

FREEPORTS CONSULTATION

Submission by Transparency International UK to the Department for International Trade, 13 July 2020.

INTRODUCTION

Around the world, freeports present a major money laundering risk due to the secrecy and security they offer. Without proper protections in place, creating similar areas in the UK risks effectively establish onshore havens in which criminals and the corrupt could anonymously hide their ill-gotten gains. Such a situation would prove detrimental to our prosperity, security and reputation for fair business practices and the rule of law.

The UK's freeports aim to increase jobs and innovation across the UK and promote trade and investment globally. However, ignoring the significant corruption risks presented by freeports does more to threaten these objectives than achieve them.

Our submission outlines the corruption risks that emerge in freeports, and makes the following key recommendations to reduce these risks.

KEY RECOMMENDATIONS

1. **Develop strict oversight and accountability measures** for freeport operators and their employees to reduce the risk of corrupt behaviour.
2. Businesses using freeports must undergo **thorough due diligence procedures** to ensure criminals cannot make use of freeport facilities, including providing **verified beneficial ownership information**.
3. The Government should firmly commit that **freeports will at no point be used for high-value storage**, including artworks, to stop them becoming safety deposit boxes for illicit goods.
4. There should be **sufficient controls and enforcement measures in place to prevent money laundering**, particularly trade-based money laundering, which pose reputational and security threats to the UK.
5. There should be **clarity over which sectors are permitted to operate in the freeports** and **no weakening of money laundering controls** for regulated sectors, such as banking and professional services.

1. **Develop strict oversight and accountability measures** for freeport operators and their employees to reduce the risk of corrupt behaviour.

In Chapter 3 Customs of the Freeports Consultation, the Government notes that the customs sites would be run by a Freeport operator, with responsibility for record keeping and security, while facilities would be made available for government agencies to carry out inspections if necessary. While checks on operators are referenced briefly, the consultation provides no details on what requirements and obligations will be placed on freeport operators and how ongoing oversight of freeports operators will be maintained.

While the UK has strong anti-bribery legislation, specific consideration should be given to the risks posed by freeports, particularly given the bribery and corruption risks associated with

borders and customs decisions.¹ While bribery in ports and at borders may often seek to evade complex regulatory requirements, the converse may apply in freeports. If businesses have an incentive to access freeports due to the competitive advantage provided by a relaxed regulatory environment, those who have been denied permission to operate may seek to bribe operators and employees to gain this access.

Given the risks surrounding bribery in freeports, it is concerning that the Government is yet to address how it will manage these risks as they apply to the freeports operators and employees. This becomes even more pertinent given the significant evidence of corrupt activities carried out by freeport operators in other countries:

- According to a report published by the European Parliamentary Research Service in October 2018, Yves Bouvier played a key role in the development of the new generation of freeports, holding the majority of shares in the Geneva and Luxembourg Freeports, owning the Singapore Freeport, and acting as a consultant to the Beijing Freeport.² However, he was also involved in a number of international lawsuits alleging that he defrauded his clients in art deals. Forbes reported that he was sued for over 1 billion USD for art fraud, also noting that another owner of the Luxembourg Freeport was charged with stealing artworks.³
- The CEO of Geneva's Le Freeport, Philippe Dauvergne, a former French customs official, has numerous business ties to an Azerbaijani businessman called Khagani Bashirov.⁴ Between 2008 and 2014, both men were part of the senior management of a Luxembourg holding company called Tiara, as well as Bashirov's consulting firm V.E.S. Consultancy, registered in London.⁵ Bashirov is closely linked to the International Bank of Azerbaijan (IBA) scandal, having been arrested in 2010 for failing to repay \$109 million in loans from the IBA.⁶ He is also a close business associate of the former chairman of the bank, Jahangir Hajiyev, who was convicted of embezzling funds and whose family was the respondent to the UK's first Unexplained Wealth Order.
- In December 2019, Ventspils Freeport was one of four Latvian bodies sanctioned for links to the politician and businessman Aivars Lembergs, who was placed on the US sanctions list for corruption.⁷ The Ventspils Freeport was only removed from the sanctions list when the Latvian government took over full control of its operations.

While there may be differences in the structure of the UK's freeports to those referenced above, it would be naïve to assume they will be immune from corruption risks associated with their operators. Moreover, the risks of corruption are apparent at all levels of the freeport's operation; it only takes a small number of corrupt actions or actors to create significant problems.

