



ISSP-CGCC JOINT

# BASELINE STUDY ON ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM IN THE IGAD SUBREGION

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A moneychanger carrying Somali currency poses at the Bakara open airmarket  
in Mogadishu, October 10, 2008.

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## About This Baseline Study

This Baseline Study was prepared by a project team of 10 independent researchers, with logistical support and analytical guidance from the Intergovernmental Authority on Development (IGAD) Security Sector Program (ISSP), the Center on Global Counterterrorism Cooperation (CGCC), and an informal advisory group of interested officials, academics, and business professionals from the subregion. The project was supported financially by the Royal Government of Denmark.

Two advisory group meetings were held in Addis Ababa to develop the project and critique earlier drafts of this report, the first in October 2011 and the second in March 2012.

The project team was made up of Project Coordinator and ISSP-CGCC Liaison Officer Tu'emay Aregawi Desta and CGCC Co-Director James Cockayne, editors, and Abdisaid Ali, Richard Barno, Demessie Fantaye, Mesfin Gebremichael, Charles Goredema, Richard Ogetii, Atuwani Phiri, and Aly Verjee, researchers and contributing authors.

None of the views presented here necessarily represent the official view of the ISSP, the CGCC, or the Royal Government of Denmark.

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## Acronyms

**ACSRT** African Center for Studies and Research on Terrorism

**AfDB** African Development Bank

**AMISOM** AU Mission to Somalia

**AML** Anti-money laundering

**AU** African Union

**CDD** Customer due diligence

**CFT** Countering the financing of terrorism

**CGCC** Center on Global Counterterrorism Cooperation

**DNFBP** Designated nonfinancial business and profession

**EAC** East African Community

**EADB** East African Development Bank

**EAPCCO** Eastern Africa Police Chiefs Cooperation Organization

**EPRDF** Ethiopian People's Revolutionary Democratic Front

**ESAAMLG** Eastern and Southern Africa Anti-Money Laundering Group

**FATF** Financial Action Task Force

**FIC** Financial Intelligence Center (Ethiopia)

**FIU** Financial intelligence unit

**FRC** Financial Reporting Centre (Kenya)

**FSAP** Financial Sector Assessment Program (World Bank and IMF)

**FSRB** FATF-style regional body

**GCTF** Global Counterterrorism Forum

**GDP** Gross domestic product

**ICPAT** IGAD Capacity Building Program Against Terrorism

**ICRG** International Cooperation Review Group (FATF)

**IFI** International financial institution

**IGAD** Intergovernmental Authority on Development

**IMF** International Monetary Fund

**Interpol** International Criminal Police Organisation

**ISS** Institute for Security Studies (South Africa)

**ISSP** IGAD Security Sector Program

**KACC** Kenyan Anti-Corruption Commission

**KYC** Know your customer

**MENAFATF** Middle East and North Africa Financial Action Task Force

**MER** Mutual evaluation report

**MLA** Mutual legal assistance

**MOU** Memorandum of understanding

**NCP** National Congress Party (Sudan)

**NICE** National Insurance Corporation of Eritrea

**OAU** Organisation of African Unity

**OECD** Organisation for Economic Co-operation and Development

**PEP** Politically Exposed Person

**PFDJ** Popular Front for Democracy and Justice (Eritrea)

**POCAMLA** *Proceeds of Crime and Money Laundering Act* (Kenya)

**SRO** Somali remittance organization

**STR** Suspicious transaction report

**TFG** Transitional Federal Government of Somalia

**TFML** Task Force on Money-Laundering (Kenya)

**UAMLG** Uganda Anti-Money Laundering Committee

**UNDP** UN Development Programme

**UNMISS** UN Mission in the Republic of South Sudan

**UNODC** UN Office on Drugs and Crime

**UNPOS** UN Political Office for Somalia

## Executive Summary

### About This Baseline Study

Money laundering and terrorist financing are major, interconnected problems for East Africa and the Horn. As the World Bank's *World Development Report 2011* makes clear, they pose a significant threat not only to security but also to development.

Both the Financial Action Task Force (FATF) and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) have identified a number of states in the subregion as demonstrating weak implementation of international standards on anti-money laundering (AML) and countering the financing of terrorism (CFT). Some states in the subregion (Ethiopia and Kenya) have even been placed within the FATF International Cooperation Review Group (ICRG) process, which can ultimately lead to obstacles to engagement with the international financial system. There is consequently a growing recognition that states in the Intergovernmental Authority on Development (IGAD) subregion stand to benefit in multiple ways from a more concerted effort to combat money laundering and terrorist financing. There is also, however, a chronic limitation of data and knowledge about the problems of money laundering and terrorist financing and about AML/CFT vulnerabilities, risks, and capacities in the subregion. States of the subregion have their own specific vulnerabilities, challenges, weaknesses, and strengths, even as they share certain cross-cutting challenges.

In this Baseline Study, the IGAD Security Sector Program (ISSP) and the Center on Global Counterterrorism Cooperation (CGCC) set out with support from the Royal Government of Denmark to provide a more detailed and nuanced analysis of AML/CFT challenges and opportunities in the IGAD region, to inform a better allocation of resources to risk and to potential return on investment. The study is a joint effort developed in response to repeated requests by the ISSP's and the CGCC's governmental, intergovernmental, private sector, and civil society partners in the subregion who sought assistance in obtaining baseline data about money laundering risks and AML capacity in the region and guidance on the data's potential use for CFT efforts.

Throughout the project design and execution, emphasis has been placed on local ownership. Experts from the East African and Horn subregion coordinated and conducted the project and, where appropriate, also drew on outside expertise. This included input from members of the Danish, Malawian, and Nigerian financial intelligence units (FIUs). The study was prepared by a project team of 10 independent researchers with logistical support and analytical guidance from the ISSP and the CGCC and an informal advisory group of interested officials, academics, and business professionals from the subregion, serving in a personal capacity. That advisory group met twice in Addis Ababa: in October 2011 to help frame the project and develop the research methodology and in March 2012 to critique the resulting analysis and a draft version of this report. The final draft report was shared with all IGAD member states for further review, interagency discussion, comment, and revision. The ISSP and the CGCC approved this report before publication.

This study does not provide an exhaustive catalogue or review of money laundering and terrorist financing risks or AML/CFT efforts in the subregion. Also, it does not purport to provide a categorical assessment of specific AML/CFT projects in the subregion or a country's "performance." This study did not set out to replicate the technical proficiency or political legitimacy of a FATF or ESAAMLG assessment or peer review. Instead, this study represents the collected views of stakeholders in the subregion, gathered by a group of independent analysts, convened by the ISSP and the CGCC, and guided by our Advisory Group. Our aim was not to pass judgment but to provide some starting points for an inclusive and, we hope, coordinated and evidence-based discussion in the years ahead among many stakeholders—national, international, private sector, and civil society—regarding strengthening AML/CFT capacities in the IGAD subregion.



This study explores AML/CFT efforts in Djibouti; Eritrea; Ethiopia; Kenya; Somalia, including Transitional Federal Government (TFG) and non-TFG efforts; South Sudan; Sudan; and Uganda and at the regional and subregional level (the African Development Bank [AfDB], the African Union [AU], the East African Community [EAC], the East African Development Bank [EADB], the ESAAMLG, and IGAD). Researchers developed desk analysis that was tested through roughly week-long field visits, during which researchers met with relevant local and foreign government officials, civil society actors, private sector entities, and independent analysts. Twenty to 25 interviews were conducted for most jurisdictions—approximately 160 in all—over the course of 60 days of fieldwork. Interviewers used a semistructured format responding to a common set of research questions. The names and institutional affiliations of interviewees have been withheld to ensure confidentiality; a list of institutions that participated may be provided on request. Due to limited resources and concerns about the physical security of the researchers, a methodology not involving field visits by external researchers was used for Eritrea and Somalia. Analysis for these jurisdictions should be read with additional caution, as further verification of the results may be necessary before they can serve as the basis for policy development.

A separate chapter of the Baseline Study addresses each of the covered jurisdictions. As far as possible, each chapter addresses similar issues.

- Money laundering and terrorist financing risks and vulnerabilities and how they are perceived by different stakeholders.
- An overview of AML/CFT efforts, including discussion of capabilities and resources (material, legal, human, financial, and political) and how they are perceived by different stakeholders.
- An identification of key entry points for international assistance and support to local stakeholders to promote AML/CFT efforts.

None of the views presented here necessarily represent the official position of the ISSP, the CGCC, or the Royal Government of Denmark.

