and the EU have varying levels of legislation and enforcement concerning illicit finance in the real estate industry. Across all three jurisdictions, however, beneficial ownership and source of funding reporting requirements for real estate remain too low, with the beneficial owners of real estate being difficult to trace in many cases. This is true even though all jurisdictions committed to establishing beneficial ownership registries that would include real estate assets, and even recommitted to this goal following the Russian invasion of Ukraine in February 2022. However, the United States has introduced Geographic Targeting Orders (GTOs) to identify beneficial owners in specific locations (covered in greater detail in the US section below). Additionally, the EU has gone further than the United States and the UK in its commitment to improve regulations with reporting requirements on real estate transactions.[67]

Analogous trends appear in the arts trade across the United States, the UK, and the EU. Authorities have identified shell companies in the arts trade in both the United States and the UK, raising concerns of money laundering within the industry. The United States is relatively new to the task of identifying some of the issues with money laundering and other forms of illicit finance in the arts trade industry; the UK and the EU, in contrast, have both officially prioritized improving transparency within the arts trade. Furthermore, the United States is moving to extend AML oversight requirements to the antiquities trade, which is a relatively small component of the overall arts trade, while the UK and the EU remain more vigilant about illicit finance in the arts trade more generally. Still, all three jurisdictions have had some issues with enforcement in tackling illicit finance in the arts trade.[68]

The cryptocurrency trade is at risk of kleptocratic infiltration as well. US, UK, and EU requirements on transparency, AML compliance, and other financial regulations are insufficient when it comes to cryptocurrency trade in part because of that industry's status as an emerging financial technology. Nonetheless, the EU's 5AMLD, issued in 2018, extended some AML requirements to cryptocurrency exchanges, such as performing CDD on potential clients and submitting suspicious activity reports (SARs) where appropriate. In the United States, the Biden administration committed to developing new regulations on cryptocurrency and other digital assets in March 2022, following up with an action plan in September 2022 that committed the United States to a whole-of-government approach (see the "Recent Developments" section for more information). On the other hand, the UK has become much stricter with cryptocurrency regulation, going as far as to force 90 percent of cryptocurrency exchanges that had applied for licenses to shut down for failing to fully implement AML regulations that the Financial Conduct Agency (FCA) had made them adopt. Following an increase in Russia-based ransomware attacks and the Russian invasion of Ukraine, the G7 has taken steps to extend sanctions on the Kremlin's war chest to cryptocurrency exchanges.[69]

Nevertheless, across all these jurisdictions in each of these industries, the same issues appear to varying degrees: a lack of financial intelligence sharing, asymmetries in regulation across jurisdictions, legislative gaps, and issues with enforcing existing standards. The following sections of this report will examine to what extent the United States, the UK, and the EU are struggling to strengthen their defenses against weaponized corruption across the private investment, real estate, cryptocurrency exchange, and arts trade industries.

Loopholes Exploited by Kleptocrats in the United States

Overview

The potential scale of financial crime in the United States is staggering. The FinCEN Files, a trove of leaked documents from the Financial Crimes Enforcement Network (FinCEN), the US financial intelligence unit (FIU), showed that at least $2 trillion worth of suspicious transactions between 1999 and 2017 were not fully investigated.[70] This highlights how difficult it is for US authorities to properly clamp down on money laundering and other illicit finance and defend the United States against weaponized corruption. It also lays bare a serious lack of investigation of potential financial crime and a lack of resources for FinCEN to engage in AML supervision. These issues stem primarily from insufficient legislative backing for more regulation, although the United States also has enforcement problems. These enforcement problems are evident in the private investment, real estate, cryptocurrency exchange, and arts trade industries.[71]

The US Private Investment Industry

An examination of the US private investment industry reveals many financial intelligence-sharing and legislative gaps in US AML and transparency regulations. For example, US private investment firms are currently not required to register with the Securities and Exchange Commission (SEC), and they do not have to abide by most AML regulations if their assets under management are less than $100 million. Without the registration requirements, US regulatory authorities cannot know the beneficial ownership of assets managed by private investment firms. The exact legal definition of and regulatory obligations on private investment firms are similarly murky, as hedge funds and private equity firms sometimes do not officially have employees. Private investment firms have likewise worked with real estate managers, art dealers, and actors in other less regulated financial sectors when storing the wealth of kleptocrats. According to the Pandora Papers, some of the biggest nodes for illicit finance in the US private investment industry are in Delaware and South Dakota, which have lax regulatory standards on private investment firms compared to other states. However, it is possible that Delaware and South Dakota are merely the tip of the iceberg as there could be other nodes that have gone undetected so far. In the global money-laundering operations of kleptocrats, these states act as hubs for shell companies that own property elsewhere.[72]

As of May 2021, there were almost thirteen thousand registered investment advisers with the SEC. Despite multiple warnings and proposed reforms to regulations on private investment groups over two decades in the United States, private investment firms are still not held to as high a level of anti-money laundering/combating the financing of terrorism (AML/CFT) compliance as other financial entities. This is despite the fact that private investment firms fall under the scope of legislation like the Bank Secrecy Act (BSA), which is enforced by FinCEN, and under the scope of the Investment Company Act of 1940, which is enforced by the SEC. One notable regulatory exemption for private investment firms in the United States is the fact that they are not required to register with the SEC if their assets under management are less than $100 million. This allows for foreign kleptocrats to

A man holds a placard attending an anti-kleptocracy rally in Petaling Jaya near Kuala Lumpur, Malaysia October 14, 2017. REUTERS/Lai Seng Sin

The 1MDB Scandal

Although private investment firms are not normally associated with corruption and illicit financial risks, they have been implicated in some of the largest cases of kleptocracy and illicit finance in financial history. The 1Malaysia Development Berhad (1MDB) scandal was the largest political scandal in Malaysian history and the most publicly known case of kleptocracy in the world before the release of the Panama Papers in 2016. Estimates for the total amount of money stolen reach as high as $4.5 billion. It even implicated then Malaysian prime minister Najib Razak, who was alleged to have channeled more than RM 2.67 billion (approximately $700 million) into his own personal bank accounts. The stolen funds were channeled through multiple jurisdictions, including in the British Virgin Islands and the Dutch Caribbean country of Curaçao, before being passed through US-based private investment firms.[I]

A large amount of the stolen wealth remains in US real estate and fine art, which the Department of Justice is continuing to recover on behalf of Malaysia. Additional funds were laundered into the film industry, including funding for the 2013 film *The Wolf of Wall Street*.[II] The film's production further resulted in the exchange of fine art purchased with dark money, such as pieces of art by Pablo Picasso and Jean-Michel Basquiat that were gifted to actor Leonardo DiCaprio because of his starring role in the film. (DiCaprio returned the paintings to US authorities upon learning how they were acquired.)[III]

As of August 2021, more than $1.2 billion had been recovered.[IV] Yet, given the number of private investment firms, real estate traders, film producers, and arts dealers that were involved in the 1MDB-related illicit finance, it is highly likely the stolen funds have been dispersed across a variety of industries. With better financial intelligence sharing between US, UK, and Dutch authorities, these suspicious dark money flows might have been identified before the money was moved across US financial institutions.

I US Department of Justice Office of Public Affairs, Over $1 billion in misappropriated 1MDB funds now repatriated to Malaysia, press release, August 5, 2021, https://www.justice.gov/opa/pr/over-1-billion-misappropriated-1mdb-funds-now-repatriated-malaysia and Richard Paddock, "Najib Razak, Malaysia's Former Prime Minister, Found Guilty in Graft Trial," *New York Times*, May 25, 2021, https://www.nytimes.com/2020/07/28/world/asia/malaysia-1mdb-najib.html.

II United States of America v. "The Wolf of Wall Street" Motion Picture, Including Any Rights to Profits, Royalties and Distribution Proceeds Owed to Red Granite Pictures, Inc. or its Affiliates and/or Assigns, No. CV 16-16-5362 (US Dist. Court for the Central District of California, July 20, 2016), https://www.justice.gov/archives/opa/page/file/877166/download and United States v. Certain Rights to and Interests in the Viceroy Hotel Group, No. CV 17-4438 (US Dist. Court for the Central District of California, June 15, 2017), https://www.justice.gov/opa/press-release/file/973671/download.

III Duncan Ballantyne-Way, "Leonardo DiCaprio, The Asian Great Gatsby and an Art Market Revolution?" fineartmultiple, accessed June 30, 2022, https://fineartmultiple.com/blog/art-regulations-anti-money-laundering/.

IV US Department of Justice Office of Public Affairs, Over $1 billion.

store their wealth in US-based assets by distributing it across multiple smaller private investment firms without risking the attention of US regulatory authorities. This uneven regulatory environment has encouraged kleptocrats to use private investment firms to evade sanctions and as a place to hide some of their ill-gotten gains.[73]

The US Real Estate Industry

Participants in the US real estate industry have also struggled with illicit finance. This partly stems from too little financial intelligence sharing, a lack of legislation mandating greater AML regulation in the real estate industry, regulatory inconsistencies across US localities, too little compliance with the FATF's recommendations, and possible weaknesses in enforcement. At least $2.3 billion of dirty money was laundered through the real estate industry between 2015 and 2020, over 50 percent of which had foreign origins, primarily in Latin American states.[74] Notably, real estate brokers, agents, attorneys, and other managers of real estate are not obligated to follow AML regulations at the national level, which is inconsistent with the FATF's recommendations. Moreover, a 2016 study by the National Association of Realtors Research Department noted that foreign buyers of real estate were more likely to use all-cash payments, preventing institutions like banks, which are covered by BSA/AML reporting requirements, from having any oversight over potentially suspicious transactions. The same study additionally highlighted that, of all buyers with known origins, 14 percent came from China between 2015 and 2016. Of that proportion, 39 percent were nonresident buyers.[75]

The New York City and Miami metropolitan areas have come under increasing scrutiny for the large proportion of real estate offshoring by anonymous owners. In 2014, an investigation by *New York* magazine revealed that about 30 percent of New York City real estate was purchased by foreign investors, either directly or through an anonymous LLC. The report also noted that the US Census Bureau found that "that 30 percent of all apartments in the quadrant from 49th to 70th Streets between Fifth and Park are vacant at least 10 months a year."[76] Meanwhile, in Miami and the rest of southern Florida, Russian oligarchs invested at least $100 million in Trump-branded luxury towers. However, most of the sixty-three individuals identified as owners of these properties are not members of the Kremlin's inner circle. Consequently, few if any have been placed under sanction by US, UK, or EU authorities since Russia invaded Ukraine.[77] In these geographic areas, legitimate actors typically dealt with potential financial criminals without any knowledge of their suspicious activities in other parts of the real estate industry. The lack of financial intelligence sharing and flagging between

The Case of 'the Turkish Gatsby'

Reza Zarrab, sometimes referred to as "the Turkish Gatsby" for his opulent lifestyle, was arrested in March 2016 after he was found to have helped Iran evade Western sanctions, partly through money-laundering operations. US law enforcement officials estimate that he may have moved $15–$20 billion on behalf of the Iranian government through his Royal Holding A.Ş., a Turkish holding company, which operated within a large network of other shell companies. Much of this criminality was centered in Zarrab's gold business, which worked with Iranian entities under US sanctions. This sanctions evasion network allegedly included Bank Mellat, one of Iran's largest banks.[I]

Despite his arrest and subsequent plea deal with US federal authorities, Zarrab was found to be living in continued luxury through the support of suspicious Turkish-based money transfers. Zarrab also allegedly continued to operate shell companies that were found to own, through additional shell companies, several Miami properties worth millions of dollars. Some of these companies may be based on false identities, including "Erich C. Ferrari" and "Aaron Goldsmith." The latter alias, which was provided by the US government to Zarrab as part of his plea deal, is listed as president of Next Level Performance Center Inc., which in turn owns a commercial stable complex. Such investments in real estate and high-end sports like horse riding raise questions about federal authorities' scrutiny of Zarrab and whether the money-laundering operation he once oversaw still continues to provide him support.[II] If there were better financial intelligence sharing between public authorities and the private sector, Zarrab might have been flagged as a politically exposed person (PEP), thus curtailing his ability to acquire real estate in Miami and other luxury goods like thoroughbred horses. Even if Zarrab's financing for these purchases did not come from potentially illicit sources, there is still an issue of absent regulation.

I Nate Raymond, "U.S. Arrests Turkish Businessman Accused of Evading Iran Sanctions," Reuters, March 21, 2016, https://www.reuters.com/article/cnews-us-usa-iran-zarrab-idCAKCN0WN295 and Kelly Bloss et al., "Notorious Money Launderer Reza Zarrab's Lavish Life and New Business in Miami," OCCRP and *Miami Herald*, December 7, 2021, https://www.occrp.org/en/how-iran-used-an-international-playboy-to-launder-oil-money/notorious-money-launderer-reza-zarrabs-lavish-life-and-new-business-in-miami.

II Bloss et al., "Notorious Money Launderer" and "About," Next Level Performance Center, accessed November 22, 2022, https://nlpc.co/about/.

private real estate actors was a factor in obscuring the suspicious activities of potential kleptocrats and other financial criminals.

To counter some of the potential real estate-based money laundering, FinCEN developed real estate GTOs. These require parties to real estate purchases occurring in Boston, Chicago, Dallas-Fort Worth, Honolulu, Las Vegas, Los Angeles, Miami, New York City, San Antonio, San Diego, San Francisco, and Seattle to report beneficial ownership information of people behind shell companies for purchases over $300,000, for all-cash purchases. In April 2022, GTOs were issued for the same areas, as well as for the District of Columbia, Northern Virginia, and Maryland (DMV) metropolitan area; the Hawaiian islands of Maui, Hawaii, and Kauai; and Fairfield County, Connecticut. Baltimore's reporting threshold was distinct from the others, with a $50,000 purchase threshold.[78]

While GTOs may have been successful in identifying beneficial owners of certain properties, the geographic and market (residential only) limitations, the temporary nature of the orders, and the lack of training and oversight of real estate brokers and other participants in real estate-related transactions led to an incomplete AML program, as explained in a 2022 Brookings Institution report. FinCEN issued an Advance Notice of Proposed Rulemaking (ANPRM) to solicit public feedback on potential reforms for their oversight and regulation of the real estate industry.[79] GTOs were further restricted by their temporary nature and by the fact that they focused only on residential properties. Nevertheless, the primary purpose of GTOs was to collect data on potential money laundering and other financial crimes occurring in the real estate industry, for which Brookings' assessments do not fully account. Additionally, the value of even the limited information generated by the GTOs was enough for FinCEN to decide to move forward with a rulemaking to extend AML responsibilities to the real estate sector. Rules are expected by the end of 2023.[80]

The US Cryptocurrency Exchange Industry

Regulatory problems involving US-based cryptocurrency exchanges include acquisition of financial intelligence, legislative reform, and enforcement. The AML Act of 2020 extended BSA/AML reporting requirements to cryptocurrency exchanges, which are officially categorized as money service businesses, with reporting requirements for transactions over $10,000. Nonetheless, specific regulations for cryptocurrency exchanges have not yet been developed. As government regulation of cryptocurrencies has increased, "mixers"—service providers who deliberately conceal the trail of cryptocurrency transactions to make them harder for authorities to track—have become increasingly popular. Although the Department of Justice filed charges against Bitcoin Frog, a mixer associated with cyber criminals, these service providers are becoming increasingly common, raising the question of whether US law enforcement authorities can keep pace with existing mixer services even as they attempt to deter other mixers from going into business.[81]

As per the March 2022 Executive Order on Ensuring Responsible Development of Digital Assets, the secretaries of Treasury, State, and Commerce and the administrator of USAID formed an interagency framework for engagement with international counterparts. This aligns with the executive order's intention to match US regulations and approaches to regulating digital assets to those of other FATF members. This goal was specifically outlined in other Biden administration strategic documents for tackling corruption (see more about the proposed reforms in the "Proposed Reforms of US Cryptocurrency Exchange Regulations" section).[82]

The US Arts Trade Industry

Law enforcement capacity is similarly weak in the US arts trade industry. In fact, when the US Congress commissioned the Department of the Treasury to provide an overview of potential illicit finance in the arts trade industry, the department did not recommend extending existing BSA/AML regulations to the industry, except in the case of antiquities trade firms and art finance services (boutique art lending firms, auction houses with lending programs, and similar institutions). Experts warned that there may be difficulties defining an arts market participant, as well as potential unintended negative consequences of increased oversight and enforcement. Instead, the Treasury suggested targeted recordkeeping, encouraging better financial intelligence sharing between private sector actors, and more training for law enforcement agencies to identify potential cases of illicit finance, among other recommendations. The Treasury did not, however, recommend an immediate legislative overhaul of the arts trade industry.[83]

Proposed Reforms of US Private Investment Regulations

Some of the reforms proposed for the regulation of private investment firms go back as far as 2002, indicating how little progress has been made on improving regulation for private investment firms in the United States. The original 2002 reform proposal by FinCEN was meant to support the anti-financial crime aspects of the 2001 PATRIOT Act. However, the proposed rule was not implemented, as there is no regulatory body to oversee private investment firms and unregistered investment companies are corporate entities without actual employees, being managed by investment advisers, brokers, and other service providers that are legally sepa-

The Largest Known Case of Cryptocurrency Laundering

On February 8, 2022, federal authorities arrested Ilya Lichtenstein and his wife, Heather Morgan. They were charged with an alleged conspiracy to launder $4.5 billion worth of bitcoin stolen during the 2016 hack of Bitfinex, a cryptocurrency exchange. Beginning in January 2017 and until its seizure in February 2022, the stolen bitcoin was laundered through a complex process involving fraudulent online profiles, automated transactions, deposits and withdrawals of the stolen funds in several cryptocurrency exchanges and darknet markets, and the employment of US business accounts to make the cryptocurrency seem legitimately acquired.[I]

Despite this laundering attempt, US federal authorities were able to seize about $3.6 billion of the stolen bitcoin. The money-laundering trail was uncovered through collaboration between the Internal Revenue Service Criminal Investigation (IRS-CI) Division Washington, DC, Field Office's Cyber Crimes Unit; the Federal Bureau of Investigation's (FBI's) Chicago Field Office; Homeland Security Investigations (HSI)–New York; and the Ansbach Police Department in Germany.[II] The fact that such a large quantity of bitcoin was seized again indicates the importance of whole-of-government approaches and financial intelligence sharing.

Still, the fact that automated processes conducting large numbers of transactions in a relatively short period were not flagged by cryptocurrency exchanges demonstrates the importance of BSA/AML reporting requirements. Although these requirements were officially extended to US-based cryptocurrency exchanges in 2019, their implementation remains uneven across the exchanges. The suspicious transactions, while traceable, were not deterred by the new regulations, nor did the exchanges flag them.

Furthermore, even though there was tactical-level collaboration between US federal authorities and a local police department in Germany, sharing of financial intelligence at the strategic level between the United States and its allies could have highlighted some of the structural regulatory gaps that enabled such a large-scale cryptocurrency laundering operation to continue for years.

I Office of Public Affairs, US Department of Justice, Two arrested for alleged conspiracy to launder $4.5 billion in stolen cryptocurrency, press release, February 8, 2022, https://www.justice.gov/opa/pr/two-arrested-alleged-conspiracy-launder-45-billion-stolen-cryptocurrency.

II Ibid.

Nathan Isen's Art Collection

In 2011, federal authorities raided the Philadelphia home of drug trafficker Ronald Belciano. In addition to stacks of cash, authorities found at least forty-seven pieces of fine art, including works by Pierre-Auguste Renoir, Pablo Picasso, and Salvador Dalí. After analyzing the source of these artworks, federal authorities began investigating Nathan Isen, the owner of the I. Brewster & Co. arts dealership located near Philadelphia's Museum Row. An undercover agent then approached Isen to purchase twelve Dalí lithographs for $20,000. Isen failed to flag this transaction to authorities when the undercover agent made the full payment in cash infused with the scent of marijuana, even going as far as to declare his intention not to write an invoice for the transaction. Isen later pled guilty after being charged with money laundering in 2015.[I] Had there been greater BSA/AML reporting requirements in the arts trade, Isen's dealership would have been legally obligated to report transactions and suspicious behavior, at the risk of losing his license to do business in the arts trade. Isen's criminality was only exposed by the raid on Belciano's house, meaning that other art dealers that operate money-laundering and other illicit financial operations are more likely to be discovered through their interactions with known criminals or from suspicious activity reported by financial institutions subject to BSA/AML reporting requirements. Art traders like Isen who are complicit in financial crimes are much more likely to be caught or deterred if BSA/AML reporting requirements are fully extended to the fine arts trade.