For this reason, there should be strict monitoring procedures in place for all those employed to operate and manage the UK's freeports and at all levels of the security structure. The freeport operator should be registered with a money laundering supervisor with responsibility for

¹ Marie Chêne, *Corruption at borders*, U4 Anti-Corruption Resource Centre, Chr. Michelsen Institute (U4 Helpdesk Answer 2018:3). <https://www.u4.no/publications/corruption-at-borders>.

² European Parliamentary Research Service, *Money laundering and tax evasion risks in free ports* (October 2018). https://www.europarl.europa.eu/cmsdata/155731/EPRS_STUD_627114_Money%20laundering-FINAL.pdf

³ Kenneth Rapoza, 'EU Spotlights New Ways To Bribe and Launder Money', *Forbes* (19 April 2019). <https://www.forbes.com/sites/kenrapoza/2019/04/19/eu-spotlights-new-ways-to-bribe-and-launder-money/#6c9d55856c03>

⁴ Ibid.

⁵ Companies House (accessed 8 July 2020). <https://beta.companieshouse.gov.uk/company/05953154/officers>

⁶ Edward Robinson, Gavin Finch and Stefania Spezzati, 'Crooked Banker Tapped Professionals to Manage Web of Dirty Money', *Bloomberg* (5 March 2020). <https://www.bloomberg.com/news/features/2020-03-05/crooked-banker-tapped-professionals-to-manage-web-of-dirty-money>

⁷ Gederts Gelzis, 'U.S. sanctions Latvian oligarch charged with corruption', Reuters (9 December 2019). <https://uk.reuters.com/article/uk-latvia-sanctions-usa/u-s-sanctions-latvian-oligarch-charged-with-corruption-idUKKBN1YD2DH>

monitoring the operator. Checks on operators and employees should draw on existing Government procedures, including HMRC's fit and proper person test and UK Security Vetting.⁸

2. Businesses using freeports must undergo thorough due diligence procedures to ensure criminals cannot make use of Freeport facilities, including providing verified beneficial ownership information.

Alongside the operators, there are risks which also apply to the businesses who work within and move goods or provide services in, from and through freeports. However, Chapter 3 Customs of the consultation also states that businesses would be authorised by the Government in a light-touch process involving a basic compliance, solvency, and record-keeping check. There is no mention of carrying out customer due diligence checks which would provide safeguards against the UK's freeports becoming vehicles for money laundering.

Failing to carry out customer due diligence checks would attract the wrong type of business to the UK's freeports and place them out of step with current best practice:

- The OECD recommends certain steps which should be taken to enhance transparency in Free Trade Zones, including prohibiting those convicted of illegal economic or financial activities from operating in the zone and ensuring that economic operators in freeports communicate information about the identity of their clients.⁹ They further state that clients who act as agents or representatives should communicate the identity of the person or persons on whose behalf they act to the relevant authorities.
- The Financial Action Task Force (FATF) states that any businesses that set up in free trade zones should be subject to the same requirements as legal entities in the rest of the country where the free trade zone is located.¹⁰
- As of January 2020, the EU's Fifth Anti-Money Laundering Directive explicitly includes Freeport operators, subjecting them to the same customer due diligence requirements as estate agents.¹¹

Businesses seeking to operate within Freeports should undergo due diligence conducted by freeport operators including verifying their beneficial owners, source of wealth and background as well as monitoring their ongoing business activity.

Without this information, it will be impossible to know who is operating in the freeports and for what purpose. Such a scenario is particularly concerning when Transparency International UK's research has shown that the UK is a haven for corrupt wealth and that a range of UK sectors participate in this process, at times unwittingly or through complacency.¹²

The combination of frequent scandals surrounding freeports and the UK's existing role as an enabler of global corruption could be a recipe for disaster, one which limits the attractiveness of freeports for legitimate businesses and undermines recent positive steps towards beneficial ownership transparency in the UK. Given this, it would be irresponsible to have business

⁸ HMRC Fit and Proper Persons Test (Accessed 8 July 2020). <https://www.gov.uk/guidance/money-laundering-regulations-apply-for-the-fit-and-proper-test>; UK Security Vetting (Accessed 8 July 2020).

<https://www.gov.uk/government/publications/united-kingdom-security-vetting-clearance-levels>

⁹ OECD Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones, 21 October 2019. <https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0454>

¹⁰ FATF, *Money Laundering Vulnerabilities of Free Trade Zones* (March 2010). <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

¹¹ European Parliamentary Research Service, *Money laundering and tax evasion risks in free ports* (October 2018). https://www.europarl.europa.eu/cmsdata/155731/EPRS_STUD_627114_Money%20laundering-FINAL.pdf

¹² Transparency International UK, *At Your Service* (October 2019). <https://www.transparency.org.uk/publications/at-your-service/>

authorisation procedures for freeports that did not include robust customer due diligence procedures.