#### SUMMARY OF AML/CFT ARRANGEMENTS IN THE IGAD SUBREGION

Country	FIU and year of establishment	Specific AML legislation	Specific CFT legislation	Membership in an FATF-style regional body	Under FATF ICRG
Djibouti	2006	Yes	Yes	—	—
Eritrea	Unknown	Unknown	Unknown	—	—
Ethiopia	Enacted in 2009, operational since late 2011	Yes	Yes	ESAAMLG observer status	Since 2010
Kenya	Enacted but not yet operational	Yes	No	ESAAMLG	Since 2011
Somalia	No	No	No	—	—
South Sudan	No	No	No	—	—
Sudan	2010	Yes	Yes	MENAFATF	—
Uganda	No	No	No	ESAAMLG	—

## DJIBOUTI

Given its geographic situation and role as a trade gateway to the region, especially Somalia, money laundering and terrorist financing pose significant challenges to Djibouti's financial integrity. The Djiboutian government has sent a number of signals regarding its commitment to AML/CFT efforts, including the ratification of treaties dealing with money laundering, terrorism, and transnational organized crime; support for the passage of relevant laws and establishment of institutions, notably an FIU; and its role as the first IGAD state to ratify the IGAD Mutual Legal Assistance (MLA) and Extradition Conventions. Numerous challenges remain, however, notably

- the limited operational and supervisory capacity in the FIU and law enforcement;
- the limited interagency coordination, especially with law enforcement, customs, and tax authorities;
- the weak extension of AML/CFT supervision to the real estate, *bureaux de change*, and mobile banking markets; and
- a lack of awareness among relevant governmental and nongovernmental stakeholders of money laundering and terrorist financing risks, particularly among informal financial institutions and remittance organizations.

In order to address these challenges, priority should be given to a rapid effort to raise awareness among senior Djiboutian politicians and officials of the threat to Djibouti's future growth posed by money laundering and terrorist financing. This awareness-raising exercise should take the form not only of technical training sessions but of coordinated, high-level diplomatic outreach. On the back of this awareness-raising exercise, the aim should be to put in place a national AML strategy and capacity-building work plan, supported by external partners and providing a mechanism for coordination among relevant Djiboutian government agencies. The nascent FIU offers a key entry point for rapid scale-up of such capacity-building efforts. Further attention to strengthening Djibouti's legislative framework will also be required. In time, consideration should be given to Djibouti joining a FATF-style regional body (FSRB), whether the ESAAMLG or the Middle East and North Africa Financial Action Task Force (MENAFATF).

## ERITREA

Like many other East African and Horn states, Eritrea's economy is heavily reliant on informal and cash-based transactions, as well as remittances from an overseas diaspora. Unlike many other East African and Horn states, both Eritrea's informal economy and Eritrean foreign remittances are significantly controlled by a single autocratic political party, the ruling Popular Front for Democracy and Justice (PFDJ). With some PFDJ members accused by the United Nations and others of involvement in money laundering and terrorist financing and with international sanctions consequently in place, the Eritrean financial system has become isolated from the international financial system. The result has been the flourishing of cross-border smuggling and trafficking outfits. There may also be a danger that international sanctions encourage state actors to seek nonconventional revenue-raising, i.e., criminal, and power-projection, i.e., terrorist, capabilities.

AML/CFT efforts in such a context are extremely difficult. Eritrea has no formal AML/CFT law or framework. There are some suggestions it may have developed a kind of FIU and imposed suspicious transaction report (STR)-like requirements on its state-owned banks, but their existence and role could not be verified. Eritrea does not actively participate in the global AML/CFT regime.

Entry points for strengthening AML/CFT efforts under these circumstances are few and far between. IGAD has an important role to play in outreach to Eritrea and the potential normalization of its relations with the international community. In the meantime, international pressure, through effective implementation of UN sanctions, may create some leverage. The due diligence requirements imposed on mining firms operating in Eritrea by UN Security Council Resolution 2023 offer an important new entry point in this respect. In addition, there may be benefit in seeking to engage other actors—Eritrea's



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donors, such as China, Qatar, and the United Arab Emirates, as well as Sudan, which is, with Qatari financial support, creating a free trade and industrial area with Eritrea on their joint border.

## ETHIOPIA

Ethiopia is undergoing a period of very rapid economic growth, which is expected to last for a number of years. Its financial system, long closed to outside investment and influence and controlled by the state, is slowly liberalizing, as are other parts of the economy. This development is increasing opportunities for corruption and money laundering related to trafficking, commercial fraud, tax evasion, and other criminal conduct, and Ethiopian institutions are lagging. Security institutions have paid more attention to terrorist financing issues, particularly in the context of *hawalas*, but counterterrorism arrangements remain a work in progress.

As a result, Ethiopia is currently among those countries of most concern to the international community on AML/CFT issues, as reflected by the continuing attention of the FATF ICRG, which continues to express concern about Ethiopia's AML/CFT arrangements. This seems increasingly to presage possible actions by some FATF members recommending that financial institutions based in those countries cease business with Ethiopia. Any such action would quickly and severely interrupt Ethiopian trading relationships and economic growth.

Fortunately, there are signs that the senior Ethiopian leadership recognizes these dangers. A number of steps have been taken in the last 18 months that suggest a serious commitment to strengthened AML/CFT arrangements in the country, including the creation of the independent Financial Intelligence Center (FIC), the establishment of an interministerial board on AML/CFT, the initiation of a process for joining the ESAAMLG, and the approval by Parliament of the IGAD MLA and Extradition Conventions. Prime Minister Meles Zenawi also reportedly made commitments during the 2012 London Conference on Somalia to move this agenda forward.

Less fortunately, however, these processes are moving so slowly that the FATF ICRG continues to issue warnings about the situation. The problem seems not to be one of high-level political will, as our research suggests it may be in other countries in the region, such as Kenya and Uganda, but of an insular, cumbersome, slow-moving, and still developing civil service with limited absorption capacity.

We advocate a dual-track approach focusing on rapid, deep, institutional development of the FIC over the next two years and broad, long-term strengthening of AML/CFT-related skills in multiple parts of government, financial institutions, financial intermediaries, and remittance organizations. These efforts would include

- working with the National Bank of Ethiopia to develop effective supervision of banks, other financial intermediaries, and remittance organizations on know-your-customer (KYC) issues;
- training law enforcement and customs officials in AML/CFT-related analytical and investigative skills; and
- working with the interministerial board to develop a system for interagency information sharing and coordination.

## KENYA

As the major financial center in East Africa, Kenya represents the primary source of money laundering and terrorist financing risk in the subregion, along with Somalia. Kenya has thriving informal and illicit sectors that the Kenyan government struggles to control. They are closely entwined with illicit flows in and through neighboring states, including Somalia. FATF recently listed Kenya among a group of “jurisdictions that have not made sufficient progress in addressing strategic AML/CFT deficiencies.” Its inclusion of Kenya, alongside fellow IGAD member state Ethiopia, on the FATF ICRG process

list is a significant indicator of how vulnerable Kenya is perceived to be to money laundering and terrorist financing by the international community.

Money laundering in Kenya services a number of predicate offenses, including political corruption; trafficking in drugs, wildlife, counterfeit goods, and humans; and import tax evasion. It occurs through a range of vehicles, including real estate investment, charitable trusts and foundations, casinos, bureaux de change, election finance, and remittance companies. The absence of effective AML controls has made Kenya vulnerable to terrorist financing, which is a major concern given the continuing presence and activity of terrorist cells in Kenya. Reporting by the UN Monitoring Group on Somalia and Eritrea makes clear, for example, that terrorist financing has occurred in recent years through a number of avenues in Kenya, including informal money transfers, cash couriers, and exploitation of charities and nonprofit organizations.

In December 2009, the Kenyan Parliament adopted a watershed AML law. As of April 2012, the first real steps toward implementation were just beginning to be taken. The FIU created by the law (the Financial Reporting Centre [FRC]) was not yet operational and will not have the power independently to request evidence from foreign FIUs. The law includes no definition of terrorist financing and does not provide for asset seizure arrangements. Moreover, financial sector supervision and law enforcement authorities have been unable effectively to investigate and prosecute money laundering and terrorist financing offenses. The private sector in Kenya, including the finance sector, is anxious to see Kenya acquire an effective AML/CFT system. Law enforcement authorities are also enthusiastic, but the slow pace of implementation suggests limited political will, perhaps partly because money laundering currently plays a significant role in financing electoral campaigns. Given the atmosphere of uncertainty that currently pervades Kenyan politics, elites are unwilling to foreclose financing options.