I Graham Bowley, "As Money Launderers Buy Dalís, U.S. Looks at Lifting the Veil on Art Sales," *New York Times*, updated March 24, 2022, https://www.nytimes.com/2021/06/19/arts/design/money-laundering-art-market.html and "Pennsylvania Man Sentenced to Sixty-Three Months in Federal Prison for Drug Distribution and Conspiracy to Commit Money Laundering," US Attorney's Office, Middle District of Pennsylvania, US Department of Justice, January 20, 2015, https://www.justice.gov/usao-mdpa/pr/pennsylvania-man-sentenced-sixty-three-months-federal-prison-drug-distribution-and.

rate from the entities. Even though FinCEN revised the proposal less than a year later, recommending that the SEC be the regulatory body responsible for private investment firms and for ensuring that advisers are still legally obligated to answer for private investment fund regulation, the proposal was dropped in 2008 without any further changes. In more recent reexaminations of this reform, Treasury has expressed an interest in collecting more evidence to see if this reform is workable.[84]

The SEC did increase some compliance requirements for private investment firms, but these reforms were primarily for their overseas operations. In 2008, the Department of Justice warned all financial institutions, including private investment firms, to conduct CDD to ensure that clients with government ties were transparent about such connections. The SEC also established a new unit to better enforce the Foreign Corrupt Practices Act (FCPA) in 2010. Consequently, FCPA enforcement actions grew in the early 2010s. Although the FCPA does not directly require private investment firms to have accurate bookkeeping, the SEC expects that US-based private investment firms do so as part of their compliance.[85]

While there was progress on improving private investment fund compliance overseas, little changed domestically in the 2010s. In September 2015, FinCEN proposed a new rule to have private investment advisers establish AML rules, implement customer identification programs, and improve their general recordkeeping. FinCEN did not officially withdraw this proposal, but it has not made any progress toward implementing it either, despite continued scrutiny of the regulatory gap that exists with AML compliance and private investment firms. The FATF warned US authorities in December 2016 about the regulatory gap, and an internal FBI bulletin that was leaked in 2020 repeated this warning. Both emphasized the lack of required AML regulation, CDD, filings under the BSA and in the SEC, or compliance with PATRIOT Act-enabled information sharing, which were complaints raised originally in the early 2000s.[86]

2020 Leaked FBI Bulletin

An FBI bulletin leaked in 2020 warned that present regulations on private investment firms in the United States allowed beneficial owners of the funds to remain hidden. The bulletin added that these firms had historically been used to support fraud, transnational organized crime, and sanctions evasion. The bulletin notably included historical examples of how hedge funds and private equity firms had engaged in these financial crimes in the past. The most notable cases included Mexican drug cartels using California-based hedge funds for money laundering, a New York-based private equity firm receiving funds from actors known to be connected to Russian organized crime, and a representative of a New York- and London-based hedge fund who suggested using shell companies based in Luxembourg and the Channel Island of Guernsey to buy and sell items prohibited under current US sanctions.[I]

I Joskowicz, "Leaked FBI Report Reveals."

Proposed Reforms of US Real Estate Regulations

Experts at the Financial Accountability and Corporate Transparency (FACT) Coalition have criticized real estate GTOs for being too restricted in scope and suggest that FinCEN should adopt new rules for the real estate industry. The FACT Coalition proposed several changes to provide more AML oversight of the real estate industry, such as: developing a permanent nationwide reporting regime; reporting beneficial ownership information of buyers and sellers, including for transactions below $300,000 (citing how a series of transactions below the threshold bypassed reporting requirements); extending reporting requirements to commercial properties; and having multiple actors in each stage of a real estate transaction be required to provide reporting. These suggestions would address the more limited scope of GTOs both in terms of location and time, and they would improve private-private financial intelligence sharing on potential suspicious activity. Private-private financial intelligence sharing is permitted under Section 314(b) of the PATRIOT Act. It would additionally bring US regulations and AML supervision for participants in the US real estate industry into closer alignment with the FATF's recommended standards.[87]

Proposed Reforms of US Cryptocurrency Exchange Regulations

For changes in regulations on cryptocurrency exchange, as noted above, in March 2022, US President Joe Biden called for a whole-of-government study to understand how each part of the federal government could regulate cryptocurrency exchanges. The study resulted in an interagency framework published in September 2022 to address the priorities listed in the executive order: "consumer and investor protection, promoting financial stability, countering illicit finance, U.S. leadership in the global financial system and economic competitiveness, financial inclusion, and responsible innovation."[88] In terms of tackling illicit finance in the cryptocurrency exchange industry, the study highlighted regulatory gaps as an area that required particular attention. Biden has signaled potential interest in recommending an amendment to the

BSA and other laws prohibiting unlicensed money transmittals that would extend their coverage to digital asset service providers. Other commitments include greater AML supervision and financial intelligence sharing with the private sector, as well as future Treasury assessments on illicit finance risks in decentralized finance by the end of February 2023 and another assessment on non-fungible tokens by July 2023. The March 2022 executive order also committed to a follow-up study in March 2023 to identify any potential knowledge gaps in the whole-of-government study.[89]

Proposed Reforms of US Arts Trade Regulations

As referenced above, despite concerns raised by experts about financial crime in the arts trade, FinCEN has not proposed any new structural reforms, except for supporting the extension of BSA/AML obligations to the antiquities trade and arts lending services. Scott Rembrandt, deputy assistant secretary for strategic policy in the Treasury, justified this decision by saying, "We have found that while certain aspects of the high-value art market are vulnerable to money laundering, it's often the case that there are larger underlying issues at play, like the abuse of shell companies or the participation of complicit professionals, so we are tackling those first."[90] This assessment overlooks the fact that cases like Nathan Isen's did not involve shell companies. While Isen was a complicit enabler of money laundering, he would have been detected and fined for his criminality, and potentially lost his license to deal in the arts trade for consistently failing to report red flags.

General Overview of Reforms in the United States

US AML regulations are currently being overhauled by the Anti-Money Laundering Act of 2020 (2020 AML Act). The 2020 Corporate Transparency/AML Act, which was passed as part of the 2021 National Defense Authorization Act, significantly expands FinCEN's role. The act broadens the BSA, formalizes the risk-based compliance of financial institutions, establishes new compliance measures on cryptocurrency, increases penalties for compliance failures, expands the resources and role of FinCEN, permits US courts to subpoena foreign banks that maintain correspondent relationships with US banks, establishes a beneficial ownership registry, and codifies several other broad AML/CFT modernization reforms. In accordance with the Corporate Transparency Act, FinCEN released a final rule on beneficial ownership reporting. Under this rule, most corporations, limited liability companies, and other corporate entities are obligated to report their beneficial ownership information to FinCEN, effective from January 1, 2024.[91]

In May 2022, the Treasury published its 2022 National Strategy for Combatting Terrorist and Other Illicit Financing (2022 Strategy). The Treasury's priorities were to improve financial transparency and strengthen the existing framework for AML regulations and supervision in the United States. The strategy also outlined four priority recommendations:

1. "Close legal and regulatory gaps in the US AML/CFT framework that illicit actors exploit to anonymously access the US financial system through the use of shell companies and all-cash real estate purchases;
2. "Continue to make the US AML/CFT regulatory framework for financial institutions more efficient and effective by providing clear compliance guidance, sharing information appropriately, and fully funding supervision and enforcement;
3. "Enhance the operational effectiveness of law enforcement, other U.S. government agencies, and international partnerships in combating illicit finance so illicit actors can't find safe havens for their operations, and
4. "Enable the benefits of technological innovation while mitigating risks, staying ahead of new avenues for abuse presented by virtual assets and other new financial products, services, and activities."[92]

The other primary need in US financial regulations targeting weaponized corruption and other forms of illicit finance is to provide FinCEN with more resources to enforce regulations. As noted above, FinCEN does not have the capacity to properly enforce all the regulations that it is meant to, partly because it is both understaffed and under-budgeted. FinCEN's staff size is only about three hundred people. In comparison, the Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia's FIU analogous to FinCEN, had a staff size of 418 in the 2019–20 fiscal year, even though Australia has a much smaller economy than that of the United States.[93] FinCEN's outdated technology means that it cannot do the necessary analysis of the data it receives, and that it does not have the personnel to respond to inquiries by other law enforcement or private sector partners. Meanwhile, FinCEN's budget for fiscal year 2022 is $161 million, which Deputy Treasury Secretary Wally Adeyemo has argued is too small, and is highlighted by Transparency International as being only 0.0006 percent of the US GDP. The Biden administration presented Congress with a discretionary budget request for FY2023 that would increase FinCEN's budget by 31 percent, to $210.3 million.[94]

Recent Developments

The Biden administration released its anti-corruption strategy in December 2021. The strategy is comprehensive and outlines an overhaul of US AML regulations. Much of the strategy relies on cooperation and coordination with chief allies; the strategy especially notes the ways in which the United States acts as a tax haven for kleptocrats and other financial criminals. Crucially, it highlights financial sectors that have been underregulated in the past, with a particular focus on private equity. The strategy also highlights reviewing the 2015 FinCEN Notice of Proposed Rulemaking (NPRM) for potential implementation and formulating a viable alternative rule if the NPRM is found to be insufficient for regulating private equity. The United States further commits to advocating for its allies to undertake similar reforms where applicable, such as the one for regulating private investment firms. Such advocacy could come through bilateral engagement or through multilateral engagement at the G7/Group of Twenty (G20), NATO, OECD, or regional bodies like the Organization of American States.[95]

The Biden administration reconsidered the implementation of the 2015 FinCEN rule, including it as part of its anti-corruption strategy.[96] On the other hand, the implementation of the Corporate Transparency Act (CTA), which was supposed to provide accurate and updated beneficial ownership information (effectively banning the operation of anonymous shell companies), has been slower than hoped. While the legislation mandated that rules to be complete by January 1, 2022, FinCEN finalized the first rule establishing the CTA directory in September 2022, and has just proposed its second draft rule in December 2022. The database is scheduled to come online January 1, 2024.[97]

During the initial delays with the CTA's drafting of new rules, the release of the Pandora Papers in October 2021 further illustrated US tax enforcement and AML regulatory gaps. Kleptocrats and other financial criminals from all over the world were revealed to have bought assets and conducted illicit financial operations in the United States. Common destinations for the kleptocrats' financial crime operations include Delaware and South Dakota, where several trusts helped financial criminals buy assets. Art dealers additionally helped kleptocrats store money, sometimes working with hedge funds to acquire art as an asset.[98]

Interest in tackling tax evasion and corruption has grown in the White House and Congress, especially after the release of the Pandora Papers. US Sen. Sheldon Whitehouse (D-RI) and US Rep. Lloyd Doggett (D-TX) reintroduced the Stop Tax Haven Abuse Act, which prohibits US citizens from investing in tax havens. This act, first introduced since at least 2017, gained more momentum after lawmakers took notice of the issues highlighted in the papers. It is intended to further strengthen the US AML/CFT framework by addressing other existing regulatory gaps. The Biden administration has listed anti-corruption as a core national security objective. Additionally, the US House of Representatives formed the Congressional Caucus against Foreign Corruption and Kleptocracy (CAFCAK) in June 2021. Members in the 117th Congress include US Reps. Steve Cohen (D-TN), Sheila Jackson Lee (D-TX), Sara Jacobs (D-CA), Marcy Kaptur (D-OH), Dean Phillips (D-MN), Katie Porter (D-CA), Abigail Spanberger (D-VA), Jack Bergman (R-MI), Anthony Gonzalez (R-OH), Adam Kinzinger (R-IL), Peter Meijer (R-MI), Maria Elvira Salazar (R-FL), and Mike Waltz (R-FL). Following the release of the Pandora Papers, US Rep. Tom Malinowski (D-NJ) introduced the ENABLERS Act with Florida's Salazar. The act aims to increase AML and risk-based anti-corruption regulations on those that serve as gatekeepers to the US financial system, including those that form companies, arrange trusts, and manage money for a third party. Many of these bills are meant to address the regulatory loopholes on private investment firms that observers have repeatedly highlighted.[99]

Revelation from the Pandora Papers: Ihor Kolomoisky's US Assets

Ihor Kolomoisky, a Ukrainian kleptocrat, purchased a derelict factory in Harvard, Illinois, in 2008 despite his already having been identified as being involved in a money-laundering operation sustained by private equity funds. US authorities were only tipped off about Kolomoisky's purchase after working with New Zealand, Canadian, and Ukrainian law enforcement. Kolomoisky denies any foul play, claiming that the factory was bought with his own money. Still, the fact that Kolomoisky was still able to buy the factory indicates that, even when a kleptocrat is implicated in money laundering through US private equity firms, there is a lack of communication with other financial sectors about their criminal actions. This incident shows that public-private and private-private communication on financial crime and PEPs like Kolomoisky remains too low.[I]

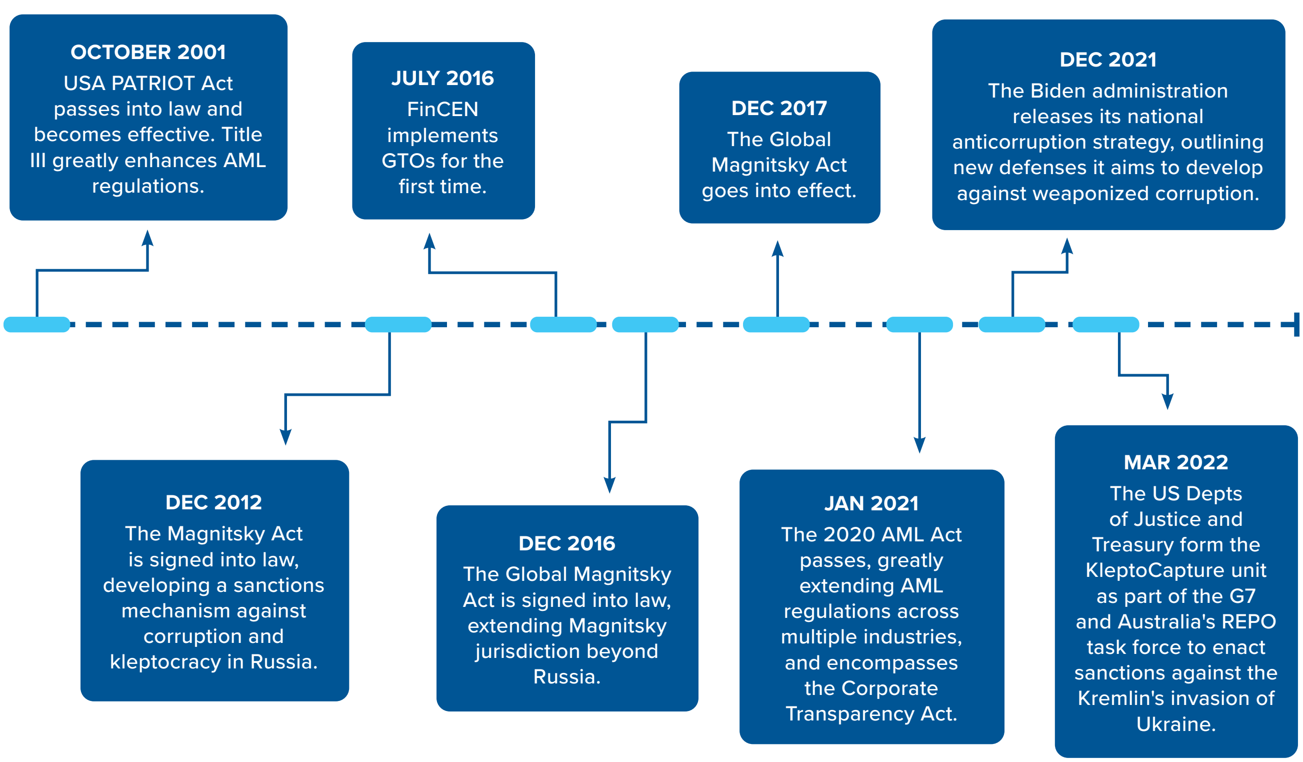
I Casey Michel, "A Ukrainian Oligarch Bought a Midwestern Factory and Let it Rot. What Was Really Going On?" *Politico*, October 17, 2021, https://www.politico.com/news/magazine/2021/10/17/ukrainian-oligarch-midwestern-factory-town-dirty-money-american-heartland-michel-kleptocracy-515948 and Joint Stock Company Commercial Bank PrivatBank v. Igor Valeryevich Kolomoisky, et al., C.A. No. 2019-0377-JRS (Court of Chancery of the State of Delaware, August 23, 2021), https://law.justia.com/cases/delaware/court-of-chancery/2021/c-a-no-2019-0377-jrs.html.

The Act is expected to be reintroduced in the 118th Congress. With the rising popularity of cryptocurrency, the Department of Justice created the National Cryptocurrency Enforcement Team (NCET) in October 2021. NCET staff are drawn from the Justice Department Criminal Division's Money Laundering and Asset Recovery Section, Computer Crime and Intellectual Property Section, and other sections. The purpose of NCET is to work on cases of cryptocurrency laundering, such as the usage of mixer and tumbler services, and to help trace and recover assets lost to fraud and extortion, such as cryptocurrency payments to ransomware groups. Just a week before the Russian invasion of Ukraine, NCET announced its first director, Eun Young Choi, who promised to tackle the growing issue of ransomware and cryptocurrency laundering closely.[100]

Amid the Russian invasion of Ukraine, the US priority of improving regulation should be to extend registration and CDD requirements to private investment firms managing assets totaling less than $100 million, actors in the real estate industry managing transactions less than $300,000, cryptocurrency exchanges managing transactions less than $10,000, and fine arts dealers beyond antiquities traders and art lenders. The actions outlined in the anti-corruption strategy are promising, but the Biden administration must follow through on its many commitments. This is especially the case with the reconsideration of the 2015 NPRM rule by FinCEN. Other improvements would come from both legislative reform and executive action by Biden. Improving registration requirements will ensure that beneficial ownership information is provided to US regulatory authorities, and strengthening AML regulations will help reduce sanctions evasion committed through private investment firms. The passage of the ENABLERS Act in the United States would encourage private investment firms to take AML standards more seriously and would reduce the chance that kleptocrats would use private investment firms as vehicles for buying more US-based assets in other less regulated financial sectors, such as the arts sector. As of the time of writing, the US House of Representatives had passed the ENABLERS Act, but the Senate still had not.[101]

More recently, Congress approved a rise in funding for FinCEN in the fiscal year 2023 appropriations package. Congress increased FinCEN's funding to $190.2 million, an 18% increase from its budget of $161 million the previous year. Although this increase in funding increases FinCEN's ability to carry out its mandate, it still falls short of the Biden administration's budget request of $210.3 million. Transparency International US Executive Director Gary Kalman supported the usage of this increased funding to update FinCEN's technology and equipment and increase its staff size.[102]

Figure 5. Timeline of Changes in US Regulations Since 2001



SOURCES: AUTHORS.

Summary of Key Findings

US vulnerabilities to the second wave of kleptocracy are prevalent in the private investment, real estate, cryptocurrency exchange, and arts trade industries. Much of the problem stems from a lack of legislation enabling more comprehensive law enforcement and regulatory compliance within these underregulated industries. Broken down into more specific loopholes, the problems in US regulations are:

- In addressing regulatory vulnerabilities in the private investment industry:
  - There need to be requirements for private investment firms to register with the SEC even if they do not manage assets totaling more than $100 million. Without this requirement, unregistered private investment firms are not required to conduct AML/KYC measures with their clients even if those clients are suspicious.
    - Information about clients can be obscured due to a lack of beneficial ownership requirements for potential clients of private investment firms.
    - Even investment advisers that have registered are not fully obligated to follow AML reporting requirements.
  - More awareness needed on the part of private investment firms on which clients are suspicious or on the need to check for possible sanctions evasion
- In addressing regulatory vulnerabilities in the real estate industry:
  - There should be a requirement to report beneficial ownership information of the buyer and seller for transactions below $300,000.
  - Outside of a dozen metropolitan areas, there should be requirements for real estate professionals to report at least beneficial ownership information, and encouragement to report suspicious behavior. Full AML obligations should ensure that at least one person in every real estate transaction—residential and commercial—has AML reporting responsibilities. Global Financial Integrity has recommended that there be a cascading structure of reporting responsibility so at least one US-based participant reports the appropriate information.[103]
  - Section 314(b) of the PATRIOT Act permits private-private financial intelligence sharing of suspicious activity on a voluntary basis.
- In addressing regulatory vulnerabilities in the cryptocurrency exchange:
  - While cryptocurrency exchanges are obligated to follow BSA/AML regulations and report beneficial ownership information, this is only for transactions above $10,000. A series of dark money transactions below $10,000 can avoid the legal requirement for reporting, so US authorities should raise awareness of this potential loophole
  - Several cryptocurrencies, by design, are not meant to be regulated by government oversight. Even cryptocurrencies that do leave a trail, such as bitcoin, can be laundered through mixer and tumbler services that are primarily available on the darknet.
  - Cryptocurrency exchanges are especially vulnerable to cyberattacks that lead to theft, and authorities should raise awareness of de-risking measures. Identifying stolen cryptocurrency can sometimes be difficult for cryptocurrency exchanges even when they do report transactions above $10,000, due to sophisticated laundering programs.
- In addressing regulatory vulnerabilities in the fine arts trade industry:
  - Fine arts dealers should be encouraged to follow BSA/AML regulations, including reporting beneficial ownership information, conducting CDD, and identifying and reporting suspicious activities, among other basic AML practices. FinCEN has only recommended extending BSA/AML obligations to the antiquities trade and art finance services (such as institutions that loan art).
  - FinCEN has not recommended any structural reforms for the regulation of the fine arts trade to address money laundering or other illicit finance.
  - Because of the lack of reporting obligations, art dealers that engage in money laundering and/or other financial crime are more likely to be discovered through their interactions with criminals known to law enforcement agencies and/or from flagging by financial institutions that are subject to BSA/AML reporting requirements.
- With the US regulatory environment as a whole:
  - FinCEN, the US FIU, is chronically understaffed, underbudgeted, and relies on outdated technology. Even if legislative reform was passed and/or executive action taken to extend BSA/AML obligations to more financial institutions, FinCEN would be hard-pressed to fully investigate reports it received and to enforce its authority in cases in which financial crime was present.