3. The Government should firmly commit that **freeports will at no point be used for high-value storage, including artworks.**

In Chapter 8 Additional Policy Considerations the consultation notes the need to prevent illicit activity in freeports. Although the consultation references the concerns of international organisations and the need to consider best practice, it stops short of making any explicit commitments to tackle this problem.

The consultation notes that the UK Government does not intend to designate freeports for the purposes of High Value Luxury Storage, however the gravity of this money laundering risk requires firm commitment that freeports will at no point be used for this purpose.

Section one above noted the links between illicit activity and high-value items in the case of Yves Bouvier, yet it is important to further outline why this poses such a significant money laundering risk:

- According to the BBC, luxury freeports such as Geneva are said to hold over a million works of art (for comparison, the National Gallery in London holds about 2,300).¹³ These works of art are hidden from public view and, if no money laundering regulations apply, can be sold privately and anonymously within the freeport zone.
- This situation is easy to exploit for those wishing to launder large amounts of wealth, particularly since the luxury art market has already been identified as a key risk area for money laundering.¹⁴
- The EU identified luxury freeports as a key money laundering risks and recently categorised freeports as art market participants in the 5th Anti-Money Laundering Directive, subjecting any freeport which stores works of art where the value is €10,000 or more to money laundering regulations.¹⁵

International cooperation is essential for tackling money laundering, and the UK's decision to adopt the EU's 5th Anti-Money Laundering Directive was crucial in demonstrating its commitment to this topic post-Brexit. Moving to create luxury freeports in the UK at any point, even if now categorised as art market participants and subject to money laundering regulations, would undermine this drive towards more transparency in the world's freeports.

To minimise significant and well-established money laundering risks and signal its commitment to international cooperation on anti-money laundering measures, the UK Government should firmly commit that any freeports developed in the UK will not, at any point, be used for high value luxury storage.

4. There should be **sufficient controls and enforcement measures in place to prevent money laundering**, particularly trade-based money laundering, which poses reputational and security threats to the UK.

¹³ Will Gompertz, 'Geneva Free Port: The greatest art collection no-one can see', *BBC News* (1 December 2016). <https://www.bbc.co.uk/news/entertainment-arts-38167501>

¹⁴ Transparency International UK, *Don't Look, Won't Find: Weaknesses in the Supervision of the UK's Anti-Money Laundering Rules* (November 2015). <https://www.transparency.org.uk/publications/dont-look-wont-find-weaknesses-in-the-supervision-of-the-uks-anti-money-laundering-rules/>

¹⁵ European Parliamentary Research Service, *Money laundering and tax evasion risks in free ports* (October 2018). https://www.europarl.europa.eu/cmsdata/155731/EPRS_STUD_627114_Money%20laundering-FINAL.pdf

We note that high-value items are not the only money laundering risk in freeports. In particular, we recommend that the Government takes steps to ensure that the UK's freeports do not become vehicles for trade-based money laundering. Chapter 8 Additional Policy Considerations makes no reference to this risk.

Trade-based money laundering schemes seek to use legitimate trade to disguise and justify the transfer of the proceeds of illicit activities. These schemes are carried out through actions such as moving illicit goods, misrepresenting financial transactions, falsifying documents, and under- or over-invoicing the value of goods. FATF notes that relaxed oversight measures in free trade zones create prime settings for trade-based money laundering schemes.¹⁶ Several examples testify to this situation:

- The Colón Free Trade Zone in Panama has been abused by those wishing to carry out trade-based money laundering, including by individuals placed on the US State Departments' international sanctions list.¹⁷
- The Kings Cross investigation discovered trade-based money laundering at the Curacao Free Zone, in which businesses operating in the zone exchanged currency for drug traffickers.¹⁸
- In April 2020, customs officials at Malta Freeport found falsely declared items in three containers, including television sets declared as computer monitors and air-conditioning units declared as generators.¹⁹
- We also have emerging evidence that there is significant trade based money laundering out of Russia, often with the use of UK shell companies.