To date, neither the ESAAMLG nor FATF have been able to stimulate the necessary political will in Kenya. A concerted, coordinated effort is needed from local and external stakeholders to make clear to Kenyan political elites that improved financial governance, including strengthened AML/CFT arrangements, are a strictly necessary precondition for Kenya's continuing participation in the global financial and trading system.

Forward progress on the FRC will not be feasible until such political will is mustered. In the meantime, therefore, steps should be taken to strengthen Kenya's regulatory capacity wherever possible, through engagement with the FRC but also outside the FRC. This could include training financial investigators, reforming electoral finance law, and revising the existing AML law to address terrorist financing and asset seizures.

## **SOMALIA**

After decades of war and state collapse, Somalia now represents the most significant source of money laundering and terrorist financing risk for the whole IGAD subregion, alongside and linked with Kenya. It is an "economy without a state" and the most corrupt country in the world, according to Transparency International. It has no effective national financial regulatory institutions and essentially no formal banking system. Its economy operates through a mixture of licit trade and revenue extraction from illicit financial flows, including public corruption, piracy, arms and human trafficking, and trade-based money laundering, especially in the export of charcoal and livestock and the import of basic foodstuffs and consumer goods.

Different political authorities within Somalia benefit from these flows in different ways. Some of these authorities are legitimate and recognized; others have simply taken advantage of effective, internationally recognized governance structures. In south and central Somalia, al-Shabaab controls and taxes many of these flows, using them as a source of terrorist financing.

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Neither the TFG, the Somaliland authorities, nor the Puntland authorities have the capacity to control money laundering and terrorist financing in the areas they control. Indeed, there are some signs that some officials in each place are implicated in or at least benefit from money laundering.

The absence of effective federal institutions and a formal banking sector inside Somalia means that efforts to build an effective AML/CFT system inside Somalia will require long-term commitment from international partners. In the meantime, there are four main entry points for improving AML/CFT capacities.

First, partners should work with authorities in Mogadishu, Puntland, and Somaliland to build effective financial regulatory institutions and criminal justice capacity, especially basic investigative and prosecutorial capacity. Such efforts should not be undertaken piecemeal, or they risk stoking fragmentation. Instead, international partners should look to work with the central banks of Somalia, Somaliland, and Puntland to develop a system of policy coordination and perhaps even information sharing on financial supervision issues, perhaps in coordination with the proposed new Joint Financial Management Board. Likewise, now that the TFG is taking increasing responsibility for governance in Mogadishu and there are signs of a federalized constitutional settlement emerging, there is scope for greater coordination between these authorities on criminal justice capacity-building efforts.

Second, building on discussions recently held in Mogadishu under the auspices of the UN Political Office for Somalia (UNPOS), which produced the “Mogadishu Roadmap,” international partners should work with these authorities to develop a common maritime security policy, which should include a shared strategy for the development of governance of Somalia’s coastline and key ports—Berbera, Bosaso, Mogadishu, and Kismaayo. Governance of these ports and the revenues associated with them, as well as Somalia’s coastal space more generally, will be crucial not only to developing a stable political settlement for Somalia, but also for addressing money laundering and terrorist financing issues because so much money laundering and terrorist financing in the country currently occurs through seaborne trade and piracy.

Third, there is a need to engage Somali remittance organizations (SROs). As the CGCC has recently explored at length in its study “Capitalizing on Trust: Harnessing Somali Remittances for Counterterrorism, Human Rights and State Building,” developing effective AML/CFT strategies with those organizations may go a long way toward addressing Somalia’s and other East African and Horn states’ money laundering and terrorist financing risks and vulnerabilities. Additionally, that study suggests that SROs offer an important source both of social and financial capital for Somali reconstruction, which could be harnessed through the development of a Somali financial reconstruction plan or even the offering of diaspora bonds to support local infrastructure projects.

Fourth, much more attention needs to be paid to reducing the opportunity for Somali actors to launder money offshore. There is increasing attention to the possibility of the UN Security Council adopting targeted sanctions against those involved in laundering the proceeds of piracy offshore. The council has also adopted sanctions restricting the charcoal trade. States already have a range of diplomatic and criminal law tools at their disposal to buttress the new UN sanctions on the Somali charcoal trade. A coordinated effort to reduce these money laundering opportunities through bilateral cooperation, IGAD, the Gulf Cooperation Council, the Global Counterterrorism Forum (GCTF), and the Contact Group on Piracy Off the Coast of Somalia is within reach.

## SOUTH SUDAN

The newest state in the world, South Sudan has a number of characteristics that may make it especially vulnerable to money laundering, if not terrorist financing. It has extremely weak financial governance capacity and low AML/CFT awareness, although it recently criminalized money laundering. High-value cash transactions are common. Foreign exchange bureaus are proliferating and largely unregulated. There is growing alarm about corruption, especially in the oil sector and public procurement processes.

Yet, there appears to be a disconnect between these high-risk indicators and the attention being paid both by national regulators and international actors to AML efforts. Despite growing international concern around corruption, there appears to be only limited international effort to block the avenues through which the proceeds of corruption may be laundered, including through cross-border transfers out of South Sudan. There are even some signs that South Sudan may be becoming a conduit for money laundering from other jurisdictions in the region.

AML/CFT efforts in South Sudan are in their infancy. An AML bill was apparently approved by the Cabinet in March 2012, but the text is not yet publically available. It is not clear if it contemplates the creation of an FIU. Regardless, the awareness of government officials on AML/CFT issues is extremely low. Our research suggests three particularly promising entry points for strengthening AML/CFT efforts in South Sudan: (1) influencing the development of the AML bill as it proceeds to parliamentary approval, including to provide for the creation of an FIU; (2) developing a narrative connecting AML/CFT efforts to effective anticorruption efforts; and (3) long-term institutional strengthening, particularly to improve governmental supervision of the financial sector.

## SUDAN

[Note: Interviews for this study regarding topics involving Sudan were conducted by a non-Sudanese researcher in Khartoum from early to mid-December 2011. Due to logistical constraints, it was not possible to meet a number of important actors, including officials from the state audit chamber, the economic intelligence department of the National Intelligence and Security Service, or the customs department. Sudanese officials have provided extensive commentary critiquing a draft of this report. Where appropriate, their concerns about our methodology and findings have been noted in the full report.]

Sudan's isolation from the international financial system makes it difficult to assess the true state of financial governance in the country. Many external observers remain deeply concerned about its vulnerabilities to money laundering and terrorism financing, given its heavy reliance on cash transactions, its porous borders, and the opacity of some commercial dealings. Sudanese officials expressed less concern.

Yet there are also some promising signs of institutional reform. In 2010, Sudan adopted the *Money Laundering and Terrorist Financing Act*, which has created an independent and functional FIU. That FIU has plans to adopt an electronic STR system and works smoothly in a formalized interagency coordination framework. Also, Sudan has reportedly created a presidential committee to tackle corruption. There remain some signs of weak AML/CFT capacity in law enforcement institutions. The extent of the involvement of customs and border control authorities in AML/CFT discussions was difficult to establish conclusively, but evidence of pro-AML/CFT reforms points to meaningful opportunities for supportive engagement by external actors.

Priority should be given to strengthening the FIU. Given Sudan's continuing financial ties to the Middle East and North Africa, these efforts may perhaps be best led by MENAFATE, of which Sudan is already a member. There may also be a role

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for other supportive actors, such as the Egmont Group, which Sudan has applied to join, and the GCTF Horn of Africa Region Working Group.

## **UGANDA**

Uganda is deeply vulnerable to money laundering and terrorist financing and has a well-established record of both. In the course of this study, Ugandan law enforcement officials stated explicitly that money laundering is “rampant” in the country and closely linked to Uganda’s endemic public corruption. Ugandan AML/CFT efforts are at an almost complete standstill. It has no FIU. An AML bill was drafted in 2003, approved by the Cabinet in 2005, and introduced to Parliament in 2009 and has gone nowhere since then. The national interagency AML committee has stopped meeting, out of frustration with the legislative process. The ESAAMLG has written to Uganda expressing its concern at the slow pace of reform.

The result of this lack of forward progress is a growing sense of alarm within Ugandan law enforcement authorities and the Ugandan business community, especially the financial sector. Law enforcement authorities expressed frustration with the absence of an effective AML/CFT system. Private sector actors see the absence of effective legal frameworks as offering competitive advantage to firms with political influence, distorting markets. AML measures are frequently portrayed by members of the political and business elite as “anti-investment.” The opposite is the case: AML/CFT measures are a necessary precondition to Uganda’s participation in the subregion’s accelerating economic integration and growth.