A horse guard on duty in Whitehall, 2008.

Loopholes Exploited by Kleptocrats in the United Kingdom

Overview

According to an April 2022 research briefing for the UK House of Commons, the total annual amount of financial crime in the UK could be in the tens or even hundreds of billions of pounds. The UK's National Crime Agency (NCA) concurs with this assessment, noting in 2021 that it is a realistic possibility that hundreds of billions of pounds are involved in UK-based financial crime, especially based on the United Nations' assessment that 2 to 5 percent of global GDP is involved in money laundering.[104]

Unlike the United States, many of the UK's issues with illicit finance stem not from a lack of legislation or executive direction to agencies, but from a failure to fully implement and enforce existing regulations over private investment firms, real estate firms, cryptocurrency exchanges, and arts market participants. However, as in the United States, the UK's financial regulations are uneven across jurisdictions (such as Scotland or the City of London, for instance). These jurisdictional discrepancies in regulation are partly due to the nature of devolution in the UK, even though some financial regulations are, notwithstanding their names, subject to centralized regulation instead of devolved regulation (for example, Westminster retains regulatory power over Scottish limited partnerships).[105]

Further complicating matters are British Overseas Territories (like Gibraltar and the British Virgin Islands) and Crown Dependencies (like the Isle of Man and Guernsey). Despite their political association with the UK, these jurisdictions are not directly ruled from London, making most of them de facto autonomous. This legal separation stems from their history as some of the last remaining territories of the British Empire. Even with their autonomy, however, these jurisdictions retain easier access to the City of London as an activity hub compared to other jurisdictions due to their political association with the UK. According to the *Guardian*, *New York Times*, Oxfam, and Tax Justice Network, money launderers infiltrate the City of London after opening shell companies in UK Overseas Territories, either storing their wealth in London or laundering it elsewhere. The growing influence that private investment firms have over political processes in the UK presents other issues. For instance, private investment firms make up an increasingly dominant portion of the donor base of the UK's Conservative Party, which may be affecting the British government's approach to enforcing regulations. Given the potential for foreign kleptocrats to use private investment firms for money laundering and other financial crimes, their influence on government policy is concerning.[106]

Jahangir Hajiyev and Zamira Hajiyeva's Exploitation of 'Londongrad'

Jahangir Hajiyev is the former chairman of the International Bank of Azerbaijan (ABB), a state-owned bank that is also the largest bank in Azerbaijan in terms of assets. Under Hajiyev's leadership, ABB expanded operations significantly, opening branches in financial centers across the former Soviet Union, the Middle East, Europe, and North America. Hajiyev's profile as a competent banker grew globally even though ABB was losing money under his leadership.[I]

In December 2015, Hajiyev was arrested in Azerbaijan on suspicion of fraud and embezzlement of state funds. In 2016, Azerbaijani authorities alleged that he stole up to 5 billion Manat (approximately $2.94 billion). These authorities initially became suspicious because Hajiyev and his wife, Zamira Hajiyeva, had no significant income beyond Hajiyev's annual salary of $70,650. However, after moving to the UK in 2003, they spent more than £57 million between then and Hajiyev's arrest in 2015. Some of these purchases included a private Gulfstream jet bought for $42.5 million and another £600,000 ($760,000) spent in a single day at the Harrods department store in London. The couple spent a total of £16 million ($20 million) at Harrods over the course of a decade.[II]

Most of the money the Hajiyevs stole was channeled through private investment firms and other private corporate vehicles on the advice of the primarily transatlantic Trident Trust and London-based Werner Capital. The former notably has several offices in British Overseas Territories, which have regularly been flagged for not fully enforcing AML and anti-corruption procedures. Several Hajiyev-owned private corporate entities were similarly based in British Overseas Territories and Crown Dependencies. For example, two properties that the Hajiyevs acquired were a golf course in Ascot and a home in London. The golf course was worth £10.52 million ($13.5 million) and the residential property was worth £11.5 million ($15.1 million). These properties were bought using companies registered in the Guernsey Channel Island and the British Virgin Islands, respectively. This demonstrates the relative opacity of corporate laws in these jurisdictions, especially compared to other British jurisdictions.[III]

Following Hajiyev's 2015 arrest, his wife, Hajiyeva, faced the first unexplained wealth order (UWO) in British history. Under the terms of a UWO, if an individual cannot explain a legal means for their accumulation of wealth, then British authorities are permitted to seize properties bought with that money. Despite appealing against the UWO and insisting upon her innocence, Hajiyeva's appeal was denied. Although she was arrested after an extradition request by Azerbaijan, she remains in the UK due to British concerns about the independence of the Azerbaijani judiciary under Ilham Aliyev's regime. Though this case demonstrates the power of UWOs, the fact that the case remains open to this day shows that UWOs need further refinement.[IV]

Even though the Hajiyevs' spending sprees were suspicious, they went undetected for more than a decade in the UK because the wealth that they had stored while in the UK was officially owned by private entities in jurisdictions that have had issues with financial crime. London has attracted many businesspersons like Hajiyev and gained a reputation as a hub for post-Soviet financial activities, earning the nickname "Londongrad." The lax financial regulations are a major reason that some experts dub the UK the "money-laundering capital of the world." Suspicious assets based in these territories have easier access to the City of London, which can be used as a springboard for further transnational financial crime.[V]

The Hajiyevs exploited these loopholes for their own personal gain at the expense of the Azerbaijani public and the integrity of British financial institutions. They were able to discover these loopholes through the advice of private investment advisers like Trident Trust. As noted above, Trident Trust even operates in several British Overseas Territories and Crown Dependencies, which likely familiarized it with the regulatory gaps that exist in these jurisdictions.[VI] This case demonstrates the inability of existing systems to detect kleptocratic schemes that use an interconnection of offshore finance, shell companies, and private investment advice from firms based in the transatlantic world.

I "About Us," ABB, accessed January 12, 2021, https://abb-bank.az/en/haqqimizda/missiya-ve-strateji-baxis; "International Bank of Azerbaijan Reports Net Profit of $19 Million in First Quarter," *Tribune*, April 22, 2021, https://www.thetribune.com/international-bank-of-azerbaijan-reports-net-profit-of-19-million-in-first-quarter/; and "Reaping the Benefits," Business Year, 2011, https://www.thebusinessyear.com/interview/reaping-the-benefits/.

II RFE/RL's Azerbaijani Service, "Ex-Chairman of Azerbaijan's Biggest Bank Detained for Fraud," Radio Free Europe/Radio Liberty, December 6, 2015, https://www.rferl.org/a/azerbaijan-ex-central-bank-chief-detained/27409843.html; Rupert Neate, "'McMafia' Law: Woman Who Spent £16m at Harrods Is Jailed Banker's Wife," *Guardian*, October 10, 2018, https://www.theguardian.com/uk-news/2018/oct/10/wife-of-mcmafia-banker-with-16m-harrods-spending-habit-named; Edward Robinson and Gavin Finch, "Dirty Money Spotlights Role of Family Offices as Enablers," Bloomberg, July 30, 2019, https://www.bloomberg.com/news/features/2019-07-30/dirty-money-spotlights-role-of-family-offices-as-enablers; and Rob Picheta, "Court Papers Reveal How a Jailed Banker's Wife Spent $20 Million at Harrods," CNN, May 28, 2019, https://edition.cnn.com/2019/05/28/uk/zamira-hajiyeva-harrods-spending-details-gbr-intl/index.html.

III Robinson and Finch, "Dirty Money Spotlights"; Picheta, "Court Papers Reveal"; and Heathershaw et al., "Annex" *in The UK's Kleptocracy Problem*.

IV Dominic Casciani, "Woman Who Spent £16m in Harrods Revealed," BBC News, October 10, 2018, https://www.bbc.com/news/uk-45812210; Angus Crawford, "Woman Who Spent £16m in Harrods Arrested," BBC News, https://www.bbc.com/news/uk-46108803; and Dominic Casciani, "Woman in £16m Harrods Spend Loses Wealth Seizure Challenge," BBC News, February 5, 2020, https://www.bbc.com/news/uk-51387364.

V Davies et al., "Tories Facing Calls."

VI Robinson and Finch, "Dirty Money Spotlights."

The UK's Private Investment Industry

As noted above, the UK has struggled more with implementing existing regulations over the private investment industry than with developing new regulations. As of early 2020, there were 118 private equity funds in the UK, managing up to £22.33 billion ($30.44 billion) worth of assets. Private investment firms in the UK are required to implement AML/KYC standards, but public oversight into firms' compliance is lacking. While the UK has a comprehensive set of regulations, these are insufficiently implemented. Moreover, the UK's Overseas Territories and the City of London have proven attractive to kleptocrats, some of whom use these jurisdictions as vehicles for money laundering and other illicit financial activities. Even after Brexit, which prompted some international investment entities to move their operations to Ireland or other EU jurisdictions to retain closer ties to the European single market, money-laundering schemes that operate in the EU still have some interest in using British financial institutions as facilitators of financial crime.[107]

The UK's Real Estate Industry

Much like the United States, the British real estate industry has ongoing issues with AML compliance, legislation enabling oversight and financial transparency, a lack of harmonization between jurisdictions inside the UK, and enforcement. In 2019, Global Witness identified £100 billion ($127.7 billion in 2019) of anonymously owned real estate in England and Wales alone. In February 2022, just prior to the Russian invasion of Ukraine, Transparency International UK highlighted how almost ninety thousand opaque companies, some of which could very well be shell companies, own properties across the UK. Transparency International UK identified at least £1.5 billion worth of UK property ($1.79 billion) owned by Russian PEPs who allegedly committed financial crimes or had close ties to the Kremlin. Other PEPs included figures from post-Soviet countries like Azerbaijan and Kazakhstan.[108]

The UK's Cryptocurrency Exchange Industry

The UK's cryptocurrency regulations are very similar to the EU's due to the FATF's suggested standards, and they tend to be more far-reaching than those in the United States. Despite the UK's official withdrawal from the EU in January 2020, the UK Parliament passed legislation mirroring the EU's 5AMLD. Part of 5AMLD extends AML regulations to cryptocurrency exchanges and other virtual asset providers. These included performing CDD on potential clients and submitting SARs where appropriate. Under 5AMLD, the UK's Financial Conduct Authority (FCA) was likewise authorized to collect beneficial ownership information on the addresses and identities of cryptocurrency owners. Cryptocurrency exchanges were further obliged to register with the FCA to ensure that they were complying with UK AML regulations. (See the EU section for more information on 5AMLD issued in 2018.)[109]

Still, compared to the United States and the EU, the UK has taken a somewhat stricter stance on enforcing AML regulations on cryptocurrency exchanges. In January 2022, the

Ownership of 221B Baker Street

For years, the ownership of 221B Baker Street in London, the iconic home of the fictional detective Sherlock Holmes, was unknown. However, an investigation by the *Times* uncovered that Dariga Nazarbayeva, the daughter of Kazakhstan's first president, Nursultan Nazarbayev, was the owner of the property. Nazarbayeva was able to acquire the property despite her status as a PEP, and despite concerns that the spoils of Nazarbayev's alleged kleptocracy within Kazakhstan were being offshored in the UK.[I]

Nazarbayeva had acquired 221B Baker Street through a real estate firm based in the United Arab Emirates. At the time, British regulations did not cover real estate involving foreign firms, which is why 221B Baker Street's ownership was a mystery from 2015, when it was acquired by Nazarbayeva's husband (who was also a PEP), to 2020, when the *Times* investigation revealed its beneficial owner.[II] Extending real estate AML reporting requirements and implementing a beneficial ownership registry sooner might have exposed and prevented Nazarbayeva's purchase.

I George Greenwood et al., "Strange Case of Dariga Nazarbayeva, Mystery Owner of Sherlock Holmes's Baker Street Address," *Times*, November 10, 2020, https://www.thetimes.co.uk/article/strange-case-of-dariga-nazarbayeva-mystery-owner-of-sherlock-holmess-baker-street-address-23q7c2fpl and Jon Ungoed-Thomas, "How the Kazakh Elite Put Its Wealth into UK Property," Guardian, January 8, 2022, https://www.theguardian.com/world/2022/jan/08/how-the-kazakh-elite-put-its-wealth-into-uk-property.

II Greenwood et al., "Strange Case."

Treasury Select Committee expressed concerns that the FCA had not encouraged enough cryptocurrency exchanges to register with authorities for AML purposes. On April 1, 2022, the FCA extended licenses to a relatively small number of UK-based cryptocurrency exchanges after most of them failed to prove that they could comply with 5AMLD reporting requirements. According to the FCA, up to 90 percent of UK-based cryptocurrency exchanges were forced to cease operations as a result. In that respect, the UK has taken the lead on improving AML supervision of the UK cryptocurrency exchange industry, although it still lags behind the United States in policing cryptocurrency exchanges, as evidenced by its lack of an equivalent cryptocurrency task force.[110]

As noted above, London's lack of direct rule over British Overseas Territories and Crown Dependencies means that current UK cryptocurrency regulations do not extend to these jurisdictions despite their close ties with the City of London. This once again demonstrates how regulatory asymmetries between metropolitan Britain and the associated jurisdictions continue to be a problem, including in the UK-based cryptocurrency market. Most of these jurisdictions have lax AML regulations, with the notable exception of the Cayman Islands, which has stronger AML oversight.[111]

The UK's Arts Trade Industry

As in the United States, the British arts trade industry has acted as a vector for money laundering. However, the UK has stricter AML regulations on arts market participants, in part because it mirrored the EU's 5AMLD on arts trade regulations. Other trade regulations not linked to anti-illicit finance measures restrict the movement of art out of the UK, such as the Waverly Criteria, used to determine if individual pieces of art are historically, aesthetically, or scholastically essential to the United Kingdom.[112] For example, beginning in January 2020, arts market participants (such as dealers, advisers, auction houses) that handle transactions above the €10,000 threshold are required to conduct CDD on clients, verify the identity of buyers and sellers, and carry out risk assessments on transactions. The threshold of €10,000 was selected to align British regulations with the EU's 5AMLD, which mandated that the arts trade industry come under AML regulations.[113] (The UK government specifically identifies €10,000 as a threshold to align with 5AMLD requirements, despite the UK's use of pound sterling.) Despite these changes, in June 2021, the UK government issued official guidance on money-laundering risks for arts market participants, noting that there was still a high risk of money laundering in the arts trade. Additionally, beginning in June 2021, all participants handling transactions above €10,000 must register with HM Revenue & Customs (HMRC). All UK-based companies and their branches abroad fall under this reporting regime.

The Case of Picasso's *Personnages*

In 2018, US authorities charged British arts dealer Matthew Green for using his art dealership as a site of money laundering. An undercover FBI agent caught Green working with Beaufort Securities investment manager Peter Kyriacou and his uncle Aristos Aristodemou. Kyriacou and Aristodemou had engaged in stock market manipulation and looked to use the British arts trade to launder the money that they had acquired by criminal means. When discussing with the undercover FBI agent why the British arts trade was appealing for money laundering, Aristodemou allegedly said that it is "the only market that is unregulated."[I] As part of this money-laundering scheme, Green suggested that the undercover agent purchase Pablo Picasso's *Personnages* (1965).

At the time that US authorities charged Green, beneficial ownership reporting requirements and CDD were not part of British AML regulations for the arts trade, which is one reason why Aristodemou claimed that the market was unregulated. Although the UK Parliament has since passed reforms to mandate beneficial ownership reporting and CDD, enforcement of the new regulations remains lacking.

I Eileen Kinsella, "UK Art Dealer Matthew Green Charged in a $9 Million Picasso Money-Laundering Scheme," *Artnet News*, March 6, 2018, https://news.artnet.com/art-world/matthew-green-charged-money-laundering-us-1236929.

However, even with these new regulations and commitments for greater AML supervision on the UK arts trade industry, flaws in the system remain. HMRC has not done enough to enforce regulations or to provide AML supervision to arts market participants. For example, money launderers could circumvent the €10,000 threshold through a series of cheaper art transactions, despite warnings from HM Treasury, in guidelines formed with the British Art Market Federation, of precisely this possibility.[114] Some arts market participants have also misunderstood when to conduct CDD on clients and to collect beneficial ownership information. In some cases, arts market participants have claimed that they relied on one of the parties within the chain to conduct CDD on clients and believed that they did not need to collect beneficial ownership information or investigate the level of CDD already conducted. This lack of clarity has potentially allowed some cases of money laundering to occur unhindered in the UK arts trade industry. Furthermore, ultimate beneficial ownership of art remains difficult to verify and can still be concealed from UK authorities due to the global scale of the arts trade industry and its growing online presence. Although

UK authorities have improved AML requirements on the UK arts trade recently, there remain issues with enforcement. The primary structural flaws with the existing regulations are enforcement and extending these requirements to arts trade transactions below the €10,000 threshold.[115]

Proposed Reforms of the UK's Private Investment Regulations

The UK has made some progress in reforming its financial regulations to prevent tax evasion and money laundering. Nonetheless, problems with these laws remain, including acquiring actionable financial intelligence; facilitating greater harmonization between England and Wales (which are one jurisdiction), Scotland, and Northern Ireland; bridging regulatory asymmetries between the UK, its associated jurisdictions, and the EU; and implementing existing regulations for private investment firms. In April 2017, the UK Parliament passed the Criminal Finances Bill, which came into effect in September 2017.[116] Additionally, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations bill passed in June 2017 and was implemented in the same month. Despite the passage and implementation of these bills, private investment firms have still avoided a great deal of scrutiny over their regulatory compliance by the FCA, the UK's main regulatory body and AML supervisor for financial institutions.[117]

By 2019, British public authorities began to increase their oversight over private investment firms. The FCA began to audit select hedge fund managers over their AML/KYC compliance following concerns that money-laundering operations were working through British financial institutions. Public authorities' growing interest in financial conduct was matched by more legislation, including the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 bill, which further amended the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. Following the 2019 bill's passage, the FCA increased its oversight of all private investment firms in January 2020, when the FCA publicly warned private equity and hedge fund CEOs that their regulatory compliance was lacking. The FCA then recommended to them a list of compliance measures that included implementing de-risking and CDD measures and increasing AML screenings in fundraising and transactions. Later, the FCA listed hedge fund fraud among the several types of fraud it was working to address, although it was not its primary fraud concern between 2019 and 2020.[118]

As in the United States, public concern in the UK is growing over the political leverage that private investment firms have over policymaking. *OpenDemocracy* reported that hedge fund owners contributed more than £11 million to the Conservative Party in December 2019, just before the general election. This comprises almost 40 percent of the Conservative Party's current donor base, and the British political opposition worries that the Tories' current deregulation priorities have been influenced by these donor relationships. Notably, the shift of the Tory donor base toward hedge fund owners from City of London bankers is reflected in the Conservative Party's approach to Brexit, as the latter favored the UK remaining in the EU.[119]

Despite some setbacks, the UK has made progress in tackling its beneficial ownership problem, which has already begun to manifest in its private investment industry. Because EU legislation no longer applies to the UK because of the UK's official departure from the EU on January 31, 2020, the Financial Services Act (FSA) of 2021 received royal assent on April 29, 2021, to replace and build on EU legislation on financial regulations. The act came into effect on June 29, 2021. The FSA also established the UK Investment Firms Prudential Regime (IFPR), which regulates firms overseen by the FCA. The UK IFPR was deliberately designed to be like the EU Investment Firms Regulation and Investment Firms Directive (IFR and IFD, respectively, discussed in more detail in the EU section). Under the IFPR, firms are expected to comply with international standards on de-risking and other regulations as determined by the FCA.[120]

The UK Parliament also passed the National Security and Investment (NSI) Act, which enables the government to scru-

Revelation from the Pandora Papers: The Role of the City of London and UK Overseas Territories in Money Laundering and Other Financial Crime

The Pandora Papers further implicated the UK's financial regulatory system in money laundering and other financial crime because of the lack of regulations on British assets owned by offshore firms. Even though the UK has multiple laws tackling money laundering and other financial crime, the Pandora Papers illustrated how exposed the City of London was to offshore firms' influence, especially ones located in British Overseas Territories. One anonymous Tory member of Parliament went so far as to call the city "the money-laundering capital of the world."[I] The overall perception of the UK is that it facilitates money laundering by not implementing stronger regulations in the City of London or by failing to monitor potential dark money networks connected to the Crown Dependencies and Overseas Territories.