The risks arise from the relaxed customs checks in place in freeports and the ability of importers to self-declare, which may attract illicit actors and super-charge the already present links between organised crime and the UK's ports. The Government should take note of the risks this creates not only for trade-based money laundering, but for other illicit activities like smuggling, counterfeiting, and trafficking.

To address these concerns, we recommend that the Government:

- Fully empowers customs officials to carry out regular spot-checks of goods in the freeports at any point, including entrance, storage, and exit.
- Ensures that detailed digital records of goods in the freeport and activities carried out in the freeport are collected, maintained, and checked.
- Provides adequate training to enforcement bodies on the unique risks posed by freeports, ensures the active presence of enforcement bodies on-site, and makes sufficient funding available for these purposes.

In addition, measures outlined above, including following HMRC fit and proper person tests and robust due diligence procedures, are crucial elements in deterring organised criminals and those tempted to engage in money laundering.

¹⁶ FATF, *Money Laundering vulnerabilities of Free Trade Zones* (March 2010). <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

¹⁷ Daniel Neale, 'Free Trade Zones: a Pandora's Box for Illicit Money', Global Financial Integrity (7 October 2019). <https://gfintegrity.org/free-trade-zones-a-pandoras-box-for-illicit-money/>

¹⁸ FATF, *Money Laundering vulnerabilities of Free Trade Zones* (March 2010). <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

¹⁹ Kurt Sansone, 'Customs bust: TVs instead of monitors, ACs instead of generators', *Malta Today* (20 April 2020). https://www.maltatoday.com.mt/news/national/101816/customs_bust_tvs_instead_of_monitors_acs_instead_of_generators#.XwXdcDpKjIX

5. There should be clarity over which sectors are permitted to operate in the freeports and no weakening of money laundering controls for regulated sectors, such as banking and professional services.

A common theme throughout the Freeports Consultation is the desire to apply a light-touch and more flexible regulatory approach. This is detailed in Chapter 3 Customs, as already noted in Sections 1 and 2, but also in Chapter 4 Planning and Chapter 6 Innovation.

While the Government notes that encouraging innovation is a key objective of its freeports policy, it should ensure that any regulatory flexibility does not apply to sectors which are regulated by anti-money laundering legislation. Doing so would be detrimental to the goal of preventing illicit activity outlined in Chapter 8 Additional Policy Considerations.

We raise these concerns because of existing weaknesses in the UK's anti-money laundering regime which, if combined with lighter regulations and the existing risks of freeports outlined above, would provide a gaping hole in the UK's defences against dirty money:

- In our analysis of over 400 corruption cases we identified 582 firms and individuals offering services in the UK to those suspected to be involved in corruption and money laundering. Of these 582 firms and individuals, we found 86 banks and financial institutions, 81 law firms, and 62 accountancy firms (including all of the Big Four).²⁰
- Despite this, it is nearly impossible to bring a successful criminal prosecution against large and complex businesses who have facilitated money laundering.
- The UK's disjointed anti-money laundering supervision regime has left firms with weak defences against corrupt funds, which would likely be further tested in an environment where regulations and oversight are further relaxed.

The Government should offer clearer information about which sectors will be permitted to operate in the freeports, particularly those which pose a money laundering risk. It is essential that freeports do not open the door to any easing of money laundering controls and that the Government takes steps to address existing weaknesses in its anti-money laundering oversight and enforcement regime:

- Any sectors which are regulated under The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 should have the same rules apply to them if they are permitted to operate in freeports.
- The Government should carry out a risk assessment for sectors operating in freeports which are not already subject to these regulations and consider whether they should also apply in this context.
- The Government should reform the UK's corporate liability laws to introduce a 'failure to prevent economic crime' offence akin to Section 7 of the Bribery Act 2010.
- The UK's anti-money laundering supervision regime should be reformed to strengthen the ability of supervisors to provide a credible deterrent, protect the independence of anti-money laundering oversight, and remove conflicts of interest.

²⁰ Transparency International UK, *At Your Service* (October 2019). <https://www.transparency.org.uk/publications/at-your-service/>

ABOUT TRANSPARENCY INTERNATIONAL UK

Transparency International (TI) is the world's leading non-governmental anti-corruption organisation. With more than 100 chapters worldwide, TI has extensive global expertise and understanding of corruption.

Transparency International UK (TI-UK) is the UK chapter of TI. We raise awareness about corruption; advocate legal and regulatory reform at national and international levels; design practical tools for institutions, individuals and companies wishing to combat corruption; and act as a leading centre of anticorruption expertise in the UK.

We are independent, non-political, and base our advocacy on robust research.

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