The basic problem is one of political will. Unlike other East African and Horn countries, therefore, the priority should not be on investment in the creation of an FIU or similar institution-strengthening measures, but rather on a coordinated and broad push by diplomatic, political, security, law enforcement, and even business actors to create the will among Uganda’s political and business elite to get serious about AML/CFT issues. Foreign, subregional and multilateral donors, other states in the region, the ESAAMLG, IGAD, and the EAC should all make clear that, without effective legal protections and basic law enforcement capabilities relating to AML/CFT matters, Uganda will get left behind and, with it, the prospects of Uganda’s ruling classes.

AML/CFT reforms should be framed not just in technical terms and not in terms of demands from foreign actors, but expressly in public policy terms. It is also important, given the concerns raised by civil society organizations, that any such intervention be framed as part of a broader push for comprehensive rule of law–based governance reforms in Uganda. Otherwise, based on evidence from events surrounding the recent Ugandan elections, there is a danger that AML/CFT tools will be used not to fight crime, but rather to silence political dissent.

## **REGIONAL INITIATIVES**

A variety of regional and subregional institutions active in East Africa and the Horn address AML/CFT issues in one way or another. None of them has shown a clear ability to create increased political will in the region to tackle these issues. Many of them struggle to ensure states implement their rhetorical commitments on AML/CFT issues.

The AfDB is potentially a useful programming partner in the limited context of its lending arrangements, although some concerns raised by its rhetoric seem to suggest that FATF standards are not suited to the African context. The AU is a key partner in AML/CFT norm development on the continent but has not demonstrated a capacity to ensure implementation of these norms. Appropriately equipped, however, the African Centre for Studies and Research on Terrorism, the AU’s research center on counterterrorism, might be a useful partner in AML/CFT training efforts. The EAC and, to a lesser extent, the EADB offer an important entry point for efforts to strengthen AML/CFT efforts in Kenya, Uganda, and perhaps

South Sudan, as well as Burundi, Rwanda, and Tanzania. The EAC offers an important source of political leverage because of those states' apparent appetite for market integration through the EAC and because the EAC has been able to connect that process of market integration to those states' meaningful engagement with other subregional partners who can help them build AML/CFT and related (e.g., criminal justice) capacities.

Clearly, the ESAAMLG will be a crucial player in any effort to drive forward AML/CFT efforts in East Africa and the Horn, although only three IGAD members are currently involved (Kenya and Uganda as members, Ethiopia as an observer). As a subregionally owned initiative, it has unique legitimacy and access, but its emphasis to date on local ownership may be unnecessarily limiting its impact and the quality of its services. FATF has expressed concerns about its mutual evaluation process, follow-up arrangements, and typologies. Consideration may need to be given to amending the ESAAMLG memorandum of understanding to allow it to receive external funding support. It may also be worth revisiting an earlier idea for a partnership among the ESAAMLG, academia, the financial sector, and external government and international financial institution (IFI) donors to create a regional center of excellence on AML/CFT and anticorruption issues in the region.

Finally, the ISSP may have an important role to play, although it is largely unproven on AML/CFT issues. Its precursor, the IGAD Capacity Building Program Against Terrorism (ICPAT), had a demonstrable track record of helping IGAD states build their counterterrorism capacities, in part through leveraging effective partnerships with external actors, including the United Nations and civil society actors such as the CGCC and the Institute for Security Studies (ISS) in South Africa. Unlike ICPAT, the ISSP is being implemented from within IGAD intergovernmental structures (ICPAT was a joint venture with the ISS). That may impact ISSP access to human and financial resources.

#### **OVERALL CONCLUSIONS AND RECOMMENDATIONS**

The weakness of AML/CFT initiatives at the national and regional levels in East Africa reflects weak political will to tackle these issues. The region continues to treat AML/CFT issues as a technical exercise, seeking the adoption of FATF-compliant technologies to appease “development partners” without actually internalizing AML/CFT as a necessary precondition for economic growth and a reflection of other public policy priorities. A stronger AML/CFT effort for the region will need to place greater emphasis on the political and development significance of AML/CFT. Furthermore, although local ownership is important, improved implementation may require creating a broader web of partnerships with external supporters, including nontraditional partners such as civil society, the financial sector, and in some cases, other commercial actors. Different strategies will be needed in three different groups of countries.

The first group, comprising Djibouti, Kenya, and Uganda (and possibly Eritrea, to the extent that this research can be validated), will require broad, coordinated diplomatic, political, and business pressure to get serious about AML/CFT issues as a basis for those countries' inclusion in the region's economic integration and growth before substantial forward progress is likely to be visible on the ground. A coordinated effort is needed to make clear to political and business elites in these countries that they stand to benefit more from the increased growth and development that respect for property rights, the rule of law, and market-based solutions will offer than they can expect to gain from patronage-based economic governance and tapping into illicit and even criminal financial flows. Foreign business investors with strategic interests in these countries should be recruited into this effort. In Djibouti, for example, Dubai Ports has a strategic interest in the development of the port and the stable development of Djibouti's financial governance. In Eritrea, about a dozen foreign mining firms from around the world could exercise leverage. In Kenya, numerous foreign business actors could play such a role. In Uganda, the oil sector might need to be engaged.



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The second group of countries, namely Ethiopia and Sudan, has recently demonstrated significantly higher levels of political commitment to building their AML/CFT capacities. In these countries, the emphasis should be on holding governments to their AML/CFT promises by offering them large, coordinated packages of AML/CFT capacity-building assistance with a particular focus on strengthening FIUs. In each case, the beneficiary country is already part of an FSRB, so that FSRB should be intimately involved in the delivery process—in Ethiopia, it would be the ESAAMLG; in Sudan, MENAFATE. In time, as political will is developed, Kenya might also join this group of countries.

The third group—Somalia and South Sudan—are in a different situation altogether. In those countries, state institutions are in their infancy, and the priority must be on building relevant institutions, especially the criminal justice sector, from the ground up. In both places, regional and subregional organizations have an opportunity to create an operational presence, alongside the UN Mission to the Republic of South Sudan, for example, through the IGAD Liaison Office, or alongside the AU Mission to Somalia. These cells would work with local officials to strengthen criminal justice institutions, including police, prosecutors, and the judiciary, as well as financial regulatory institutions. They would be staffed by personnel from IGAD member states, which would serve a secondary purpose of creating personal networks between these officials, which may in time facilitate cross-border cooperation on these issues throughout the subregion.

Finally, there is a need to consider whether some cross-cutting issues might best be addressed through regional-level processes or forums. Two stand out. First, as the CGCC has argued in its report “Capitalizing on Trust,” there may be an opportunity to strengthen AML/CFT efforts in the subregion by organizing a series of confidence-building roundtables focusing on the role of remittance organizations and how they are regulated. Remittances and informal money transfers play a key role in the mixed formal/informal political economy of the region. Improving their capacity to discharge KYC and customer due diligence obligations, to identify and manage the risks associated with Politically Exposed Persons, and to work cooperatively with regulators could go a long way toward dealing with the region’s pervasive AML/CFT risks and vulnerabilities.

Second, serious thought should be given to setting up a regional Center for Excellence on AML/CFT and Anti-Corruption to provide responsive analysis conducted by independent experts, conduct training for the public and private sector on AML/CFT and anticorruption issues, and convene seminars and conferences. This center should work with all concerned subregional organizations and countries but not be owned by any one of them. Instead, it could be established within a trusted academic institution or think tank, perhaps with support and guidance from subregional organizations and the IFIs. Its stakeholders should be seen not only as foreign donors interested in AML/CFT issues, but also local consumers: local governments, local subregional organizations, and crucially the private sector in the subregion, especially the financial sector. For that reason, although it might be set up through seed grants from government donors and major private foundations such as the Gates Foundation, which has recently started funding work in this area, it should aim to become financially self-sufficient over time, using training offerings for the private sector to raise sufficient revenue to be able to conduct independent research and analysis and provide bespoke assistance to interested governments.