I Davies et al., "Tories Facing Calls to Return Cash."

tinize and intervene in business takeovers that potentially threaten national security. If foreign actors threatening UK national security attempt to acquire "material influence" over an investment entity in the UK through share acquisitions, the UK government has the power to restructure or undo the transaction. Notably, private investment firms are not exempt from the NSI Act. Investment entities that fail to comply with the NSI Act face steep financial penalties. Nonetheless, the NSI Act did not go into effect until January 4, 2022, and the government is only permitted to review and take retroactive action on deals that occurred from July 4, 2021.[121]

Proposed Reforms of the UK's Real Estate Regulations

Even though the British real estate industry faces many of the same AML supervision and regulatory problems as the US industry, British authorities have not developed specific geographic targeting measures like those found in the United States. According to Global Financial Integrity, over 90 percent of money laundering in British real estate occurs in England, primarily in London. Legislative reform could provide the UK FIU the capacity to develop GTOs like those of the US-based FinCEN, with higher standards for verification, CDD, and AML reporting requirements for participants in the English property market, particularly for property based in the Greater London metropolitan area.[122]

Nonetheless, some criticisms aimed at British authorities' oversight of the UK real estate industry regarding beneficial ownership were addressed in the Economic Crime (Transparency and Enforcement) Act 2022, also known as the Economic Crime Act (see the "Recent Developments" section for more information). The Parliament passed the act following the Russian invasion of Ukraine, intending to address the transparency issues in several UK financial industries and transparency of ownership of British real estate. This included developing a beneficial ownership registry for property that was foreign-owned, and retroactively requiring registration for property purchased in England and Wales since 1999, and in Scotland since 2014. This beneficial ownership registry for property, known as the Register of Overseas Entities, officially came into force on August 1, 2022, and is available to the public through Companies House.[123]

Proposed Reforms of the UK's Arts Trade Regulations

Unlike the British private investment, real estate, or cryptocurrency exchange industries, there have as yet been no significant reforms of the British arts trade industry. The Economic Crime and Corporate Transparency Bill (the second Economic Crime Bill) does not address the structural flaws in intelligence sharing and enforcement of existing standards concerning the industry. In fact, even with British authorities' imposition of sanctions on Kremlin-aligned oligarchs and proxies after February 2022, Chris Bryant, a Labour member of Parliament (MP), noted that these sanctions could be circumvented through financial crime conducted in the British arts market. Despite this warning, UK parliamentarians have not prioritized reforming regulations for the arts trade, instead resorting only to warnings to high-profile arts traders like the Christie's and Sotheby's auctions houses to refuse to do business with sanctioned individuals, entities, and proxies of sanctioned figures. Additionally, though existing regulations require beneficial ownership information concerning buyers and sellers in transactions, such identity information can be faked, as verification by British arts market participants remains lax.[124]

General Overview of Reforms in the UK, British Overseas Territories, and Crown Dependencies

Although the UK maintains a corporate beneficial ownership registry through Companies House and mandates private investment firms to register there, the government's verification measures on all registered companies are deeply lacking. Companies House, which is the UK government's

British Virgin Islands Fails to Detect OneCoin Ponzi Scheme

OneCoin was a scam cryptocurrency, and much of the money its architect stole was placed in a private investment firm in the British Virgin Islands. The scheme involved users acquiring the cryptocurrency in a way similar to a Ponzi scheme. The scheme is estimated to have led to the theft of up to $4 billion globally. Mark Scott, a corporate lawyer, worked with OneCoin designer Ruja Ignatova to store some of the proceeds in a fake private investment firm named Fenero Funds, which was based in the British Virgin Islands. Up to $400 million was stored in the British Virgin Islands in this fake private investment fund under the guise of transfers from wealthy European families. US authorities caught Scott lying to US banks as part of this scheme, and he was convicted by the Manhattan Federal Court in November 2019.[I]

I US Department of Justice, Former partner of Locke Lord LLP convicted in Manhattan Federal Court of conspiracy to commit money laundering and bank fraud in connection with scheme to launder $400 million of OneCoin fraud proceeds, press release, November 21, 2019, https://www.justice.gov/usao-sdny/pr/former-partner-locke-lord-llp-convicted-manhattan-federal-court-conspiracy-commit-money.

official registrar of companies, repeatedly failed to undertake basic checks, permitting several shell companies to operate in the UK. In one case, a company listed its director as "Jesus Holy Christ."[125] Even after such failures, Companies House openly admits that it does not verify the information entered into its system. However, in a policy reversal, the second Economic Crime Bill, expected to pass this year and go into effect next year, will increase verification mechanisms by Companies House (see the "Recent Developments" section for more information on these reforms).[126]

UK Overseas Territories have yet to follow through on official commitments to develop beneficial ownership registries. This includes the government of the British Virgin Islands, which has been criticized for its lassitude in establishing a beneficial ownership registry.[127]

Foreign investigations have uncovered other instances of corruption in British private investment firms. Vijay Sankar, a trader at the UK-based Duet Group hedge fund, was detained in Germany in October 2021 over his connection to the CumEx tax fraud scheme. He was initially arrested in London in connection with three other cases of tax fraud before prosecutors in Cologne requested his extradition. Although the UK agreed to extradite Sankar to Germany, his alleged involvement in the CumEx tax fraud scheme has raised questions concerning the degree to which the UK has inadvertently facilitated global money-laundering operations through private investment firms. In this case, British authorities learned about Sankar's alleged illicit financial operations during an investigation into tax fraud.[128]

Given the security threat posed by illicit finance, Helena Wood and Karen Baxter of the Royal United Services Institute have proposed a tiered enforcement structure that would address economic crime. At the center of this structure would be the National Economic Crime Centre (NECC). The NECC, which was established in 2018, draws together law enforcement, justice, government department, regulatory, and private sector officials to coordinate responses against economic crime in the UK. In this proposal, the NECC would provide strategic oversight over the UK's responses to economic crime through data analysis and intelligence development given its existing coordination role. The City of London Police (CoLP) would operationalize strategic priorities set by the NECC In the following tier, acting as a single command structure for action taken against economic crime across the UK. In the tier below, regional super hubs that would unite local law enforcement authorities across jurisdictional boundaries would have intervention capabilities and maintain close communications with private sector entities. This tiered structure approach was designed to ensure that there would be flexibility in responding to and preventing economic crime. Wood and Baxter further propose that this reorganization, including the expansion of duties of existing institutions like the NECC and the CoLP, could be funded by the UK Home Office with a policing grant of at least £250 million by 2030.[129]

Recent Developments

The first Economic Crime Act, which made changes to UK real estate regulations, also reformed UWOs to lower the costs to authorities of issuing them and to permit the Office for Financial Sanctions Implementation (OFSI), the primary sanctions enforcer of the UK government, to publicly name companies that have breached sanctions but have not been fined. The act also expanded the scope of UWOs, which had become increasingly underused by early 2022. Their underutilization stemmed from authorities' inability to issue them against financially nontransparent companies, as well as from a lack of financial investigation expertise, resources (like funding and staff time), cooperation between agencies, and judicial prioritization. The act permits authorities to issue UWOs against companies suspected of association with PEPs, even if their ownership is difficult to identify, and provides more time for investigation.[130]

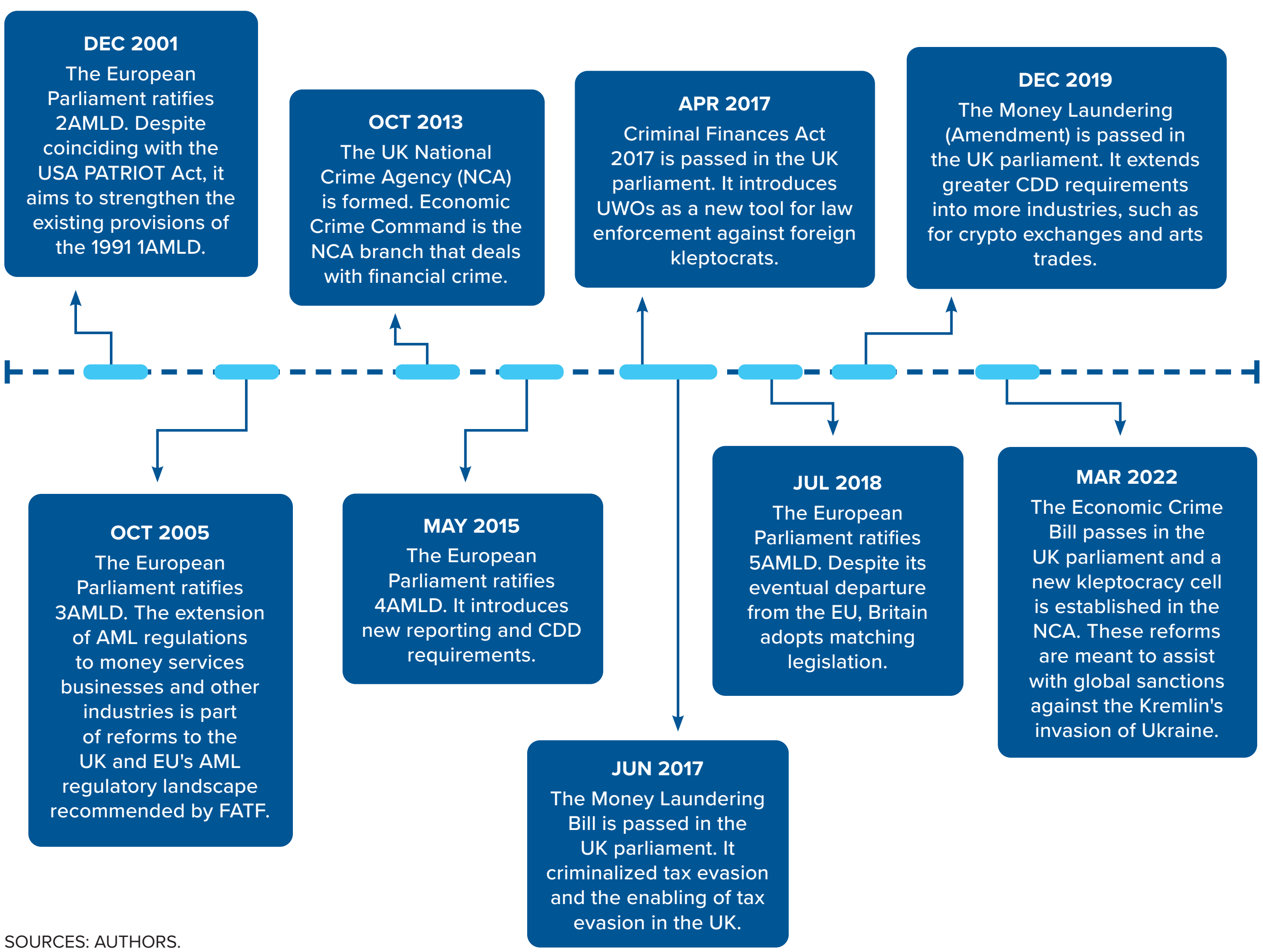
Despite the introduction of the first Economic Crime Act, general AML supervision and enforcement of existing regulations in the UK are still lacking. The FCA needs more staff and funding dedicated to the supervision of AML compliance across the private sector. The FCA is too focused on the retail banking sector because of its emphasis on first-wave style kleptocrats. Its purview should be expanded to address other industries like the private investment, real estate, cryptocurrency exchange, and arts trade markets. For example, beneficial ownership information is still too easy to fake across these industries due to a lack of verification and enforcement capacity by UK financial law enforcement authorities.[131]

Nevertheless, the UK Parliament has recognized some of the deficits of the first Economic Crime Act, introducing the Economic Crime and Corporate Transparency Bill (or the second Economic Crime Bill) in September 2022. This new Economic Crime Bill aims to: grant Companies House the power to check, remove, or decline information submitted to or already on the Company Register; enhance verification requirements for people who manage and own UK companies and other corporate vehicles; enhance transparency requirements for limited partnerships (including for Scottish limited partnerships); enable the civil forfeiture of cryptocurrency assets; and enable private-private financial intelligence sharing on a case-by-case basis. This latter element is especially noteworthy given British authorities' wariness of surveillance overreach by the General Data Protection Regulation (GDPR). However, information about how this would be enabled under the second Economic Crime Bill remains scarce at the moment. Furthermore, while the bill would address internal regulatory asymmetries between Scotland, the City of London, and other parts of the UK, the regulatory asymmetries between metropolitan Britain and the Overseas Territories would remain. Finally, given the vast scope of these measures, their enforcement is still untested and raises questions concerning how British authorities would scale up their activities to match their new responsibilities without receiving additional resources.[132]

Beyond these economic crime bills, there has been some restructuring of British law enforcement to tackle the issue of transnational kleptocracy. In the week following the Russian invasion of Ukraine, then British prime minister Boris Johnson's government announced that it had established a new kleptocracy cell within the NCA to address the widespread issue of offshoring in the British economy. The kleptocracy cell has already scored some early successes, such as the issuance of a no-sail notice to a £38 million superyacht in Canary Wharf owned by a Russian oligarch under sanction by UK authorities. Nevertheless, the UK Parliament has not delegated any new resources to the kleptocracy cell, hampering its performance.[133]

In the future, the British government should add to its momentum in reforming AML regulations and laws by passing the second Economic Crime Bill, as doing so would address deficits in legislative reform and financial intelligence sharing. It should likewise promote regulatory synergy inside the UK and influence reforms in the British Overseas Territories. Beyond that, ensuring that the FCA, Companies House, and UK FIU have the staff and funding to ensure AML compliance is essential. The loopholes that the UK faces in the regulation of private investment firms, real estate actors, cryptocurrency exchanges, and arts market participants primarily lie in enforcement deficits instead of in the British legal system itself. The enforcement of the Money Laundering and Terrorist

Figure 6. Timeline of Changes in UK Regulations since 2001



SOURCES: AUTHORS.

Financing (Amendment) Regulations 2019 bill and the NSI Act, both of which are well-suited to addressing money laundering and other financial crimes committed through private investment firms and real estate, is especially essential.

Furthermore, given the increasing influence of private investment firms in the Conservative Party, one legislative change the UK Parliament should consider is the adoption of a Foreign Lobbying Act (FOLO) modeled on the US Foreign Agents Registration Act (FARA), which would also apply to private investment firms. FOLO, as proposed by Bob Seeley, a Tory MP, would require foreign agents and their UK proxies to register themselves publicly. This would apply stricter transparency measures, including materials about disbursement activities related to lobbying. Although FOLO itself was not adopted, many of its foreign agent reporting requirements are included in the current UK national security bill passing through Parliament.[134]

Summary of Key Findings

Unlike the United States, the UK already has much of the legislation it needs to address AML deficiencies and sanctions evasion occurring in its jurisdictions. The problem lies less in the legislation itself and more in implementation and the close connections between the City of London and British Overseas Territories and Crown Dependencies, despite the latter's autonomy. The state of UK regulation of the private investment, real estate, cryptocurrency exchange, and arts trade industries is as follows:

- Following the Russian invasion of Ukraine, the UK's regulations and regulatory bodies were partly restructured to address the issue of transnational kleptocracy and offshoring into the UK. A kleptocracy cell was also established. The cell was more of a restructuring of existing infrastructure, however, and the UK has not delegated new resources to its functioning.

- Verification of corporate information registered in Companies House, including beneficial ownership, remains inadequate. Financial criminals are aware of these weaknesses and have exploited them repeatedly.

  - The second Economic Crime Bill, currently under debate in the UK Parliament, is meant to provide Companies House with the power to check and verify information submitted to the Companies Register, although the feasibility of enforcing such powers will hinge on the resources that Companies House receives to enforce them.

- Insufficient harmonization of regulations within the UK itself. Furthermore, while the Crown Dependencies and Overseas Territories retain autonomy from London, the introduction of beneficial ownership registries and corporate transparency is essential, given their offshore ties to the City of London.

- It is difficult for British law enforcement authorities to verify beneficial ownership of real estate.

- Financial intelligence sharing, especially within the private sector, is still inadequate.

  - The second Economic Crime Bill is supposed to make private-private financial intelligence sharing easier, even with GDPR protections for personal data. However, it has not yet been disclosed exactly how the bill would enable such intelligence sharing.

- The UK refused to give 90 percent of UK-based cryptocurrency firms licenses to operate as of April 1, 2022, because they failed to demonstrate compliance with 5AMLD regulation and reporting requirements. While the UK strictly enforces AML regulatory requirements on UK-based cryptocurrency exchanges, British authorities do not have the power of civil forfeiture for cryptocurrency assets.

  - The second Economic Crime Bill aims to address the lack of civil forfeiture power for British authorities on cryptocurrency assets.

- In the UK arts trade, brokers must conduct CDD on clients for any transactions above a €10,000 threshold, verify the identity of all parties involved, and make risk assessments on transactions. Firms that handle transactions worth more than €10,000 must also register with HMRC. All UK-based companies and their branches abroad fall under this reporting regime. However, arts market participants may not be able to detect a series of transactions that individually fall below the €10,000 threshold. Nor are verification measures to identify buyers and sellers in transactions above €10,000 properly enforced.

- UWOs, which were lauded for their innovativeness when first introduced because they were designed to target potential kleptocrats residing in the UK, were increasingly underutilized by early 2022 because authorities could not issue them against companies with opaque ownership structures and because they lacked expertise in investigating financial crime, time, staff, cooperation between agencies, and judicial priority. The first Economic Crime Act, which Parliament passed in March 2022, following the Russian invasion of Ukraine, permits authorities to issue UWOs against companies with unclear ownership that may be associated with PEPs and provides more time for investigators to investigate individuals and entities targeted by the UWOs.