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# 1. Introduction

## Background

**M**ONEY LAUNDERING<sup>1</sup> AND TERRORIST FINANCING are major, interconnected problems for East Africa and the Horn. As the *World Bank's World Development Report 2011* makes clear, they pose a significant threat not only to security but also to development.<sup>2</sup>

Both the Financial Action Task Force (FATF) and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)<sup>3</sup> have identified a number of states in the subregion as demonstrating weak implementation of international standards on anti-money laundering (AML) and countering the financing of terrorism (CFT). Some states in the subregion (Ethiopia and Kenya) have even been placed within the FATF International Cooperation Review Group (ICRG) process, which can ultimately lead to obstacles to engagement with the international financial

system.<sup>4</sup> Should those states fail to make progress in their implementation of international AML standards, they face a considerable risk of exclusion from or increased costs in dealing with the international financial system. Regional growth and development are thus at considerable risk.

Many causes underlie the subregion's vulnerability to money laundering and terrorist financing, including

- the prevalence of informal, patronage, and cash-based economies and high levels of corruption;
- correspondingly limited financial regulatory mechanisms and political opposition to AML/CFT reforms;
- patchy legal frameworks and weak law enforcement and judicial capacity;
- contested understandings of the problem;
- poorly managed and porous borders;
- political instability and armed conflict; and
- the growing presence of transnational criminal networks in the region.

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1. This Baseline Study uses the definition of money laundering contained in Article 6 of the UN Convention Against Transnational Organized Crime. UN Office on Drugs and Crime (UNODC), *United Nations Convention Against Transnational Organized Crime and the Protocols Thereto* (Vienna: UN, 2004), pp. 8–9, <http://www.unodc.org/documents/treaties/UNTOC/Publications/TOC%20Convention/TOCebook-e.pdf> (hereinafter UN transnational organized crime convention).

2. World Bank, *World Development Report 2011: Conflict, Security and Development*, 2011, [http://wdr2011.worldbank.org/sites/default/files/pdfs/WDR2011\\_Full\\_Text.pdf](http://wdr2011.worldbank.org/sites/default/files/pdfs/WDR2011_Full_Text.pdf).

3. The ESAAMLG is a FATF-style regional body (FSRB) whose members include Botswana, Comoros, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. Angola is an observer member country, and Ethiopia has applied for membership.

4. FATF, "FATF Public Statement," 24 June 2011, [http://www.fatf-gafi.org/document/54/0,3746,en\\_32250379\\_32236992\\_48263734\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/54/0,3746,en_32250379_32236992_48263734_1_1_1_1,00.html).

These weaknesses facilitate the commission of the predicate crimes and terrorism that underlie money laundering and terrorist financing and that, in their own right, negatively affect national and regional macroeconomic affairs, development, and national and human security in the subregion. AML/CFT interventions are not and should not be only about the proceeds, but also about preventing and fighting the predicate crimes and terrorism. This demands a holistic and coordinated effort among national, regional, and international agencies.

There is a growing recognition that states in the subregion stand to benefit in multiple ways from a more concerted effort to combat money laundering and terrorist financing. There is also, however, a chronic limitation of data and knowledge about the problems and risks of money laundering and terrorist financing, as well as about AML/CFT capacities in the subregion. States of the subregion have their own specific vulnerabilities, challenges, weaknesses, and strengths, even as they share certain cross-cutting challenges.

In this Baseline Study, the Intergovernmental Authority on Development (IGAD) Security Sector Program (ISSP) and the Center on Global Counterterrorism Cooperation (CGCC) set out with support from the Royal Government of Denmark to provide a more detailed and nuanced analysis of AML/CFT challenges and opportunities in the IGAD region. The study is a joint effort developed in response to repeated requests by governmental, intergovernmental, private sector, and civil society partners of the ISSP and the CGCC in the subregion for assistance in providing baseline data about money laundering and terrorist financing risks and AML capacity in the region and its potential use for CFT efforts.

This Baseline Study is not an exhaustive catalogue or review of AML/CFT efforts in the region, nor does it purport to provide a categorical assessment of specific AML/CFT projects in the subregion or of country “performance.” We did not set out to replicate the technical proficiency or political legitimacy of a FATF or ESAAMLG assessment or peer review. Instead, the study represents the collected views of stakeholders in the subregion, gathered by a group of independent analysts, convened by the ISSP and the CGCC, and guided by our advisory group. Our aim was not to pass judgment

but to provide some starting points for an inclusive and, we hope, coordinated and evidence-based discussion in the years ahead among many stakeholders—national, international, private sector, and civil society—regarding strengthening AML/CFT efforts in the IGAD subregion.

The study was prepared by a project team of 10 independent researchers with logistical support and analytical guidance from the ISSP and the CGCC and an informal advisory group of interested officials, academics, and business professionals from the subregion. The project team was made up of Project Coordinator and ISSP-CGCC Liaison Officer Tu'emay Aregawi Desta and CGCC Co-Director James Cockayne, editors, and Abdisaid Ali, Richard Barno, Demessie Fantaye, Mesfin Gebremichael, Charles Goredema, Richard Ogetii, Atuweni Phiri, and Aly Verjee, researchers and contributing authors. None of the views presented here necessarily represent the official view of the ISSP, the CGCC, or the Royal Government of Denmark.

## Objectives, Scope, and Methodology

The findings of this Baseline Study are intended to serve as an input to inform policy development, in particular by identifying entry points for AML/CFT programming in the subregion. The study aims to supplement existing analysis, particularly the evaluation reports prepared through FATF and the ESAAMLG, by examining what is known and what is perceived to be known about money laundering and terrorist financing in the region and the AML/CFT efforts in the subregion. By looking not only at what is known and what is perceived to be known, the project team aimed to identify different conceptions of AML/CFT in the region among key stakeholders and ascertain how these different stakeholder conceptions might lead to different programming entry points.

The study explores AML/CFT efforts in Djibouti; Eritrea; Ethiopia; Kenya; Somalia, including Transitional Federal Government (TFG) and non-TFG efforts; South Sudan; Sudan; and Uganda and at the regional and subregional

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level (the African Development Bank [AfDB], the African Union [AU], the East African Community [EAC], the East African Development Bank [EADB], the ESAAMLG, and IGAD). Researchers were tasked with developing desktop background studies exploring multiple aspects of AML/CFT arrangements in each jurisdiction, including

- government policy and strategy, legal, and regulatory frameworks;
- institutional settings, mandates, responsibilities, and functions;
- inter/intra-agency cooperation and coordination;
- professional expertise and resources; and
- access to private sector and civil society resources.

The sources considered in this process are listed in the bibliography. The qualitative analysis concluded through these desk studies was developed through roughly week-long field visits undertaken by researchers from within the project team. During those field visits, researchers met with relevant local and foreign government officials, civil society actors, private sector entities, and independent analysts. On average, 20–25 interviews were conducted for each jurisdiction—approximately 160 in all—over the course of roughly 60 days of fieldwork. Interviews used a semistructured format responding to a common set of research questions. The names and institutional affiliations of interviewees have been withheld to ensure confidentiality; a list of institutions that participated may be provided on request. Field visits were facilitated by support from ISSP Focal Points and members of an informal advisory group.

Due to concerns about the physical security of our researchers and to limited resources, however, no field visit was conducted in Eritrea, although interviews were conducted with relevant stakeholders outside Eritrea. A modified methodology relying primarily on desk-based analysis inside and outside Somalia was used for that country. A modified desk-plus-interview methodology was used to examine the AML/CFT efforts of various subregional institutions. The analysis for these jurisdictions should be viewed accordingly and may require further verification.

The advisory group consisted of interested officials, academics, and business professionals from the subregion, serving in a personal capacity. That advisory group met twice in Addis

Ababa: once in October 2011 to help frame the project and develop the research methodology, and once in March 2012 to critique the resulting analysis and a draft version of this report. The final draft report was shared with all IGAD member states for further review, interagency discussion, comment, and revision. The ISSP and the CGCC approved this report before publication.

Throughout the project design and execution, emphasis has been placed on local ownership. The project was coordinated and conducted by experts from within the East Africa and Horn subregion, but also drew on outside expertise where appropriate. This included input from members of the Danish, Malawian, and Nigerian financial intelligence units (FIUs). This study is thus result of a joint and collaborative effort of the ISSP, the CGCC, and a range of other national, regional, and international experts.

## Structure of the Study

A separate chapter of the study examines each of the covered jurisdictions and addresses (1) money laundering and terrorist financing risks and vulnerabilities and how they are perceived by different stakeholders; (2) AML/CFT efforts in that jurisdiction, including discussion of AML/CFT capabilities and resources (material, legal, human, financial, and political); and (3) an identification of key entry points for international assistance and support to local stakeholders to promote AML/CFT efforts. Every effort was made to follow this template for each jurisdiction, but the quality and depth of data available varied considerably across different jurisdictions. At the end of the Baseline Study, some final conclusions are offered about cross-cutting themes and trends, together with some regional-level recommendations for future AML/CFT efforts.