Loopholes Exploited by Kleptocrats in the European Union

Overview

In 2017, the European Union Agency for Law Enforcement Cooperation, also known as Europol, the EU's primary law enforcement agency at the supranational level, said that between 0.7 percent and 1.28 percent of annual EU GDP was involved in suspicious financial activity. Europol's figure, however, is unusually low when compared to that of the United Nations Office of Drugs and Crime (UNODC), which estimates that 2 to 5 percent of global GDP is involved in money laundering. Europol itself also seems hesitant to endorse its own estimate: its public website uses the UNODC estimate of 2 to 5 percent in the EU context.[135]

The EU's main regulatory weakness in the private investment, real estate, cryptocurrency exchange, and arts trade industries is—despite European Commission directives intended to correct these problems—the lack of harmonization among, and enforcement by, member states. The harmonization of financial regulations is not a new problem in the EU; policy makers have long noted loopholes in financial regulations that provide cover for money laundering and other forms of illicit finance. Given the nature of the EU's single market and integrated economy, the lack of regulatory harmonization allows financial criminals to exploit less regulated or less transparent jurisdictions when conducting their affairs in the four abovementioned industries.[136]

The EU's Private Investment Industry

As in the UK, the regulatory issues in the EU's private investment industry stem primarily from uneven implementation of existing regulations across jurisdictions. Under European law, private investment firms are referred to as alternative investment funds (AIFs). Kleptocrats use AIFs in EU jurisdictions both as intermediary way stations in their money-laundering operations and as tax havens (in Luxembourg, the Netherlands, Belgium, Ireland, or other less regulated EU jurisdictions).[137] As of early 2021, more than one thousand six hundred AIFs operated in the EU, managing assets totaling over €708 billion. At the supranational level, the EU defines AIFs as including hedge funds, private equity funds, real estate funds, and other types of institutional funds. AIF Managers (AIFMs) are not governed by the undertakings for collective investment in transferable securities (UCITS). Directive 2011/61/EU sets out the regulations for AIFMs. As in the United States, a notable omission is that AIFs that do not exceed €100 million in value are exempt from AIFM directives, although (unlike their US equivalents) these funds must still register and abide by reporting requirements. Directive 2015/849/EU, also known as the 4th AML Directive (4AMLD), was implemented in June 2017. 4AMLD increased the EU's compliance with the FATF's guidelines on AML/KYC policies. 4AMLD holds AIFs to the same CDD standards as other financial institutions.[138]

The harmonization of regulations on AIFMs remains a work in progress, but AIFMs that fully comply with existing EU directives are granted a marketing passport across all EU jurisdictions. However, AIFMs have been hesitant to operate in Eastern Europe due to corruption concerns. This hesitation is primarily because most of the EU supranational directives and national laws place more of the regulatory burden on the private sector for AML/KYC compliance.[139]

EU member states have made commitments to improve measures to prevent against tax evasion by private investment firms and other financial institutions but have not always followed through. In November 2016, the UK and many EU member states signed the "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS)," or the MLI. The MLI mandates the registration of beneficial owners. In the "Danish Cases" in Luxembourg, courts ruled that a non-EU private equity fund must comply with beneficial ownership registration to operate within EU jurisdictions.[140] Although multiple EU member states have signed and ratified the MLI, its implementation remains uneven across the EU. This uneven implementation likewise extends to how the MLI is applied to private investment firms. Some jurisdictions that did sign the MLI, such as Luxembourg and Ireland, still have not fully implemented it as it applies to private investment firms. There are other vulnerabilities in the EU's approach to AML/KYC regulations on private investment firms, mostly stemming from the varying AML/KYC standards between EU member states.[141]

Nonetheless, private equity in the EU remains primarily within the regulatory scope of member states, with EU regulations acting as a platform for investment between states. Investigations by authorities in EU member states and by journalistic outlets have repeatedly uncovered cases of foreign kleptocrats running illicit financial networks across the EU. The largest and most notable money-laundering operation in Europe was connected to funds embezzled from Hermitage Capital Management by Russian kleptocrats.

CumEx Tax Fraud Scheme

The CumEx tax fraud scheme is the largest known tax fraud scheme in Europe, and possibly the world. The scheme was partly facilitated through EU private investment firms. First discovered in 2018, at least €150 billion was stolen from European treasuries, especially from the Inner Six members of the EU—Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. The scheme involved banks and stockbrokers trading with each other while hiding their identities, which allowed them to claim tax reimbursements to which they were not entitled. Much of the stolen money went into private investment firms across the EU, especially in countries like Ireland and the UK, which used financial institutions in those countries as points of entry for the fraudsters. The network that committed the fraud was based across the EU and even involved a pension fund in the United States.[I]

The lack of harmonization of regulations among EU member states played a major role in making the fraud possible. News of the scheme drove the EU to standardize its AML regulations (including those for private investment firms) across all of its member states.[II] Germany was the most heavily impacted country, with approximately €36 billion stolen, and has since lobbied the EU to harmonize its tax regulations and the flagging of suspicious activity in banks and private investment firms across jurisdictions to prevent similar fraud. The European Banking Authority (EBA) also announced a ten-point action plan to prevent future schemes. The EBA noted that, in several EU jurisdictions, the tax fraud and the distribution of the fraud's proceeds throughout the EU was within legal bounds. Sanjay Shah, a hedge fund manager involved in the CumEx scheme, has even claimed innocence in Denmark based on these loopholes.[III]

The CumEx fraud scheme also clearly demonstrated that EU and national regulations meant to prevent financial crime are not always implemented properly, even for more traditional financial institutions like banks. In Ireland, several private investment firms and banks were implicated in transferring some of the CumEx money, including the Dublin offices of international banks Investec and BNP Paribas. These financial institutions were used to facilitate CumEx transactions as vehicles to trade and to fraudulently claim refunds in other EU jurisdictions like Germany, thus showing that a lack of harmonization in EU regulations can be exploited by means of the EU single market.[IV]

I Iaya Argüeso Pérez et al., "CumEx Files," Correctiv, October 21, 2021, https://correctiv.org/en/latest-stories/2021/10/21/cumex-files-2/.

II Jack Power, "Irish Banks and Funds Used in Multibillion-Euro Tax Fraud by Hedge Funds, Traders," *Irish Times*, October 21, 2021, https://www.irishtimes.com/news/ireland/irish-news/irish-banks-and-funds-used-in-multibillion-euro-tax-fraud-by-hedge-funds-traders-1.4706093 and Pérez et al., "CumEx Files."

III Power, "Irish Banks and Funds Used"; Pérez et al., "CumEx Files"; and Olaya Argüeso and Justus von Daniels, "EU-Behörde über Cum-Ex-Deals: Kein Austausch zwischen Aufsichtsbehörden" ["EU Authority on Cum-Ex Deals: No Exchange Between Supervisory Authorities"], Correctiv, May 12, 2020, https://correctiv.org/aktuelles/cumex-files/2020/05/12/eu-behoerde-ueber-cum-ex-deals-kein-austausch-zwischen-aufsichtsbehoerden/.

IV Power, "Irish Banks and Funds Used."

Large portions of the proceeds of this theft were laundered through banks across Europe, particularly through Danske Bank, the largest bank in Denmark, which has branches across Central and Eastern Europe.

Reports have highlighted the lack of regulation of private investment firms in several EU member states. Luxembourg, which currently hosts approximately €4.5 trillion in assets and is one of the largest centers of private investment in the EU and the second largest in the world after the United States, has repeatedly come under scrutiny for having lax standards on AIFMs. The biggest legal transparency issue in Luxembourg stems from the fact that at least 80 percent of AIFMs based in Luxembourg do not list their beneficial owners. In fact, the 2021 Corporate Tax Haven Index notes that Luxembourg's enabling of tax evasion is consistent with its lax enforcement of regulations against financial crime.[142]

Transparency International further argues that, even though Luxembourg has a beneficial ownership registry, its legal definition of beneficial ownership is too vague to be enforceable. Verification mechanisms for the registry also remain quite weak. The quality of the data in the registry varies significantly, which makes it harder for law enforcement to properly investigate potential cases of corruption and abuse. Altogether, researchers have flagged Luxembourg's private investment firms as potential vectors for sanctions evasion, money laundering, and other illicit financial schemes.[143]

Danske Bank Money-Laundering Scandal

The Danske Bank money-laundering scandal revealed the depths of the EU's regulatory asymmetries. Money stolen from the Hermitage Capital Management private investment fund by Russian authorities was laundered through the Estonian branch of Danske Bank, the largest bank in Denmark. About fifteen thousand nonresident customers (most of whom were Russian) made 9.5 million payments between 2007 and 2015. Of these activities, at least €200 billion was first laundered through Danske Bank before being distributed across the rest of the EU. Even though the transactions looked suspicious, the Estonian branch of Danske Bank chose to continue processing the transfers, failing to comply with basic AML procedures and allowing embezzled funds to be transferred across the EU. The lack of control by Danske Bank's Danish headquarters over the Estonian branch allegedly played a role in the troubles with AML compliance. This incident further highlights the lack of harmonization of AML standards across the EU, even in financial sectors that are known to be at greater risk of money laundering and other illicit financial operations. Moreover, given the large scale of the money-laundering operation, European authorities continue to seize assets paid for with the stolen money, with one recent action including the seizure of residential properties in Belgium and Latvia.[I]

I Coppola, "The Tiny Bank."; Power, "Irish Banks and Funds Used"; and Andrew Rettman, "Belgium Seizes Assets in Russia Money-Laundering Affair," *EUObserver*, May 31, 2021, https://euobserver.com/world/151985.

In France, the Financial Markets Authority (AMF) argued in 2019 that private equity firms were not likely targets of financial crime because of a lock-in period for investment. As a result of this analysis, the AMF rated the threat of money laundering and other financial crime in the private investment industry as moderate. However, it qualified this assessment by noting that foreign capital of dubious origin would likely be invested into French private equity firms with increasing frequency. The AMF further noted that private equity firms tended to maintain a direct relationship with asset owners, and that auditing was essential as a result. The AMF praised French firms for minimizing risk by working primarily within France or with other EU member states but added that French firms should be increasingly vigilant about conducting CDD and ensuring that information about beneficial ownership of assets acquired through private equity firms is recorded publicly.[144]

Notwithstanding the AMF's assessments, foreign corruption has been linked to private investment firms and large banks in France. In 2020, Sherpa and the Daphne Caruana Galizia Foundation accused four French banks and a private investment firm of facilitating money laundering and corruption. The banks were BNP Paribas, Société Générale, Natixis Bank, and Credit Industriel et Commercial, along with the Rivage Investment firm. The allegations related to a loan they gave to Electrogas Malta Ltd. A few months before the conclusion of the loans, Maltese journalist Daphne Caruana Galizia, assassinated in October 2017, had alleged that the contract would be tainted by corruption.[145]

The Netherlands has had similar issues with enforcing AML compliance and other regulations against financial crime on private investment firms. Smaller private investment firms are only required to register if the total value of assets they manage is higher than €50,000. This threshold has remained unchanged since 2003, even though the Netherlands made sure to fully implement 4AMLD for investment firms, which requires registration and AML compliance. Dutch authorities have voiced their suspicions that some AIFMs have engaged in suspicious transactions. Authorities have implicated private equity firms in the Netherlands in tax evasion as well.[146] The Authority for the Financial Markets (AFM), the AML supervisor in the Netherlands, grew increasingly concerned about private investment firms engaging in financial crime in 2021. Suspicious investments by the Dutch-based Ramphastos Investments in Italian gambling companies connected to organized crime have prompted Dutch financial authorities to begin assessments of existing regulations of private investment firms.[147]

Italian organized crime has attempted to leverage other private investment firms across Europe. Between 2015 and 2019, the 'Ndrangheta mafia attracted approximately $1.6 billion from selling bonds backed by front companies to legitimate private investment entities, including Banca Generali, one of the largest investment banks in Europe. The assets were sold through the Swiss-based CFE investment bank, which claimed to have no knowledge of the criminal nature of the enterprise.[148]

The EU's Real Estate Industry

As in the United States and the UK, real estate industries in EU member states are known vectors for money laundering and other financial crime, and EU real estate regulations are unevenly implemented. A 2019 research briefing produced by the European Parliamentary Research Service noted cases of money laundering conducted through real estate-related transactions in Czechia, Denmark, Estonia, France, Finland, Germany, Greece, Latvia, Lithuania, the Netherlands, and Portugal. Factors common to many of these cases include opaque ownership structures, too little CDD on potential clients, and expansion from one EU member country to other members of the single market. To counter money laundering and other financial crime in the EU, the European Commission developed 4AMLD and 5AMLD. These directives mandated beneficial ownership reporting, CDD, risk assessments on transactions, and raising red flags on suspicious behavior. Still, their implementation across the EU is a work in progress, and private-private financial intelligence sharing on suspicious activity is not encouraged under these directives, as little guidance is given on how such sharing could happen under the GDPR.[149]

Kleptocrats are still able to exploit one key vulnerability in the EU real estate industry: citizenship by investment, or "golden passport" schemes, which both Malta and Cyprus have utilized. Under these schemes, for a set amount of money, Malta and Cyprus award foreign investors with citizenship, effectively giving them EU citizenship as well. Foreign PEPs and criminals abused these programs, facilitated by a lack of AML supervision and enforcement of due diligence regulations on applicants.[150]

Beginning in 2014 and as of 2022, Malta awards citizenship to investors who have made investments in government-approved bonds of at least €600,000 (with thirty-six months residence) or €750,000 (with twelve months of residence). Additionally, the investor must buy and hold a property in Malta worth at least €700,000 or rent a property with at least €16,000 paid annually for at least five years. The investment and residence requirements are meant to demonstrate that the applicant has a "genuine link" to the country.[151] Due diligence is mandated for applicants, both within the scheme itself and for the investments made into the government-approved bonds and real estate.[152] However, investigations have revealed that basic checks on residency were not conducted, with many applicants renting expensive properties but staying only long enough to pick up residency cards, open bank accounts, and fulfill the other requirements before leaving Malta again. Many of the applicants did not actually reside at the properties they purchased or rented for the five-year residency requirement, and the Maltese authorities allegedly did not verify residency closely.[153]

The Cypriot citizenship-by-investment scheme, which was started in 2007 and suspended in 2020, was even more egregious. It permitted applicants to receive citizenship within six months of completing the requirements—one of the fastest naturalization schemes at the time of its introduction. The most recent requirements issued in 2019 stipulated €2.15 million in total investment. Broken down by industry, these included €75,000 for the government's Research and Development Fund, €75,000 for the Cyprus Land Development Corporation, possession of a Schengen visa, and no prior rejection of any previous EU citizenship-by-investment application. Applicants were required to maintain their investments for up to five years after the initial application. Requirements prior to 2019 were even less: a €2 million investment in Cypriot real estate, a donation of €100,000 to the government's Research and Development fund, and €100,000 to the Cyprus Land Development Corporation.[154]

Because of its six-month expedited schedule, Cypriot citizenship by investment was a popular avenue for EU citizenship among wealthy individuals, including kleptocrats. Unlike the Maltese scheme, the Cypriot scheme did not require residency, meaning that investors only needed to buy residential and/or commercial real estate without residing at the former for any set amount of time. Moreover, basic due diligence, though required, was not conducted on the applicants. Few, if any, people were rejected as PEPs attempting to abuse the scheme to gain EU citizenship quickly. According to an Al Jazeera investigation, criminals known to law enforcement in their home countries or even wanted by Interpol were able to exploit the scheme to gain Cypriot citizenship. In fact, a Cypriot government inquiry into the scheme concluded that more than half of the passports issued between 2013 and 2019 were granted illegally.[155]

The Cypriot scheme was especially popular among Russian oligarchs and other PEPs, leading to Cyprus's nickname as "Moscow on the Med."[156] Although foreign PEPs were banned from applying for Cypriot citizenship in 2019, the government did not revoke the citizenship of PEPs who received passports before the ban. The only exception to this, so far, has been a small number of Russian oligarchs and other PEPs aligned with the Kremlin, such as Oleg Deripaska, whose citizenships were revoked as part of Cyprus's sanctions coordination with the EU in response to the Russian invasion of Ukraine.[157]

Al Jazeera Investigation into the Cypriot Citizenship-by-Investment Scheme

In 2020, Al Jazeera's Investigative Unit conducted an undercover investigation into Cyprus's citizenship-by-investment scheme. During the investigation, two Al Jazeera journalists presented themselves as working on behalf of a Chinese businessman trying to get Cypriot citizenship. The journalists openly admitted to then Cypriot parliament speaker, Demetris Syllouris, and member of parliament, Christakis Giovanis, that the Chinese businessman in question had been fined for money laundering. (Under the scheme's background checks, any applicant found to have committed financial crimes like money laundering is disqualified.) Despite this revelation, Syllouris and Giovanis both agreed to help the businessman circumvent these requirements in his application process. They even told the journalists that it would be easier for Cypriot authorities to turn a blind eye to the businessman's criminality if he invested more than €2.5 million in Cyprus. Al Jazeera's Investigative Unit published the findings, implicating Syllouris and Giovanis and causing an uproar in Cyprus. Although the politicians initially denied any wrongdoing, they eventually resigned from their positions in parliament.[I]

On paper, the Cypriot citizenship-by-investment scheme had background checks at multiple stages; in reality, these checks were either not properly enforced or were circumvented by political figures who acted as enablers for foreign PEPs and criminals. The issue in this case was not so much a question of financial intelligence sharing (Interpol even had active notices for some of the successful applicants). Nor was it a lack of legislation enabling oversight. The primary problems, rather, were local enablers, a failure to enforce required background checks, and a lack of regulatory convergence with the EU's AML Directives. 4AMLD and 5AMLD both addressed real estate-based money laundering. If implemented in Cyprus, they could have flagged the applicants at other stages of the scheme.

I Al Jazeera Investigative Unit, "Cyprus Abolishes"; Al Jazeera Investigative Unit, "Cyprus MP Quits in Wake of Passports-for-Sale Scandal," Al Jazeera, October 13, 2020, https://www.aljazeera.com/news/2020/10/13/cypriot-mp-resigns-after-al-jazeera-investigation; and Eli Moskowitz, "Head of Cyprus' Parliament Steps Down for Role in Passport Scandal," OCCRP, October 15, 2020, https://www.occrp.org/en/daily/13258-head-of-cyprus-parliament-steps-down-for-role-in-passport-scandal.

The EU's Cryptocurrency Exchange Industry

Though the EU has the same regulatory framework for cryptocurrency exchanges as the UK, it does not enforce these regulations with similar rigor. As noted above in the UK section, the EU's 5AMLD, issued in 2018, establishes regulations for cryptocurrency exchanges. Cryptocurrency exchanges based in the EU are required to apply for licenses to operate, while AML supervisory authorities assess if these exchanges can fully implement essential AML regulations. This includes performing due diligence and risk assessments on potential clients and issuing SARs to their respective national FIUs. Still, considering that 5AMLD is relatively new and suffers from patchy implementation across the EU, the enforcement of these measures is hard to assess.[158]

The EU's Arts Trade Industry

As in the United States and the UK, the EU's arts market has facilitated money laundering and other financial crime. 5AMLD is the directive most applicable to financial crime in the arts trade, as noted in the UK section. Under this directive, parties in any art-related transaction that exceeds €10,000 must confirm the identity of the buyer(s)/seller(s), ultimate beneficial owner of the art, the purpose and character of the business relationship, potential risks of the transactions, and the source of funds used for the transaction.[159]

Although there is now legislative reform to back enforcement of AML regulations, the implementation of 5AMLD remains somewhat patchy across the EU, even four years after its issuance. As of February 2021, nineteen EU member states had fully implemented 5AMLD; another seven member states (Belgium, Czechia, Hungary, Ireland, the Netherlands, Poland, and Spain) had partly implemented the directive; and Cyprus had made the least progress out of all EU member states. Given that 5AMLD has only been recently implemented in at least nineteen EU member states, it is difficult to gauge how well the new regulations have been enforced. Additionally, as in the UK, the issue of arts trade transactions below the €10,000 threshold remains a flaw in the 5AMLD regulation itself, since there are no legal reporting requirements for a chain of transactions amounting to more than the threshold. Furthermore, financial intelligence sharing between arts market traders remains unexplored as an avenue for raising red flags about potential PEPs or criminal clients.[160]

Proposed Reforms of the EU's Private Investment Regulations

Following the revelations that private investment firms were used in money-laundering operations connected to tax fraud, the European Commission reassessed its AIFM directive in June 2020. It concluded that implementation of AIFM regu-

The Louvre Museum pyramid illuminated at night. Shubhagata Sengupta/Unsplash.

Antiquities as Loot: The Case of the Louvre's Ancient Egyptian Acquisitions Following the 2011 Egyptian Revolution

In May 2022, Jean-Luc Martinez, the current French ambassador for cultural heritage and director of the Louvre between 2013 and 2021, was charged with complicity in fraud and money laundering for the acquisition of several Ancient Egyptian artifacts. Among these were a rare stele that bore the name of a pharaoh, Tutankhamun, estimated to be worth €8.5 million, and a marble head depicting a Ptolemaic queen thought by some to be Cleopatra, which the Louvre acquired for €35 million. Both artifacts had potentially false provenances (records of where they came from) that claimed they had arrived in Germany before 2011, when the Egyptian revolution occurred. French law enforcement officials are currently investigating whether these artifacts were stolen during the political instability Egypt experienced in 2011 during the overthrow of President Hosni Mubarak.[I]

A further sign that the transactions were criminal was the fact the Louvre had acquired these artifacts through antiquities expert Christophe Kunicki, whom French authorities had charged in 2020 on counts of criminal conspiracy, gang fraud, and money laundering. According to *Libération's* investigation, Kunicki's provenances for the Tutankhamun stele and the marble head had flaws that Martinez may have overlooked. Still, at least one antiquities trade expert has argued that Martinez was not a knowing participant in money laundering, and no definitive proof has emerged that the provenances for the artifacts were forgeries at this early stage in the investigation.[II]

Regardless of the outcome, the case demonstrates the necessity of financial intelligence sharing and due diligence on arts trade transactions and the participants themselves. Even the Louvre, one of France's most prestigious cultural institutions, may have fallen victim to a potential money-laundering scheme because red flags were not raised over the provenances of the artifacts. A more thorough investigation of where these artifacts came from, combined with more vetting of Kunicki, who did turn out to be a criminal, would have prevented the Louvre from acquiring artifacts that may have been looted from Egypt during its period of political instability.