## 2. Djibouti

### KEY FINDINGS AND RECOMMENDATIONS

Given its geographic situation and role as a trade gateway to the region, especially Somalia, money laundering and terrorist financing pose significant challenges to Djibouti's financial integrity. The Djiboutian government has sent a number of signals regarding its commitment to AML/CFT efforts, including the ratification of treaties dealing with money laundering, terrorism, and transnational organized crime; support for the passage of relevant laws and establishment of institutions, notably an FIU; and its role as the first IGAD state to ratify the IGAD Mutual Legal Assistance (MLA) and Extradition Conventions. Numerous challenges remain, however, notably

- the limited operational and supervisory capacity in the FIU and law enforcement;
- the limited interagency coordination, especially with law enforcement, customs, and tax authorities;

- the weak extension of AML/CFT supervision to the real estate, *bureaux de change*, and mobile banking markets; and
- a lack of awareness among relevant governmental and non-governmental stakeholders of money laundering and terrorist financing risks, particularly among informal financial institutions and remittance organizations.

In order to address these challenges, priority should be given to a rapid effort to raise awareness among senior Djiboutian politicians and officials of the threat to Djibouti's future growth posed by money laundering and terrorist financing. This awareness-raising exercise should take the form not only of technical training sessions but of coordinated, high-level diplomatic outreach. On the back of this awareness-raising exercise, the aim should

be to put in place a national AML strategy and capacity-building work plan, supported by external partners and providing a mechanism for coordination among relevant Djiboutian government agencies. The nascent FIU offers a key entry point for rapid scale-up of such capacity-building efforts. Further attention to strengthening Djibouti's legislative framework will also be required. In time, consideration should also be given to Djibouti joining a FATF-style regional body (FSRB), whether the ESAAMLG or the Middle East and North Africa Financial Action Task Force (MENAFATF).



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## Risks and Vulnerabilities

Djibouti's economy is service driven, with a particularly heavy reliance on international trade. The Port of Djibouti provides a key gateway for goods transiting into the Horn of Africa, especially for exports from Ethiopia. Eighty-five percent of Ethiopia's trade passes through the port. Investment in Djibouti has increased in the recent past partly due to relative economic and political stability in the country. The ports and transportation sectors have particularly benefited from foreign direct investment through Dubai World Ports, which has invested in building a second, bigger port at Tadjoura capable of handling larger containers and quantities of cargo. To compliment this, Dubai World Ports is investing in building new roads that will carry the delivered goods further inland. There are also plans to invest in tourism by building luxury hotels and improving the general infrastructure of the country.

Djibouti's financial sector is consequently developing rapidly to service this trade and the international military, humanitarian, and other actors that are present in the country. It currently has 11 commercial banks, 12 bureaux de change, 16 money transfer agencies, three microfinance institutions, and one special financial services institution focusing on loans to small and medium-size enterprises. Most of these institutions are less than 10 years old. Much of the economy remains cash based. Only in the past year, since a presidential decree indicating that all Djiboutian citizens earning an annual salary of 40,000 Djiboutian francs (approximately \$223) should receive them through formal bank accounts, has much of the population become banked.

Some of the banks in Djibouti are Somali owned and started out as money transfer agencies (*hawalas*), providing services to Somalia. Their evolution into banks has been driven partly by demand from within Djibouti, but also by increasing demand from expatriate Somali nationals and traders who cannot access equivalent services within Somalia. Djibouti serves a key role in the "trade stream" of the Somali remittance system.<sup>5</sup> Djiboutian financial institutions serve

as an important interface between the informal and cash-based economies of the region, especially Somalia, and the international trade and financial systems. Its currency is dollar pegged, and it has unrestricted foreign exchange. Government actors in Djibouti interviewed for this study see *hawalas* as particularly vulnerable to money laundering and terrorist financing, given their decentralized bookkeeping arrangements and the high proportion of retail and walk-in customers they deal with, limiting their ability to conduct due diligence and to know their customers.

Djibouti's role as an interface between the cash-based regional economy and the more formalized global trade and finance systems has important positive benefits in Djibouti from the household to the macroeconomic level. For example, there is an informal parallel money exchange service commonly carried out by a group of women on the side of the road in the capital city. The practice is legally prohibited but is tolerated by government institutions on the basis that the amounts traded are "minimal" and that the trade provides a livelihood for these elderly women, most of whom are widows.

Considerations like this, however, apparently lead to a perception that only foreigners are involved in money laundering and terrorist financing in Djibouti. A number of government actors interviewed suggested that many Djiboutians "cannot" be involved in money laundering and terrorist financing because they only have access to a cash economy. This suggests a limited understanding of how money laundering and terrorist financing occur. It also indicates a divergence in perceptions among local actors and foreign partners regarding where AML/CFT efforts should be targeted: a number of external actors interviewed for this study suggested that local actors within Djibouti may be playing an important role in piracy-linked money laundering, as evidenced by the construction boom in Djibouti.

Such parallel currency markets weaken financial oversight. FIU and central bank officials interviewed acknowledged that, in practice, the entire focus of the AML regime is on formal financial institutions rather than informal institutions,

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5. James Cockayne and Liat Shetret, "Capitalizing on Trust: Harnessing Somali Remittances for Counterterrorism, Human Rights and State Building," CGCC, March 2012, <http://www.globalact.org/images/content/pdf/reports/CapitalizingOnTrust.pdf>.

including hawalas, although the law nominally creates obligations for designated nonfinancial businesses and professions (DNFBPs) based on perceived risk, as required by newly revised FATF Recommendation 1. In particular, international partners interviewed raised concerns regarding Djibouti's role as a potential avenue for the laundering of piracy revenues and as a channel for financing terrorism in Somalia and beyond.

Threats from piracy and terrorism to foreign interests in the region, including in the Gulf of Aden, have led to increased foreign military and law enforcement activity within Djibouti, with French, Japanese, and U.S. contingents stationed there and numerous other NATO forces operating there. In recent years, these international actors and others, especially the United Nations, have placed considerable emphasis on strengthening Djibouti's capacity to counter piracy, but the question remains open whether this will have broader flow-through impacts to strengthen the Djiboutian financial sector against money laundering associated with other predicate offenses and to effectively combat terrorist financing. The study sought, *inter alia*, to identify whether stakeholders in the region perceive AML/CFT efforts primarily as a matter of protecting foreign interests from piracy and terrorism or as integral to ensuring a sound financial footing for Djibouti's economic growth and development.

## Current AML/CFT Efforts

Central bank and law enforcement officials consulted for this study indicate that, at a senior political level, money laundering and terrorist financing is recognized as a serious risk and has been prioritized. They point to the fact that three weeks after the 9/11 attacks in the United States, the Djiboutian government issued a decree establishing a National Committee Against Terrorism, and note a number of institutional and legislative reforms that have occurred in the subsequent decade.<sup>6</sup> The national committee is composed

of the minister of justice as the chair, the Djiboutian central bank as the co-chair, the minister of foreign affairs and international cooperation, the director of national security, the chief of staff of the national army, and the minister of finance. The committee was given a wide mandate, allowing it to do what it deemed necessary to "suppress terrorism within Djibouti." The committee also had powers to establish a mechanism to ensure compliance with UN Security Council Resolution 1373, as well as ensuring compliance with other conventions relating to terrorism.

The decree did not specifically mandate the national committee to consider the threat of money laundering and terrorist financing, but the *Law on Money Laundering, Confiscation and International Cooperation in Criminal Proceeds*,<sup>7</sup> which was passed in December 2002, was a direct result of the work of the national committee through a subcommittee focused on illicit finance. This subcommittee is chaired by the governor of the central bank. Other members include the chief prosecutor and representatives from the Ministries of Finance, Foreign Affairs, and National Security. Provision was also made to have a representative from the commercial banks, but to our knowledge, this has never been implemented.

AML efforts have consequently been driven by the central bank, which chairs this Vocational Sub-Committee for the fight against money laundering and terrorist financing. Researchers for this study indicated that the central bank appeared to recognize the macroeconomic and financial risks associated with money laundering and terrorist financing. Clearly, the central bank governor's role in the Vocational Sub-Committee has helped to raise awareness of AML/CFT issues within the central bank, especially in the bank's Supervision Department.