I Vincent Noce, "Louvre Launches Civil Action as Part of Art Trafficking Case Involving Former Director Jean-Luc Martinez," *Art Newspaper*, May 31, 2022, https://www.theartnewspaper.com/2022/05/31/louvre-launches-civil-action-as-part-of-art-trafficking-case-connected-to-former-director-jean-luc-martinez.

II Ibid.

EU are expected to conduct more CDD and AML compliance, although 6AMLD still does not address the exemption of AIFMs managing assets worth less than €100 million. The regulation further adds that any cash transactions above €10,000 are prohibited. However, 6AMLD does not mandate beneficial ownership requirements for real estate that has already been purchased, which means that older financial crimes in the EU-based real estate industry will remain difficult to detect.[163]

Another reform that has recently come into effect is the Markets in Financial Instruments Directive (MiFID II), which establishes the EU IFR and IFD. MiFID II came into effect on June 26, 2021, following the Investment Firms Regulation (EU) 2019/2033 and the Investment Firms Directive (EU) 2019/2034. Much like the UK IFPR, the EU IFR and IFD formalizes international de-risking standards. Additionally, it requires investment firms to submit reports for any regulatory risks that impact clients, the investments market, and the firms themselves.[164]

However, the fact that managers of EU-based AIFs can run them from outside the EU remains a regulatory loophole in the existing AIFM directive. Discussion of this flaw has intensified in the wake of Brexit, as many UK-based managers control AIFs based in Ireland and other EU jurisdictions. The European Commission committed to examining this problem in May 2021 and released suggested amendments to the AIFM directive in November 2021. Two of the proposed amendments addressed this problem by requiring AIFs to report if more than a third of their operation is delegated to entities in countries outside the EU, and by requiring a minimum of two senior managers to be resident in the EU.[165]

The European Commission proposed several other amendments in November 2021. These included recognizing lending as a legitimate activity of AIFs, implementing the European Systemic Risk Board's suggestions on managing liquidity risks, authorizing AML supervisors that house and host AIFs to communicate with each other in exercising supervisory powers over AIFs where necessary, and reporting the origin of funds under AIFM portfolios periodically to investors, among other suggestions. Although the European Commission considered developing an EU-wide depository passport, it refused to do so in November 2021 due to the lack of harmonization among EU member states on securities and insolvency laws.[166]

Proposed Reforms of the EU's Real Estate Regulations

Malta and Cyprus, the EU member states that have proven especially vulnerable to transnational kleptocracy, have come under increasing scrutiny by the European Commission and other EU member states. The European Commission and EU member states are particularly concerned about these countries' citizenship-by-investment schemes, as they are viewed as especially acute vulnerabilities in the EU's economic defenses. Although other EU member states have pressured Malta over its scheme, the Maltese government continues to operate it, albeit with more promises to conduct due diligence on applicants, to enforce requirements, and to fully adopt EU AML regulations on real estate-related transactions.[167]

In contrast, Cyprus terminated its scheme following Al Jazeera's publishing of the "Cyprus Files," and it is unlikely to revive it, given how politically toxic the scheme has become. Despite this, the scheme continues to be a source of controversy for Cyprus among EU member states following the Russian invasion of Ukraine, as relatively few Russian oligarchs aligned with the Kremlin and sanctioned by the EU have had their Cypriot citizenships revoked and their assets seized by Cypriot authorities. Cyprus likewise had laws enabling shell companies to operate on its territory, raising questions of how effective the EU's sanctions can be within its own jurisdictions if it does not have the financial intelligence to properly execute a response against sanctioned individuals and entities. This lack of financial intelligence cooperation between Cyprus and other EU member states drew the ire of the Czech Financial Analytical Office (the Czech FIU), which criticized its Cypriot counterpart, Unit for Combating Money Laundering (also known by its Greek acronym MOKAS), for failing to comply with Czech requests in late April 2022.[168]

General Overview of Reforms in the European Union

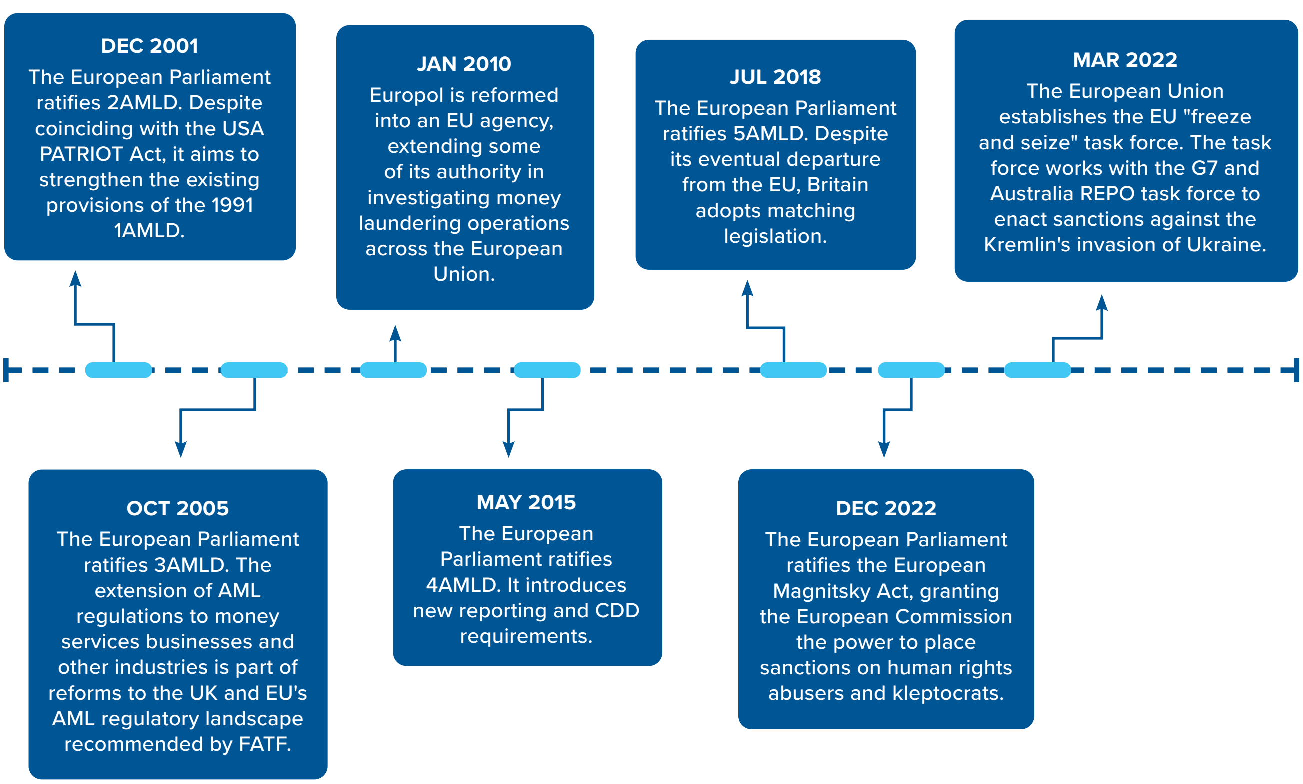
More developments have occurred beyond the proposed reforms of regulations on particular industries. On July 20, 2021, the European Commission proposed establishing an AML Authority (AMLA) at the EU supranational level. In its original proposal, the AMLA would act as a platform for AML supervisors of EU member states to coordinate and provide support for national FIUs within member states when tracking illicit financial flows that cross internal EU boundaries. In extreme cases of money laundering and other financial crime, the AMLA would have the power to directly investigate, supervise, and order administrative actions at large financial institutions that may be involved in these illicit financial operations. This AMLA, which would be overseen by an executive board, was planned to be operational by 2024. In cases of direct supervision, the European Commission would determine if the AMLA needed to be involved. The European Central Bank's Banking Supervision department lauded the proposal for addressing regulatory asymmetries between EU member states, enabling better financial intelligence sharing between member state FIUs, and encouraging enforcement.[169]

With the plan to harmonize EU AML regulations across all member states under the AMLA proposed in the AML Authority Regulation, there is more momentum on the regulators' side for improving regulatory compliance in Luxembourg. Some AIFM consultants, such as Pieter Leguit and Pierre-Régis Dukmedjian at the Simmons & Simmons law firm, have welcomed this harmonization. They argue that the harmonization reduces the chances of tax deductions being paid out when there was no tax in the first place due to differences in tax laws between Luxembourg and an investor's jurisdiction. This would reduce tax fraud cases like the CumEx scheme.[170]

Transparency International (TI), while applauding 6AMLD and the proposal for an AMLA as necessary, noted that the European Commission could offer additional revisions. TI indicated that the budget for the AMLA needed to be increased to fulfill its duties; that its selection criteria could be improved for financial entities that needed direct supervision (such as cryptocurrency exchanges, which are not covered); that it needed the power to request information from entities for their own risk assessments; that there should be stronger provisions for protecting the independence of the executive board; that it should leave the power of direct supervision with the executive board instead of the European Commission; and that it should be required to publish reports on EU member states' progress toward regulatory convergence.[171]

TI had further suggestions for 6AMLD and the regulation, primarily related to its beneficial ownership reporting requirements. It recommended that beneficial ownership registers be easily accessible to the public, that authorities should prioritize developing comprehensive verification measures for that information, and that beneficial ownership information for property bought before the regulation's passing should be mandated for registration as well. TI further added that there should be stronger AML requirements for intermediary services for citizenship-by-investment schemes in any EU countries.[172]

Figure 7. Timeline of Changes in EU Regulations since 2001



SOURCES: AUTHORS.

Recent Developments

Overall, EU member states must harmonize their AML regulations for the private investment, real estate, cryptocurrency exchange, and arts trade industries, and make sure that these regulations fully apply to private investment firms regardless of their size. Issues with tax evasion and beneficial ownership can be greatly reduced if beneficial ownership registrars in EU member states must follow a legal standard set by EU institutions. Kleptocrats and other financial criminals are exploiting the lack of regulatory harmonization between EU member states to engage in money laundering and other illicit finance. Given that the EU is increasingly embracing a doctrine of strategic autonomy, which extends even to its investment practices, it is essential that these asymmetries are properly addressed to avoid increasing the potential for money laundering or other financial crimes conducted through private investment. EU member states should likewise consider implementing more public-private partnerships between financial law enforcement and financial institutions, especially private investment firms. These partnerships have been viewed favorably in the EU as a means of streamlining financial law enforcement and improving relations between public authorities and the private sector.[173]

Compared to the United States and the UK, which have enforced safeguards against private investment firms empowering corruption in foreign jurisdictions, private investment firms in one EU jurisdiction can often encourage corruption in another, absent either legislation or the enforcement of that legislation. Ensuring that private investment firms do not evade accountability by operating in multiple EU jurisdictions is essential to addressing these loopholes.

As evidenced by 6AMLD, the accompanying AML Regulation, and plans to establish the AMLA, the EU is prioritizing greater financial intelligence sharing. Toward that goal, the European Banking Authority established the EuReCA database on January 31, 2022. EuReCA is designed to collect information on financial institutions identified by FIUs of EU member states as having structural AML and terrorist financing (TF) vulnerabilities. The database is intended to help with monitoring and technical assistance from AML supervisory authorities to these institutions as these vulnerabilities are addressed. EuReCa is additionally meant to identify emerging money-laundering (ML)/TF trends in the EU financial sector from the data collected.[174]

As part of its ongoing move toward regulatory harmonization and improving financial intelligence sharing, in June 2022, the European Commission adjusted its original proposal for the AMLA. Most of the original proposal was unchanged. However, the AMLA's proposed establishment date was expedited to January 1, 2023, and private investment firms and cryptocurrency exchanges were brought under the mandate of potential direct supervision by the AMLA. "Other financial institutions" are listed as being under the AMLA's purview as well, although the adjusted proposal does not specify whether firms like real estate managers and arts traders are included under this arrangement.[175] The AMLA does not have seizure power over assets; that authority is apparently left to national FIUs and law enforcement agencies, with which it would cooperate on a case-by-case basis. However, this does not extend to any seizure of cryptocurrency assets, as there is legislation in some EU member states that permits specific entities to seize and sell cryptocurrency assets. For example, in France, the cyber section of Parisian law enforcement auctioned more than six hundred seized bitcoins (worth €23 million) that had been acquired over the course of a single investigation.[176]

A database under the AMLA is listed as part of the new proposal, although compared to the existing EuReCa, this database collects evolving statistics at the strategic level instead of specific cases of supervision. However, it remains unclear how the AMLA is meant to interact with the existing EuReCa database, given their overlapping objectives. Both the AMLA and the European Banking Authority are meant to be politically independent governing entities, although the former has jurisdictions across multiple financial industries, while the latter is more specifically directed at banks.[177]

More recently, in November 2022, the Court of Justice of the European Union (CJEU) ruled that EU member states should not ensure public access to beneficial ownership information. The CJEU justified this ruling by arguing that this public access goes against fundamental rights guaranteed in the Charter of Fundamental Rights of the European Union, specifically those outlined in Articles 7 and 8. The CJEU highlighted its concerns that public access to such data could be abused and contravened principles on privacy protections.[178] The Council of the European Union followed this up with a decision to harmonize beneficial ownership reporting requirements and regulations across the EU.[179]

This CJEU ruling was received negatively by anti-corruption experts, including Spotlight on Corruption Executive Director Susan Hawley and investigative journalist Oliver Bullough. They argued that public access to beneficial ownership information of corporations was in the public interest and did not constitute privacy violations.[180] Maira Martini of Transparency International added that the ruling would likely cause EU-based registers to be shut down soon, which would have a global impact, including on sanctions placed against Kremlin allies.[181]

Separately, the Council of the European Union recently adopted a decision to add sanctions evasion as an EU

The European Parliament in Brussels. Florian Pircher/pixabay.com

crime. Under this decision, sanctions evasion is part of a list of EU crimes included in the Treaty on the Functioning of the European Union, meaning that the EU would set out a common set of rules at minimum to define criminal offenses and penalties against the crime of sanctions evasion. The European Council unanimously took this decision as part of the EU's ongoing sanctions on Russia following the Russian invasion of Ukraine in February 2022. The decision further highlights an enlarged role for sanctions coordination among EU members occurring through the European Commission.[182]

The Council of the European Union also adopted another decision to increase rules on cryptocurrency exchanges, limits on cash payments, and engage in closer cooperation with the FATF's black and gray lists of jurisdictions found to be noncompliant with its anti-illicit finance recommendations. This decision obliges cryptocurrency providers to conduct stricter due diligence checks on clients who are involved in transactions of €1,000 or above, including enhanced due diligence measures for cross-border interactions, and greater de-risking measures for self-hosted cryptocurrency wallets. Additionally, all payments of cash above €10,000 are now prohibited, with EU members able to set lower limits if they wish. The council has further mandated that the EU match the FATF's black and gray lists of noncompliant jurisdictions with its own separate but linked black and gray lists. Finally, as part of operationalizing this specific decision, the council stated that it would be consulting closely with the European Parliament on the final text of the decision.[183]

Summary of Key Findings

Much like the UK, many of the EU's problems stem less from a lack of legislation to address AML deficiencies and sanctions evasion in multiple industries than from the implementation of those policies. The EU faces additional hurdles in ensuring that all its member states harmonize their AML policies. The main problems in the EU's regulation of private investment, real estate, cryptocurrency exchange, and arts trade industries include:

- 4AMLD (2015), 5AMLD (2018), and 6AMLD (2021) are still unevenly implemented and enforced. Consequently, AML regulations between EU member states remain patchy, and the AMLA is not yet established.
    - Beneficial ownership regulations, including for private investment firms, are put into law to varying degrees across the EU, especially in tax havens like Luxembourg.

  - Without the AMLA, no EU-level financial intelligence-sharing platform between EU member state FIUs exists, meaning that any cooperation between FIUs would need to happen outside of EU institutional structures. Such cooperation would remain on a case-by-case basis, at the tactical level, instead of identifying potential structural vulnerabilities at the strategic level.

  - The proposed AMLA has no seizure power, which remains with the national FIU and law enforcement agencies of EU member states that will cooperate with the AMLA.

- Private-private financial intelligence sharing on risks and suspicious activity across the EU financial sector is not encouraged by EU authorities due to GDPR and data protection concerns. No new reforms in the EU address this deficit.

- Private investment firms (called alternative investment fund managers or AIFMs in Europe) managing assets totaling less than €100 million are exempt from following AIFM directives, but, unlike their equivalents in the United States, must still register with authorities and abide by AML registering requirements.

- The European Commission does have a plan to implement stronger AML measures, but the policies on foreign corruption and kleptocracy coming into the EU remain primarily oriented toward law enforcement, not security, both at the supranational and national levels.

- Sponsorship of corruption in EU member states by banks and private investment firms based in other EU member states is a continuing problem, despite it being illegal in most EU member states.

- 4AMLD and 5AMLD mandated the extension of AML regulations to the EU real estate industry. These regulations included requiring the reporting of beneficial ownership information, due diligence on clients and risk assessments on transactions by brokers, and red flags on suspicious behavior. These directives are not completely implemented across the EU, creating regulatory asymmetries that criminals can exploit. The real estate industry remains a high-risk vector for money laundering and other illicit finance.

- Citizenship-by-investment schemes in EU member states remain a potential vector for weaponized corruption. Even in countries like Cyprus, kleptocrats who acquired their citizenship before the scheme's suspension have retained their citizenships with only a few exceptions. These schemes have complicated sanctions enforcement against Kremlin allies. The failure of enforcement of AML regulations on real estate investments made under these schemes, despite 4AMLD and 5AMLD, permitted corrupt actors to gain access to the EU.

- Cryptocurrency exchanges are covered by 5AMLD and will be one of the financial institutions that can come under supervisory monitoring from the AMLA. Exchanges that demonstrate they can comply with AML regulations, such as beneficial ownership registration, will be able to receive licenses to continue operation. Unlike the UK, which implemented 5AMLD strictly against cryptocurrency exchanges that failed to prove their AML regulatory compliance by an April 1, 2022, deadline, the EU has been more lax. With the right legislative reform, EU member states can follow the UK's lead in empowering their FIUs to seize cryptocurrency.

- The EU arts trade industry is covered by 5AMLD, meaning that the arts trade industry is likewise impacted by patchy implementation. Enforcement, even by countries that fully comply with these directives on paper, is likely uneven as well. In the case of France, even the high-profile Louvre was implicated in a potential case of financial crime involving antiquities. 5AMLD retains a €10,000 threshold for reporting as well, which can be circumvented by a series of arts trade transactions that fall below this threshold.

- Public access to beneficial ownership registries is no longer protected under EU law, making it more difficult to enforce financial transparency in the EU.

- Sanctions evasion is now listed as an EU crime, giving greater power to the European Commission to coordinate sanctions among EU members.