This has led to a number of important legislative developments. In 2005, Djibouti adopted a definition of money laundering in a revised law that includes conversion, transfer concealment, or disguising the illicit origin of property as well as being in possession or use of property that one should have known are proceeds of crime.<sup>8</sup> This is in line

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6. Decree no. 2001-0193 establishing the National Committee on the Fight Against Terrorism.

7. Act no. 112/AN/11/ supplementing law no. 196/AN/02 on laundering, confiscation, and international cooperation in criminal proceeds.

8. Act No. 110/AN/11 on the fight against terrorist financing, art. 1:1:1.

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with the UN Convention Against Transnational Organized Crime.<sup>9</sup> According to central bank officials, the revised law is compliant with the FATF Recommendations and has provisions on identification and verification of customers and a requirement for reporting by designated businesses and professionals and provides for the establishment of an FIU within the central bank.

In May 2011, Djibouti passed *Loi n° 110/AN/11 sur la lutte contre le financement du terrorisme*. This framework places the burden for overseeing AML/CFT efforts in Djibouti on the FIU. The law, however, does not state clearly the operational independence of the FIU as is required by the FATF Recommendations. The absence of guarantees of independence may hamper the FIU's ability to interact with FIUs elsewhere, and it will notably not be eligible to join the Egmont Group. Djibouti does not participate in an FSRB, neither the ESAAMLG nor MENAFATF. There are indications that there have been some discussions on this issue within government, but policymakers have not taken formal steps toward joining such a group, nor has there been an outreach from either institution to Djibouti on this issue.

The FIU is funded through the central bank budget and is considered a department of the central bank. At the time of its creation, it was intended to become an independent entity with its own funding, but this has not happened. The FIU carries out most of its work, including receipt and analysis of reports, primarily manually because they do not have a budgetary allocation for equipment. Human resources are also extremely limited; currently, it has only three staff with the third staffer seconded from another department.

The law also creates reporting requirements for a range of DNFBPs, including insurance companies, investment firms, intermediaries in the sale of real property or business assets, and notaries. Additionally, accountants, auditors, and auditors to auctioneers; dealers in precious stones, metals, and art objects; NGOs; travel agencies; and casinos and gaming establishments are listed among the reporting

entities.<sup>10</sup> Yet, research and interviews suggested that these obligations are not being effectively discharged and that the FIU has not taken steps to clarify whether, for example, mobile banking service operators are covered by the law.

In addition, the law does not state clearly what information these entities are required to report, beyond the reason for the transaction and the date. This leaves significant, perhaps excessive discretion to reporting institutions to determine when a transaction is suspicious without providing guidance on how that discretion should be discharged. Perhaps unsurprisingly, the FIU has identified only seven cases of possible money laundering in the six years since it was established. Consequently, awareness raising and training for reporting institutions is absolutely crucial for the effective operation of the AML/CFT regime in Djibouti.

Only very limited steps have been taken to raise awareness in the Djiboutian private sector. Some banks have been included in training initiatives led by the UN Office on Drugs and Crime (UNODC) and IGAD and other external partners, but other DNFBPs have not received such training. The central bank receives UN lists of designated terrorists and terrorist entities, but it does not officially and regularly distribute the list to banks and financial institutions. Rather, they are encouraged to retrieve the updated list regularly using the Internet, which some of them indicated may not be easy or convenient. The central bank's Supervision Department, however, has been more proactive on inspections, with all 10 banks in the country inspected in 2011.<sup>11</sup>

Challenges also appear to have arisen in extending AML/CFT awareness to and securing the involvement of stakeholders outside the central bank. There is little provision for coordination between the bank and relevant law enforcement agencies, and members of relevant private sector institutions consulted indicated they felt somewhat excluded from the implementation of AML efforts.

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9. UN transnational organized crime convention, art. 6.

10. Act No. 110/AN/11 on the fight against terrorist financing, art. 2.1.1.

11. The Supervision Department is currently receiving capacity-building assistance from the International Monetary Fund (IMF) through a resident advisor who has helped the central bank develop a three-year strategy for strengthening supervision.

The AML law provides a weak basis for effective interagency coordination. It says nothing about how the FIU should share operational information with law enforcement institutions. The central bank and FIU have played an important role in ensuring that law enforcement agencies receive training on AML measures, in collaboration with international organizations such as IGAD and UNODC, but these training sessions seem to have had limited effect. Our researchers were told during their visit that none of Djibouti's law enforcement institutions has established a unit or assigned specific responsibility for AML functions, nor have any of them included AML/CFT issues in their internal training programs. Interviewees indicated that this training had been sporadic, lacked follow-up, tended to focus on terrorist financing rather than money laundering, and was often provided by consultants who seemed to lack expertise in applying AML concepts to cash-based economies.

Despite the acknowledgment of significant money laundering and terrorist financing risks, government institutions interviewed for this study could not cite a single AML case or any suspicious transaction formally investigated in any financial institution. They pointed in particular to the weak record keeping in financial institutions in Djibouti and the absence of automated transaction monitoring systems as a barrier to effective compliance monitoring. Law enforcement officials indicated that they do not have sufficient skills to investigate money laundering cases, an analysis reflected in a recent U.S. Department of State report.<sup>12</sup> There is no evidence of a culture of proactive investigation of AML/CFT-related incidents. Both the national police and the gendarmerie are mandated to initiate investigation into money laundering only with authorization from the Djiboutian national prosecutor, even where they are already investigating a predicate offense and find indications of money laundering.

Moreover, neither the national customs nor tax department has a clearly articulated role in AML efforts or in investigating other predicate crimes, and our research suggests that they have not been actively included in AML interventions, such

as training. When customs seizes contraband at the borders, their role is limited to writing a report stating how and what goods were found. The report is forwarded to the ministry that has a direct interest in the matter, for instance, the Ministry of Health if the goods seized are medicines, who in turn reports the matter to the national prosecutor for further investigation and prosecution. This is a lengthy information-sharing process that seems to do little to encourage proactive investigation of potential money laundering or terrorist financing offenses.

At the same time, however, members of the private financial sector in Djibouti interviewed for this study seemed to argue that the responsibility for effective regulation is not theirs but that of the central bank. They argue that the bank has an intimate knowledge of the small country and its economy and that "if a stranger or someone suspicious was to conduct business in Djibouti, they would be noticed, and appropriate action would be taken." The CEO of one international commercial bank based in Djibouti specifically told us that, "in the unlikely event of a criminal using the system, the law enforcement agencies are very proactive and are usually able to apprehend criminals within a relatively short time." Again, the argument seems to misunderstand the nature of "suspicious transactions" under the global AML/CFT regime and to overlook the possible involvement of Djiboutian actors in money laundering and terrorist financing.

The arrival of mobile money has received only limited attention. The central bank recently licensed providers to establish a number of mobile banking services, but the arrangement provides for only limited application of know-your-customer (KYC) rules, and regulators could not explain clearly to us how suspicious transactions carried out through mobile banking platforms might be identified, monitored, or reported. The UN Security Council recently imposed targeted sanctions on a Djiboutian national, in part on the basis that he founded a mobile money service (Zaad) as a conduit for financing al-Shabaab, taking advantage of the lax application of KYC rules in that business environment.<sup>13</sup>

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12. Bureau of International Narcotics and Law Enforcement Affairs (INL), U.S. Department of State, "2011 International Narcotics Control Strategy Report (INCSR)—Volume II: Money Laundering and Financial Crimes Country Database," 20 May 2011, <http://www.state.gov/j/inl/rls/nrcrpt/2011/database/index.htm>.

13. See UN Department of Public Information, "Security Council Committee on Somalia and Eritrea Adds One Individual to List of Individuals and Entities," SC/10545, 17 February 2012, <http://www.un.org/News/Press/docs//2012/sc10545.doc.htm>.

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Similarly, there appears to be only very limited effort to extend AML/CFT supervision to the real estate market, despite growing concern that it may be implicated in the laundering of piracy revenues.

## Entry Points and Priorities

Djibouti has taken a number of important steps toward building an effective AML/CFT regime, notably the adoption of a basic legal framework and the creation of a function FIU. The challenge now lies in making that regime truly effective by better equipping the FIU to do its job and extending AML/CFT awareness, knowledge, and practices to other relevant stakeholders within and outside government. A coordinated effort from within the Djiboutian government, with support from relevant external actors, is needed to achieve this. Absent such an effort, Djibouti's rapid financial and trade-driven growth will be jeopardized by vulnerability to exclusion from the international financial system.