Global Governance against Weaponized Corruption

Although the United States, the UK, and the EU are all parties to the FATF, Organisation of Economic Co-operation and Development (OECD), and the G7, none of these institutions have provided the necessary impetus for the reform of regulations on private investment firms. The OECD is the only organization that has legally binding instruments that are meant to harmonize AML and measures against tax evasion among its member states, while non-binding FATF and G7 recommendations tend to be respected by its members. Despite the FATF's de-risking recommendations, the OECD's MLI, and the G7's Joint Communiqué on tackling corruption, the United States, the UK, and the EU have all been slow to implement these provisions. The Tax Justice Network has argued that this is primarily because the OECD countries setting global tax rules and many other financial regulations tend to be the ones that bend them the most, even though the OECD has taken a leading role in convening member states to sign treaties to improve tax collection.[184]

In fact, much of the undercutting of regulations in all three jurisdictions arises from a "race to the bottom" to encourage interest from investors. This is especially the case in the US states of Delaware and South Dakota, which are competing with other US states to attract businesses. Meanwhile, the FATF's recommendations for de-risking in the securities sector puts much of the burden on the private sector, without much regulatory incentive for the United States, UK, or EU to do so. The FATF's recommendations additionally do not address the lobbying power that the private sector has against such increased regulations, especially lobbying by private investment firms in the United States and the UK. Much of the issues with passing regulatory reforms in those two jurisdictions come primarily from the political power that private investment firms leverage in both of their respective legislative processes.[185]

This is further reflected in the implementation of AML regulations in the US real estate industry. Despite assessments by the FATF on the US real estate industry and recommendations by the FATF to place AML compliance requirements on real estate agents, lawyers, notaries, accountants, and others involved in real estate transactions, these recommendations have not been implemented. The FATF made its assessments on the US AML regulatory scene in late 2016, and in terms of extending global AML standards to real estate, the United States is far behind the curve on some of the recommendations that the FATF has made.[186]

Despite the shortcomings of these intergovernmental groups, they can still set standards to improve regulations on private investment firms. There have already been some promising changes in the United States since the G7's Joint Communiqué on tackling corruption. When discussing the FSA regulations in the UK, Edwin Schooling Latter, director of markets and wholesale policy at the FCA, argued against continuing to lower regulations for a competitive advantage, indicating that the UK government is taking a stronger stance with regulating private investment firms. The creation of the Investment Firms Prudential Regime (IFPR) in the UK and the EU Investment Firms Regulation and Investment Firms Directive (IFR and IFD), in part to formalize some of the FATF's de-risking recommendations on investment firms, indicates

Indonesia's Finance Minister Mulyani Indrawati speaks with Financial Action Task Force (FATF) President Raja Kumar during their bilateral meeting at the G20 Finance Ministers and Central Bank Governors Meeting in Nusa Dua, Bali, Indonesia, 16 July 2022.
Made Nagi/Pool via REUTERS

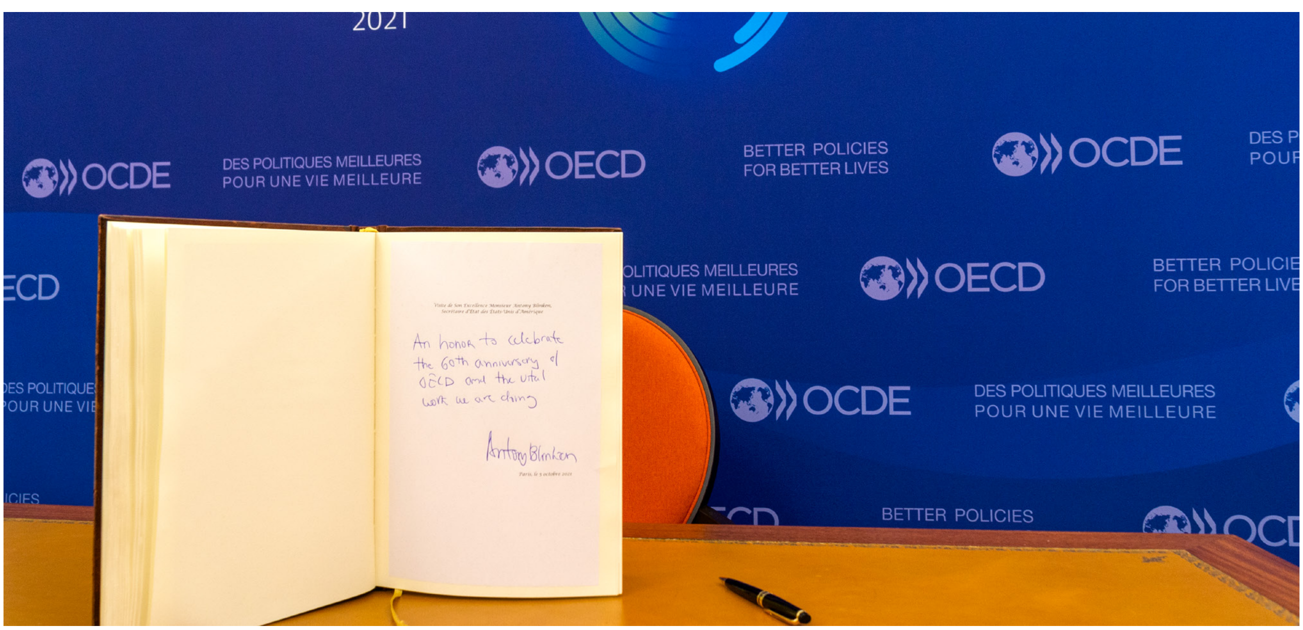
continued interest in complying with the FATF's recommendations. The EU's 6AMLD is also already designed to rectify the existing issue of regulatory asymmetries between EU member states, addressing one of its biggest flaws in regulation. If the United States, the UK, and the EU coordinate these reforms in concert, it could form the basis of a multilateral strategy to counter financial crime and threats to their shared security.[187]

The new anti-corruption strategy from the Biden administration is particularly promising. Indeed, if the United States successfully delivers on the strategy, it could mark a turning point in regulating the private investment industry. As part of the strategy, FinCEN is in the final stages of drafting a new rule for overhauling AML regulations in the United States that is likely to address the issue with applying AML/CFT compliance more comprehensively to private investment firms. Furthermore, the strategy heavily emphasizes the need to coordinate with allies, indicating that the Biden administration will focus much of its diplomatic efforts on improving anti-corruption efforts globally, particularly through multilateral and bilateral channels. New programs outlined in the strategy, such as the State Department's Democracies Against Safe Havens Initiative and USAID's Global Accountability Program (GAP), are meant to make it harder for kleptocrats to store their money in offshore accounts based in the United States or among its allies. The strategy further outlines how the United States will be advocating for similar reforms for its allies in appropriate multilateral settings, such as the G7/G20 and NATO's Building Integrity Program, or within US-based platforms like GAP. The United States must advocate for its allies to adopt similarly strengthened regulations and oversight on private investment firms for greater multilateral harmonization through these channels. This would greatly boost security in the United States, the UK, and the EU, turning the tide against corruption, money laundering, and other financial crime in the global private investment industry.

While these new strategic initiatives look promising, there is not enough of an institutional global framework to coordinate US anti-corruption policies with the UK and the EU. This report proposes that a Global Anti-Corruption Council (GACC) would fulfill this role, becoming a platform for better regulatory harmonization against weaponized corruption, especially in the global private investment industry. The GACC would be modeled on the US-EU Trade and Technology Council (TTC), a recently established platform for transatlantic cooperation on technology regulations from a strategic and multilateral perspective.

Conclusion

All these regulatory problems clearly show that the United States must have a more structured relationship in developing anti-corruption policies with the UK and the EU. The existing domestic regimes are insufficient on their own, and the existing international regimes are not properly enforced. Having established in detail what the loopholes and institutional failures are, this report now proposes a new mechanism for the transatlantic community to harmonize its necessary response: a GACC to coordinate anti-corruption policies between the United States, the UK, and the EU—a major innovation to curtail kleptocracy.



Secretary of State Antony J. Blinken signed a guest book the Organization for Economic Cooperation and Development Ministerial Council Meeting, in Paris, France on October 5, 2021. State Department photo

Chapter 4: The Global Anti-Corruption Council

Secretary of State Antony J. Blinken participates in a U.S.-EU Trade and Technology Council Ministerial family photo in Pittsburgh, Pennsylvania, on September 29, 2021. State Department photo by Ron Przysucha

US-EU Trade and Technology Council as a Template

Fortunately, there already exists a model of the kind of platform required to take on kleptocracy. On September 29, 2021, the US-EU Technology Council (TTC) met for the first time in Pittsburgh—a symbolically appropriate site given its status as a US Rust Belt city. The meeting was cochaired by five of the most high-ranking officials in Washington and Brussels. On the US side, the cochairs were US Secretary of State Antony Blinken, US Secretary of Commerce Gina Raimondo, and US Trade Representative Katherine Tai. On the European side, the cochairs were European Commission Executive Vice Presidents Margrethe Vestager and Vladis Dombrovskis. The broad array of portfolios, ranging from foreign to economic policy, was itself a statement of the TTC's intent and function: the United States and the European Union (EU) view both policy areas as intertwined and strategic dossiers.

The TTC was the Biden administration's flagship policy for its new approach to the EU.

Whereas former US president Donald J. Trump frequently lashed out at the bloc, including his claim that "Europe treats us worse than China,"[188] US President Joe Biden spoke of it in glowing terms, stating that "the partnership between Europe and the United States, in my view, is and must remain the cornerstone of all we hope to accomplish in the 21st century."[189] Whereas the Trump administration engaged in hostile trade actions against the EU by enacting tariffs, the Biden administration has sought to put that rancor behind it and enshrine a new policy of coordination against transnational threats from the pandemic to climate change and the worsening systemic rivalry between the United States and China. The Biden administration viewed the TTC as a key tool to reboot the relationship with Brussels and structure Western coordination against China.

The significant buy-in from the European side into this idea came from the fact that it was not in origin an American idea. During the Trump administration's onslaught of US regulatory actions against Chinese technology—in particular Huawei's—the EU had begun exploring the idea of the TTC with the United States, which piqued the interest of various China hawks in the Trump administration. While the US found the idea of magnifying its foreign policy influence appealing, the European Commission's interest was essentially protective. The greater access it had to US policy formulation, the less exposed it would be to sudden jolts or, as has long been suspected by the EU, the underhand use of US policy tools like tariffs and fines to secure a competitive advantage for US companies. Various European diplomats also noted that part of the appeal to the European Commission was to gain further structured, direct access to the US administration on these topics thereby enhancing its own power.

The TTC idea had even deeper sources than these, however. The TTC was only the latest iteration in a long-standing quest for a more structured form of transatlantic policy coordination, which had left significant intellectual preparatory work and support deep inside the foreign policy machineries on both sides of the Atlantic. Although transatlantic economic coordination is not a new concept, dating in earnest to the diplomatic rounds of the Bretton Woods system and the Group of Seven (G7), the more granular attempts to coordinate began under the Clinton administration with the 1995 New Transatlantic Agenda (NTA), followed by the Transatlantic Economic Partnership (TEP) in 1998. The Bush administration followed these initiatives with the Transatlantic Economic Council (TEC) in 2007, which was in turn followed in 2013 by the grandly ambitious Transatlantic Trade and Investment Partnership (TTIP). The common cause of the failure of each of these projects was agenda overreach: the NTA and TEP made good progress in several domains but fell short because of disputes over sanctions and biotechnology. The TEC was similarly derailed over divisions about the acceptability of chlorinated chicken, and TTIP over specific regulatory standards and investor-state dispute mechanisms. By the time TTIP was declared obsolete in 2019, the generation of officials working on these projects had learned the lesson that the smaller and more focused the project, the more likely its success. They had also learned not to run afoul of electoral and political sensitivities on either side of the Atlantic.

At Pittsburgh, these hard-won lessons came to fruition in the TTC. The Pittsburgh Statement on a common agenda framed the TTC's work and was accompanied by the Pittsburgh Outcomes, which committed both parties to progress in these areas. To make sure this would be achieved in a structured manner, ten working groups were launched at Pittsburgh in areas ranging from artificial intelligence (AI) to investment screening. These groups were chaired by the heads of relevant US government and European Commission agencies and services. Successful outcomes were reported in sector-specific statements—for example, in export control cooperation and AI, and commitments to enhance cooperation. The buildup to the TTC also functioned as an engagement process with stakeholders from business and civil society, and a further development and commitment to this process was announced. The TTC's work concluded with an inaugural joint statement and a pledge to continue annual council meetings.

The value both parties attach to the TTC is attested by the fact that it went ahead at all. The Pittsburgh meeting had the misfortune of being timed close to the fallout from the AUKUS security pact between Australia, the United Kingdom, and the United States, which saw Canberra dump a highly valued submarine deal with the French defense firm Naval Group. The abruptness of the cancellation and the transfer of the $40 billion deal to the United States prompted a storm of protest from French government officials. EU Commissioner for the Internal Market Thierry Breton said "something is broken" in transatlantic relations, and that there was a need for a "pause and reset."[190] French officials initially threatened to postpone the inaugural meeting of the TTC as Paris withdrew its ambassadors from Canberra and Washington. However, as French fury eased following diplomatic outreach from the United States, the value attached to the TTC by both EU and French officials and by leading EU states like Germany helped push the meeting forward. The broad consensus was that the TTC was something real, not symbolic, and too valuable to be postponed.

In June 2021, the TTC's purpose was announced as "a forum for the United States and European Union to coordinate approaches to key global trade, economic, and technology issues and to deepen transatlantic trade and economic relations based on shared democratic values."[191] On these terms, the outcome can be judged a success. Through the ten working groups, all of which meet on a regular basis and have a direct bearing on future competition with China, the TTC has created a mechanism for serious discussion of shared standards and processes. The format has clearly linked leadership of this process with success in stakeholder engagement. Crucially, the Pittsburgh meeting created a shared understanding of the TTC and its objectives. The mechanisms established are vital information-sharing platforms on which the participants expect to deliver the Pittsburgh Outcomes before next year.[192]

The TTC, therefore, offers an example of how to politically reinvigorate and bureaucratically structure transatlantic relations when it comes to developing strategic approaches to regulation. This is a template for bridging the regulatory gaps outlined in this paper concerning private investment. Furthermore, it offers the chance to build an institutional and bureaucratic relationship that can outlast different administrations and provide long-term continuity in transatlantic relations despite the volatility of US politics.

The Transatlantic Anti-Corruption Council

To face the growing threat of weaponized corruption from kleptocratic regimes, we propose that the United States, the UK, and the EU form a Transatlantic Anti-Corruption Council (TACC). Should it prove successful, the TACC should then be expanded into the Global Anti-Corruption Council (GACC), which would grow to include the G7. Much as the Russian Elites, Proxies, and Oligarchs (REPO) Task Force is composed of the G7 and Australia, the GACC should be open to states outside of the G7 as well.[193] Recent cases of weaponized corruption have exploited the lack of regulatory coordination and financial intelligence sharing between transatlantic jurisdictions to evade detection and to corrupt transatlantic democratic and financial institutions. Given transatlantic leaders' growing attention to the threat of weaponized corruption, the presence of the US president, UK prime minister, and president of the European Commission at the inaugural meeting of TACC would send a strong signal of how seriously they are approaching these issues of illicit finance.

The TACC should be modeled on the TTC, except it should be expanded to include the UK. The UK's inclusion in the first TACC structure is vital to ensuring a more comprehensive response to the threat of kleptocracy and weaponized corruption. The UK's financial services sector has a global impact, as its private investment industry amounts to £22.33 billion ($30.44 billion) worth of assets.[194] Furthermore, the various leaked "papers" have demonstrated the numerous regulatory vulnerabilities that kleptocrats have exploited in the British financial industry. The Panama and Paradise Papers indicated in 2016 and 2017, respectively, that UK-based shell companies processed at least £80 billion worth of dark money (then worth $105.6 billion).[195] The City of London, Crown Dependencies, and Overseas Territories have repeatedly been implicated in money laundering and in enabling other financial crimes, as noted in previous sections of this report. Brexit has led to decreasing regulatory convergence between the UK and the EU; this development could create new regulatory asymmetries that kleptocrats could exploit to export their graft.

Existing forums for discussing coordinated transatlantic responses to corruption are inadequate for this purpose. The Organization for Security and Co-operation in Europe (OSCE), the Organisation for Economic Co-operation and Development (OECD), and the Council of Europe are too large for there to be enough consensus on anti-corruption measures or to have effective monitoring mechanisms to ensure implementation of these measures. Transatlantic forums like the NATO Parliamentary Assembly and the TEC, or even several smaller intergovernmental platforms like the G7, deal with too many topics outside of corruption to be effective. The TEC especially suffered from getting mired in disputes over relatively small regulations (such as chlorinated chicken), which eventually forced it into a dormant state since 2008.[196]

As this report shows, the United States, the UK, and the EU cannot face the growing threat of weaponized corruption in a manner siloed by their respective jurisdictions. There is no specialized formal dialogue going on between the three parties that would bind them to improving their anti-corruption standards at the strategic level or addressing specific cases of transnational corruption through financial intelligence sharing at the tactical level. Mechanisms for financial intelligence sharing between jurisdictions, especially among private sector institutions, would be very useful in tackling transnational money-laundering rings. Transatlantic discussions on standards for financial intelligence sharing are necessary for any future financial intelligence-sharing agreements to go forward.

Political leaders across the transatlantic community voiced concerns about weaponized corruption impacting their jurisdictions even before the Russian invasion of Ukraine. Biden repeatedly raised the threat of corruption as a matter of national security with allies at the 2021 G7 Summit and the Summit for Democracy. Additionally, twenty-four British members of Parliament (MPs), including then chair of the Foreign Affairs Select Committee Tom Tugendhat, and Layla Moran, foreign affairs spokesperson for the Liberal Democrat party, have criticized the spread of foreign corruption in the UK through suspicious investments into UK-based entities, including cultural institutions like soccer clubs. While serving as Foreign Affairs Select Committee chair, Tugendhat promised more investigations into foreign-led financial crime in the UK.[197] Several EU political leaders have voiced similar concerns about the current state of anti-corruption policies. When serious anti-money laundering (AML) compliance failures were revealed at Danske Bank's Estonian branch in 2017, then Danish prime minister Lars Løkke Rasmussen expressed outrage at the scale of the corruption and multiplied by eight times the monetary penalty for money laundering. Rasmussen and other Danish political leaders oversaw cooperation with US authorities in deeper investigations of the financial crimes occurring at Danske Bank. German member of the European Parliament David McAllister further noted that corruption is a serious risk in Europe, and that more transatlantic coordination is essential to address this threat.[198] Given the ongoing Russian war against Ukraine and the foundation of the REPO Task Force, the TACC is the logical next step to actions already taken by the United States, the UK, and the EU to curtail the threat of weaponized corruption against the transatlantic community.[199]

Even before Russia's invasion of Ukraine on February 24, 2022, the Biden administration demonstrated that it was taking the threat of weaponized corruption very seriously. After outlining why foreign corruption was a threat to US national security, the Biden administration released its national anti-corruption strategy.[200] The strategy approaches anti-corruption with an emphasis on a whole-of-government approach and with multilateral coordination in mind. The strategy notably outlines the private investment, real estate, arts market, and cryptocurrency exchange industries as particular vulnerabilities in the US AML regulatory scene and recommends measures such as extending AML compliance to private investment firms managing assets under $100 million. The strategy also proposes a State Department-led Democracies Against Safe Havens (DASH) Initiative, in which the United States would encourage allies to adopt similar sanctions regime legislation. The strategy especially highlights sanctions justified by human rights legislation, inspired by the Global Magnitsky Act, as an area ripe for State Department advocacy with US allies. Magnitsky Acts have grown increasingly common among US allies partly in response to the Russian invasion of Ukraine—a development that possibly opens new avenues of cooperation with the United States. Other multilateral aspects of the strategy include USAID's Global Accountability Program (GAP), which would commit USAID to retrieving assets bought with dark money, and USAID's Anti-Corruption Response Fund, which would be invested in developing new anti-corruption approaches against kleptocratic regimes. Other US developments include the ENABLERS Act, which was introduced by US Reps. Tom Malinowski (D-NJ) and Maria Elvira Salazar (R-FL) following the release of the Pandora Papers.[201]

The TACC is also the logical next step for work already undertaken in the UK. The UK's National Crime Agency (NCA) has prioritized developing a whole-of-government plan for tackling illicit financial flows in and out of the UK, although it specified neither the overall strategy for improving AML capabilities nor the government agencies responsible. However, a later operational priority outline for strengthening the NCA's activities referenced some of the government agencies that deal with financial crime, including the National Cyber Crime Unit and the UK Financial Intelligence Unit (FIU). The NCA also said it aimed to strengthen the National Economic Crime Centre, although the strategy did not specify how that would be done. More British MPs are also paying attention to the issue of illicit finance in the UK. In addition to the Foreign Affairs Select Committee's investigation, British MPs are seriously considering regulating cryptocurrencies and non-fungible tokens more vigorously, over fears that they are being used for money laundering and other financial crime. Following the Russian invasion of Ukraine, the UK has recognized the need for multilateral cooperation against transnational kleptocracy and weaponized corruption even more. The establishment of the kleptocracy cell within the NCA, the passing of the first Economic Crimes Bill, and the expected implementation of the second Economic Crimes Bill have put the UK's AML regulations and economic defenses more in line with that of its allies.[202]

The TACC also offers an attractive next step for the EU. The revelations of the Azerbaijani Laundromat and the Danske Bank money-laundering scandal have further impressed on European authorities the need to investigate illicit finance and weaponized corruption operations in the EU. The European Commission has since issued the 6th AML Directive (6AMLD), which has been working to reduce the regulatory asymmetries between EU jurisdictions and to operate as a platform for further financial law enforcement reform. The European Commission additionally proposed an ambitious package of reforms, which would include establishing an EU-level Anti-Money Laundering Authority (AMLA) to work with European FIUs to identify illicit financial operations across the EU and improve AML measures on cryptocurrency trade. The AMLA was originally planned to be established by January 1, 2023 and become operational by 2024, although the initial target for its establishment has since passed.[203] The European Commission's Dombrovskis and Commissioner Mairead McGuinness endorsed this legislative package as being essential for improving AML procedures across the EU. The AMLA, which would already work separately from the newly founded European "Freeze and Seize" Task Force that works with REPO, would be better suited for the TACC, as both are adjacent to REPO in terms of role.[204]

The TACC (and its successor, the GACC) should also regularly convene expert working groups on, at a minimum:

- trade-based illicit finance,
- market-based illicit finance,
- bribery and other enabling forms of corruption,

- acquisition of luxury goods by kleptocrats (private jets, for example, are known to be luxury goods consistently acquired by kleptocrats),[205]
- asset returns,[206]
- tax evasion,
- terrorist financing, and
- future threats.

Financial intelligence working groups should similarly cover individual cases of corruption and illicit finance at the tactical level. At the executive level, primary stakeholders in the TACC should be:

- on the US side, the Departments of State, Treasury, Commerce, and Justice, as well as USAID;
- on the UK side, the Foreign, Commonwealth & Development Office (FCDO); His Majesty's Treasury; the Department for International Trade; and the Home Office;
- on the EU side, the European External Action Service (EEAS); and the Directorate-Generals for Economic and Financial Affairs; Financial Stability, Financial Services and Capital Markets Union; Trade; and Migration and Internal Affairs.

These positions are informed by the structure of the TTC, which allocates communications between analogous departments across transatlantic jurisdictions. Given how the US national anti-corruption strategy specifically outlines the roles of the Departments of State, Treasury, and Justice, and USAID in the strategy and has defined new initiatives for them to undertake (like State's DASH initiative and USAID's GAP), this proposed TACC structure would complement the existing strategy well.

The inaugural meeting of the TACC should be held in London and produce a London Statement and London Outcomes due to London's status as a hub for financial activity. The London Statement should discuss the threat of kleptocrats abusing regulatory loopholes over the private investment industry in the transatlantic community; in particular, it should discuss the ways that private investment firms lack full regulation,

Figure 8. TACC Working Groups

Working Group	US Department or Agency	UK Ministry or Office	EU Directorate-General or Service
Trade-based illicit finance	Commerce	International Trade	Economic and Financial Affairs, Trade
Market-based illicit finance	Treasury	Treasury	Financial Stability, Financial Services and Capital Markets Union
Bribery and enabling corruption	State, Justice	FCDO, Home	EEAS, Migration and Internal Affairs
Luxury goods	Treasury	Treasury	Financial Stability, Financial Services and Capital Markets Union
Asset returns	Treasury, Justice, USAID	FCDO, Treasury, Home	Financial Stability, Financial Services and Capital Markets Union, Migration and Internal Affairs
Tax evasion	State, Treasury, USAID	FCDO, Treasury, Home	Financial Stability, Financial Services and Capital Markets Union, Migration and Internal Affairs
Terrorist financing	Treasury, Justice	Treasury, Home	Financial Stability, Financial Services and Capital Markets Union, Migration and Internal Affairs
Future threats	State	FCDO	EEAS

either because they do not manage assets totaling over $100 million or because existing regulations are not fully enforced. The London Outcomes should emphasize regulatory convergence between transatlantic jurisdictions, especially on private investment firms. Other good outcomes would include commitments to

- Standardize unexplained wealth orders (UWOs) in the United States and the EU (about which British law enforcement can share advice on best practices). The UWOs issued to Zamira Hajiyeva were an essential part in bringing her to justice.

- Standardize regulations on beneficial ownership and AML compliance across all transatlantic jurisdictions. Even though the UK was the first country to implement a beneficial ownership registry, British Overseas Territories and Crown Dependency jurisdictions have had consistent problems matching regulations in the constituent countries of the UK itself for private investment firms. Moreover, the problem of regulatory asymmetry with corporate vehicles has been found in the special member state territories of the EU, as well, such as in the Dutch constituent country of Aruba in the Caribbean. Chinese shell companies, especially ones based in the United States, would also be particularly threatened by increased corporate transparency.[207]

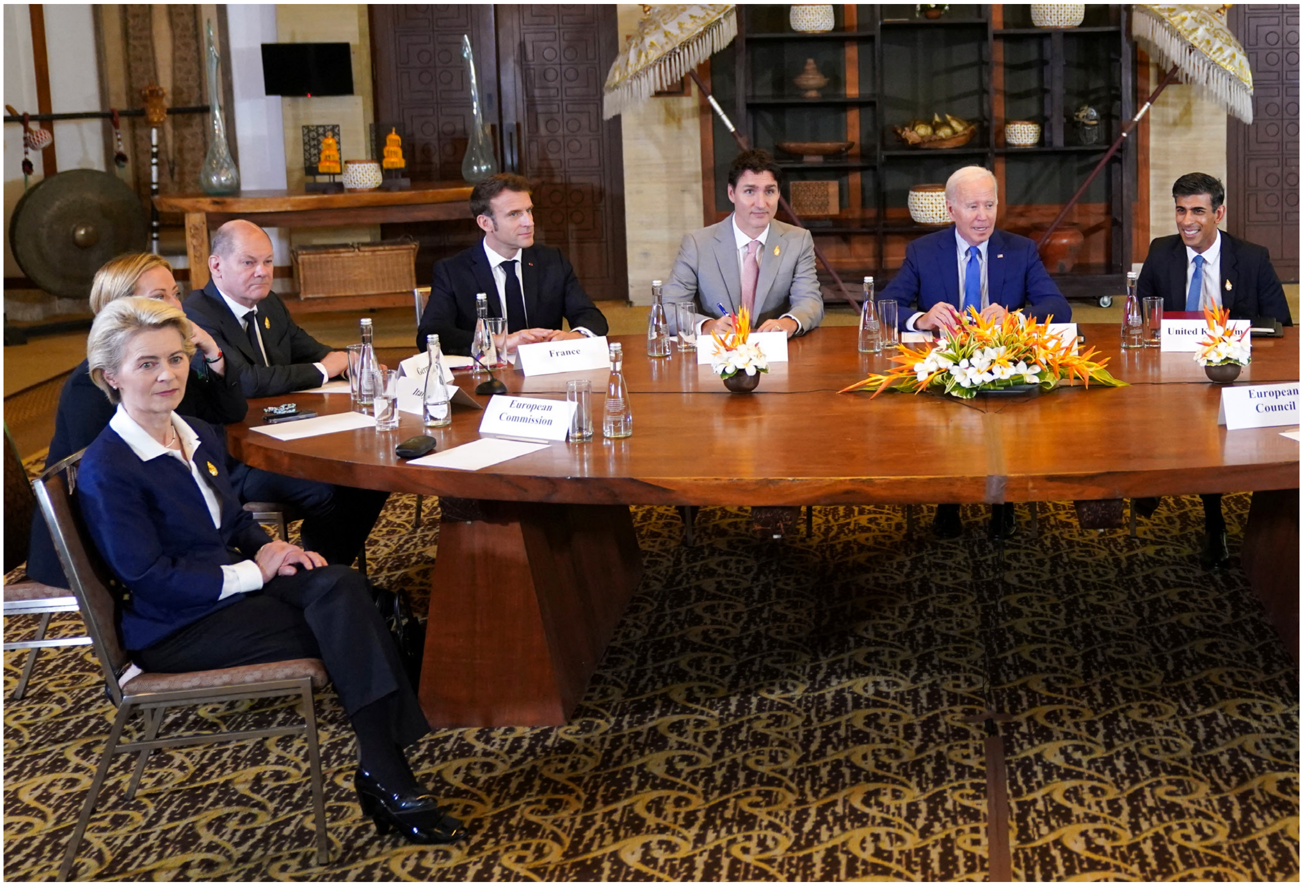
- Standardize sanctions regimes against kleptocrats. For example, even though the EU imposed sanctions on Russian oligarch Yevgeny Prigozhin for violating the United Nations' arms embargo on Libya and for sponsoring the Wagner Group's human rights abuses there before the Russian invasion of Ukraine, the UK only imposed sanctions on Prigozhin after the Russian invasion.[208]

- Develop platforms for financial intelligence sharing, both on emerging strategic trends in financial crime (such as sanctions evasion) and weaponized corruption, as well as specific cases of transnational sanctions evasion, money laundering, and other illicit financial operations occurring within transatlantic jurisdictions. For example, the AMLA would provide a central location for EU member states' FIUs to deposit intelligence about suspicious activity in EU jurisdictions. Such intelligence would be vital for the US Financial Crimes Enforcement Network (FinCEN) and UK FIU while monitoring for financial crime and other suspicious activities, and especially more so for other allied FIUs that would join the larger GACC.[209]

In the spirit of the US anti-corruption strategy and other new anti-corruption initiatives, the long-term goal beyond standardization should be for the transatlantic community to take a more proactive stance on fighting weaponized corruption, and for more trust between transatlantic financial law enforcement when it comes to identifying and restricting the activities of kleptocrats. This includes shared standards on bribery and corruption for politicians in transatlantic jurisdictions, sanctions against election interference campaigns, coordination of sanctions against kleptocrats (especially by identifying lobbyists for kleptocratic regimes that may use bribery and private investment firms used by kleptocrats to acquire assets with dark money), and efforts to address the regulatory loopholes in the United States, the UK, and the EU highlighted in the previous chapter, especially in accordance with existing multilateral frameworks, such as OECD treaties and Financial Action Task Force (FATF) recommendations.

One platform the TACC could also build upon to increase transatlantic financial intelligence is the Europol Financial Intelligence Public Private Partnership (EFIPPP). The EFIPPP was established in 2017 as a public-private partnership between Europol and several EU member states' FIUs, and the FIUs of the UK, Switzerland, the United States, and Australia. Banks from each of these jurisdictions also participate as the private sector side of this platform. In its original form, the EFIPPP was meant to exchange strategic intelligence on new trends in financial crime, such as terrorist financing, cryptocurrency trade, and tax fraud. A unit within EFIPPP could be attached to the TACC to focus on weaponized corruption at the strategic and tactical case-by-case level. As of 2021, there was a secretariat with plans to expand day-to-day operations of the EFIPPP, so the establishment of the TACC could also play a strong role in the EFIPPP's existing plans for expansion.[210]

The TACC is only the beginning of a larger transatlantic strategy against weaponized corruption. In particular, the transatlantic community should be considering the ways in which strategic competitors like China and Russia are attempting to impose their standards on the world. China in particular has already been proactive in reshaping global norms outside of corruption; among other things, it has set standards on AI development and space exploration, increased its influence in the World Trade Organization, conducted debt-trap diplomacy for less-developed states, and undermined The Hague's ruling on the South China Sea by continuing to build artificial islands for naval bases and by passing laws delineat-



European Commission President Ursula von der Leyen, Italy's Prime Minister Giorgia Meloni, Germany's Chancellor Olaf Scholz, France's President Emmanuel Macron, Canada's Prime Minister Justin Trudeau, U.S. President Joe Biden and British Prime Minister Rishi Sunak attend an emergency meeting of global leaders after an alleged Russian missile blast in Poland, in Bali, Indonesia, November 16, 2022. REUTERS/Kevin Lamarque

ing Chinese territorial waters in ways that contradict international legal standards. China and Russia aim to achieve more influence through weaponized corruption to impact transatlantic democratic and financial institutions by, for instance, bribing Western enablers, deploying mercenary groups like the Wagner Group to areas of strategic interest for plausible deniability and to undermine transatlantic interventions (as in Mali), and using shell companies (especially private investment firms) for sanctions evasion, which can in turn be used for election interference, funding terrorism, and maintaining aggressive military postures against the transatlantic community.

The late United Nations secretary-general Kofi Annan once said: “If corruption is a disease, transparency is a central part of its treatment.”[211] Annan spoke in a time before the crisis of weaponized corruption rose to prominence, but his words ring clearer now that foreign kleptocrats are spreading their malign influence by means of the money they stole from their own people. The United States and its allies must choose the partners with which it engages more carefully. Otherwise, it may find that some of its partners are in fact proxies for strategic competitors of the transatlantic community who will undermine the West’s security and the integrity of its democracies from the inside. Therefore, the TACC should be seen as a piece of a grand strategy that seeks to build a whole series of councils to coordinate the transatlantic community. This is not the proliferation of bureaucracy. This is the recognition that geopolitics is also a regulatory contest for norms.

Conclusion

Misdiagnosis is a major problem in foreign policy. Misdiagnosing the nature, objectives, and vulnerabilities of an opponent whilst misevaluating one's own leverage and weak points are the factors that typically conspire to cause a strategy to fail. It has been almost ten years since the challenge posed by kleptocracy was first widely discussed in the transatlantic community. Since then, the "ring of fire" around Russia suggests that this conversation remains behind the curve. Although authoritarianism should not be conflated with kleptocracy, it is still heavily tied to corruption. Moreover, authoritarian regimes have repeatedly demonstrated how to weaponize corruption against the transatlantic community.

Against this backdrop, this report has attempted to rethink kleptocracy. It has argued that the image of a kleptocrat that policy makers typically hold in their minds is not a universal type but a classic form of kleptocracy that flourished in the aftermath of the Cold War. This kind of kleptocrat has now been superseded by the rise of second-wave kleptocrats who are more likely to view corruption as a means rather than an end. This report also shows that it is now increasingly difficult to disentangle kleptocracy from the broader phenomenon of authoritarian aggression. Meanwhile, this problem has been exacerbated by the rise of major enablers inside the transatlantic community—typically former policy makers moving into the private sector—as kleptocrats in their own right. These changes add up to diminishing leverage for governments on both sides of the Atlantic over authoritarian states that employ kleptocratic methods.

This report has also analyzed the kleptocratic methods of authoritarian states. First-wave kleptocrats were heavily dependent on a trifecta of offshore finance, shell companies, and luxury goods or property to launder money. These techniques have been widely exposed, debated, and—provisionally, patchily, and to varying degrees of success—legislated against in the transatlantic world. This report has pointed out that second-wave kleptocrats make far greater use than their predecessors of the less discussed and significantly less well-regulated private investment industry. A more contemporary trifecta of kleptocracy is now emerging: offshore finance, shell companies, and the use or guidance of transatlantic investment funds or firms. A closer examination of this phenomenon has revealed, among other things, dramatic gaps in regulatory coverage in the United States and a chronic failure of enforcement in the United Kingdom and the European Union (EU). Anti-kleptocracy strategic and reform efforts on both sides of the Atlantic have barely begun to address these problems.

Rethinking kleptocracy implies the need to rethink our approach to it. This research has shown that the transatlantic community is nearing the limits of what can be achieved using reactive, siloed, and poorly coordinated national strategies. The transatlantic community urgently needs to catch up with the accelerating sophistication of transnational kleptocracy. The relative ease with which authoritarian kleptocrats pass through the web of sovereignties guiding Western governance shows us that a tighter web of coordination is needed. The relationship between the Biden administration and the European Commission offers a successful blueprint for a structurally deepened coordination platform. This is the US-EU Trade and Technology Council (TTC), which met in Pittsburgh for the first time in September 2021. Anchored by high-level principles, the TTC plugs multiple nodes of the regulatory bureaucracy together on both sides of the Atlantic into frequently meeting constructive working groups with agendas and capacity for deliverables. Taking the TTC as an inspiration—and including the UK due to its major role as a global financial center—the United States and the EU should launch a Transatlantic Anti-Corruption Council (TACC) in the same format to coordinate their response to second-wave kleptocracy. This should be part of a wider vision to synergize regulation and to structure bureaucratic cooperation between the United States and its allies going forward.[212]

In the twenty-first century, it is clear that most foreign policy questions also have a domestic regulatory component, from technology to vaccines to trade. Illicit finance is one such clear example. Facing a future of entrenched and expansionary authoritarian regimes, the transatlantic world needs a new tissue of bureaucratic coordination and connectivity. The context of Kremlin aggression amid alarming global kleptocracy makes the TACC a necessary part of this. Having US, UK, and EU leaders launch this initiative and for it to have coordination at the highest government level would signal that this has been understood.

A protestor holds up a banner that reads "Enough," during a demonstration calling for the resignation of the president of Cyprus over a discredited citizenship for investment scheme heavily criticised by the European Union, outside the Presidential Palace in Nicosia, Cyprus October 30, 2021. REUTERS/Yiannis Kourtoglou

Policy makers should be aware that much of the current debate surrounding kleptocracy suffers from the same kinds of problems from which the foreign policy debate in general suffers. The mental concepts and understanding of the transatlantic community's opponents are from before the Russian invasion of Ukraine. The transatlantic community's willingness to celebrate mediocre achievements and acceptance of bureaucratic malfunction and sluggishness are symbolic of widespread poor governance and an aversion to hard tasks. Worse still are the common attitudes of reluctance to accept responsibility for fueling the problem and of aversion to tackling forms of authoritarian aggression that enrich elites. This broader weakness in statecraft on both sides of the Atlantic is one of the reasons the authoritarians, especially the kleptocratic ones, feel they are winning. It is an open question whether the transatlantic community can once again legislate, coordinate, and, most critically, build new structures and infrastructures with the speed and urgency that once characterized its actions. In Washington, but also in London and Brussels, fighting kleptocracy will prove a key test of democratic resilience and the integrity of the global financial system. Until a more capable and fast-moving governance emerges, authoritarian kleptocrats will keep winning.

Policy Proposals Annex

Transatlantic Community

- Work closely with the United States in its national anti-corruption strategy. The strategy's success will be heavily dependent on the degree of cooperation between US allies and the Biden administration in its implementation.
- Match regulatory legislation on both sides of the Atlantic. This will permit better coordination of sanctions between allies and reduce tensions between the United States and its allies when the United States relies on extraterritorial action.
- Create channels for financial intelligence units and private sector actors in transatlantic jurisdictions to share information about suspicious clients, transactions, and transfers. The Europol Financial Intelligence Public Private Partnership (EFIPPP) may be a good platform for increased intelligence sharing.

United States

- Establish the Transatlantic Anti-Corruption Council (TACC). Its main purpose would be to coordinate legislation on improving anti-money laundering/Know Your Customer (AML/KYC) policies, share good governance policies (such as beneficial ownership registries) to harmonize regulations, crack down on sanctions evasion, and share financial intelligence on transnational financial criminals to shut down their operations.
  - The TACC should also regularly convene expert working groups on, at a minimum:
    - trade-based illicit finance,
    - market-based illicit finance,
    - bribery and other enabling forms of corruption,
    - acquisition of luxury goods by kleptocrats,
    - asset returns,
    - tax evasion,
    - terrorist financing, and
    - future threats.
  - Financial intelligence working groups should similarly cover individual cases of financial crime at the tactical level. At the executive level, primary stakeholders in the TACC should be
    - the Departments of State, Treasury, and Justice, and USAID on the US side,
    - the Foreign, Commonwealth & Development Office (FCDO); His Majesty's Treasury; and the Home Office on the UK side, and
    - the Directorate-General for Economic and Financial Affairs; Directorate-General for Financial Stability, Financial Services and Capital Markets Union; and Directorate-General for Justice and Consumers on the EU side
- Follow through on the US legislative national anti-corruption strategy. Many of the existing flaws in the US regulatory sphere were correctly identified and should be addressed accordingly. This includes the strategy's commitment to increasing regulation on the private investment industry, including on firms managing assets totaling less than $100 million.

United Kingdom

- Share legalistic principles and good practices of unexplained wealth orders (UWOs) with allies. UWOs have already proven to be very effective in bringing more investigative power to bear on to foreign kleptocrats based in the United Kingdom

- Reduce regulatory mismatches between the primary UK jurisdictions and the Crown Dependencies and Overseas Territories, especially with beneficial ownership registries and sanctions compliance

- Improve verification standards for companies registered in Companies House to identify shell companies

- Fully implement and enforce existing transparency and national security laws, especially the National Security and Investment Act

European Union

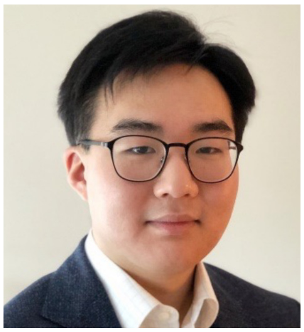
- Increase compliance requirements for private investment firms managing assets totaling less than €100 million

- Fully implement the 6th Anti-Money Laundering Directive (6AMLD) across EU jurisdictions. The establishment of an EU Anti-Money Laundering Authority will be essential for harmonizing regulations across the European Union (EU).

  - 6AMLD measures should also be applied to overseas autonomous territories like Aruba.

- Increase enforcement of laws that prohibit the spread of corruption in foreign territories, particularly for cases that involve spreading corruption to fellow EU member states

About the Authors



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