Our research suggests, however, that there is a lack of awareness at the senior political and technical, i.e., civil service, levels of the strategic threat to Djiboutian growth and prosperity posed by money laundering and terrorist financing. Absent increased awareness of the seriousness of the threat to Djiboutian interests, progress on AML/CFT issues in Djibouti seems likely to be halting. Accordingly, we believe that the first priority for strengthening AML/CFT efforts should be a coordinated action by external actors—donors, military partners, international financial institutions (IFIs), and other interested states—to raise awareness of this threat. Such an effort might involve technical training sessions targeted at senior civil servants, but it also must include a coordinated diplomatic push to demonstrate the unity of the international community's perspective and the seriousness of its resolve.

The aim of this process should be to create the political will needed to underpin the creation of a national AML strategy and capacity-building work plan, supported by external partners and providing a mechanism for coordination among relevant Djiboutian government agencies. The nascent

FIU offers a key entry point for rapid scale-up of such capacity-building efforts. Further attention to strengthening Djibouti's legislative framework will also be required. Such as strategy should consider, *inter alia*,

- the resourcing needs of the FIU and other relevant government institutions;
- reforms to ensure FIU independence;
- interagency coordination at the strategic and operational levels, covering the FIU, central bank, law enforcement agencies, customs, and tax;
- a national training strategy;
- reform of the suspicious transaction report (STR) process;
- outreach to and training of private sector institutions, especially banks, but also other DNFBPs, especially bureaux de change; and
- examination of improved AML/CFT supervision for the hawala, real estate, and mobile banking sectors.

In the near term, consideration should be given to involving Djibouti in an FSRB, whether the ESAAMLG or MENA-FATF. Joining such a body provides a sense of responsibility with regard to AML compliance as there is peer pressure from the other member states. Member states also provide support to one another in areas of mutual concern, such as providing technical assistance in the form of training or work-related attachments to institutions of other member states. Being part of an FSRB also provides opportunities for exchanges of information, especially in the area of money laundering trends and typologies. Further, taking steps to join an FSRB would create an opportunity for Djibouti to undergo the comprehensive evaluation required as a condition for joining an FSRB.

# 3. Eritrea

## KEY FINDINGS AND RECOMMENDATIONS

Like many other East African and Horn states, Eritrea's economy is heavily reliant on informal and cash-based transactions, as well as remittances from an overseas diaspora. Unlike many other East African and Horn states, both Eritrea's informal economy and Eritrean foreign remittances are significantly controlled by a single autocratic political party, the ruling Popular Front for Democracy and Justice (PFDJ). With some PFDJ members accused by the United Nations and others of involvement in money laundering and terrorist financing and with international sanctions consequently in place, the Eritrean financial system has become isolated from the international financial system. The result has been the flourishing of cross-border smuggling and trafficking outfits. There may also

be a danger that international sanctions encourage state actors to seek nonconventional revenue-raising, i.e., criminal, and power-projection, i.e., terrorist, capabilities.

AML/CFT efforts in such a context are extremely difficult. Eritrea has no formal AML/CFT law or framework. There are some suggestions it may have developed a kind of FIU and imposed STR-like requirements on its state-owned banks, but their existence and role could not be verified. Eritrea does not actively participate in the global AML/CFT regime.

Entry points for strengthening AML/CFT efforts in such a context are few and far between. IGAD, from which Eritrea withdrew for some years but has now rejoined, has an important role to play

in outreach to Eritrea and the potential normalization of its relations with the international community. In the meantime, international pressure, through effective implementation of UN sanctions, may create some leverage. The due diligence requirements imposed on mining firms operating in Eritrea by UN Security Council Resolution 2023 offer an important new entry point in this respect. In addition, there may be benefit in seeking to engage other actors: Eritrea's donors, such as China, Qatar, and the United Arab Emirates, as well as Sudan, which is, with Qatari financial support, creating a free trade and industrial area with Eritrea on their joint border.

**NOTE ON THIS CHAPTER:** Due to concerns about the physical security of our researchers and to limited resources, no field visit was conducted inside Eritrea. Moreover, Eritrean officials were not directly consulted during the course of this study. A very limited number of interviews were conducted with relevant stakeholders outside Eritrea. The analysis for Eritrea should be read with additional caution because the modified methodology used may reduce the comparability of results for this jurisdiction and others treated in this Baseline Study. Results presented here may require further verification before they can serve as the basis for policy development.



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## Risks and Vulnerabilities

Eritrea is a country of about 5.25 million people, with a sizable migrant population in the countries of the Organisation for Economic Co-operation and Development (OECD) and Middle East. Most Eritreans live in rural settings and earn their livelihood from subsistence agriculture. In the western and eastern lowlands of Eritrea, the population is mainly pastoralist. Eritrea is an autocratic one-party state, dominated by the liberation movement that fought and won the war for Eritrea's independence. Allegations have been made by foreign governments and UN bodies that implicate the Eritrean government in subverting neighboring states and lending support, such as weapons, training, logistics, and financial aid, to insurgent movements and terrorist organizations. Over time, the Eritrean government has become isolated, making Eritrea in effect a pariah state in the subregional and larger international systems. Currently, Eritrean government officials are under UN Security Council sanctions because of alleged subversion of neighboring states and support for armed movements.<sup>14</sup> As a result, the Eritrean economy is a command economy, with business firms affiliated to the ruling PFDJ and state control of import-export trade, wholesale and retail trade, and the bulk of industrial production.<sup>15</sup> The private sector is weak and small.

The emergence of the modern financial system in Eritrea dates back to the colonial era under Italy, which saw the establishment of several private banks in Eritrea in the early years of the 20th century.<sup>16</sup> Institutional development of that sector has frequently been interrupted by political interventions, including a period of British military administration followed later by federation with Ethiopia in 1952. From 1952 onward, the Eritrean banking system was an appendage of the Ethiopian, socialized financial system. It was only in 1991 with the achievement of *de facto* autonomy from Addis Ababa and particularly after formal indepen-

dence in 1994 that an independent Eritrean financial system began emerging. A key point in this process was the issuance of Eritrea's own currency, the nakfa, in 1997.

Today, four public financial institutions—the Bank of Eritrea, the Commercial Bank of Eritrea, the Housing and Commerce Bank of Eritrea, and the Eritrean Development and Investment Bank—dominate the formal financial sector in Eritrea.<sup>17</sup> The National Insurance Corporation of Eritrea (NICE) is also an important financial institution, as the sole insurance provider in Eritrea. Although technically the NICE has been privatized, the biggest shareholders are the Ministry of Finance and the Martyr's Trust Fund. In theory, Eritrean law permits the operation of foreign or domestic private banks, but none actually exist or operate in Eritrea. The tightening of economic controls in the last few years has made that possibility even more unlikely. According to some sources interviewed for this study, privately owned and operated bureaux de change are allowed to operate and a few still exist in Eritrea. Other sources indicate that formal private trading in foreign exchange in Eritrea is nonexistent.

The formal financial sector in Eritrea is tightly regulated, monopolized by the state, and largely cut off from contemporary international financial systems and practices. It is also largely inaccessible to most of the Eritrean population and offers only limited financial products and services to those customers that can access it. Like many other East African and Horn countries, the informal financial sector in Eritrea is consequently critical to the economy and a large proportion of the Eritrean people. Unlike many other East African and Horn countries, the operation of informal financial markets is mediated in Eritrea by the significant power and reach of the PFDJ, even beyond Eritrea's borders.

Remittances from the Eritrean diaspora play an important part in its political economy and have become an important means for the PFDJ to attempt to acquire and exercise power.

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14. See UN Security Council, S/RES/1907, 23 December 2009; UN Security Council, S/RES/2023, 5 December 2011.

15. International Crisis Group (ICG), "Eritrea: The Siege State," *Africa Report*, no. 163 (21 September 2010), pp. 14–15.

16. Arnaldo Mauri, "Eritrea's Early Stages in Monetary and Banking Development," *Università degli Studi di Milano Working Paper*, no. 28 (October 2003), pp. 8–18, <http://www.economia.unimi.it/uploads/wp/wp171.pdf>.

17. Bekeleza Ncube, "Eritrea," n.d., pp. 5–8, <http://fic.wharton.upenn.edu/fic/africa/Eritrea%20Final.pdf>.

Styan<sup>18</sup> estimates such flows at \$350–400 million annually. A 2003 International Monetary Fund (IMF) study estimated that financial flows from the Eritrean diaspora are the single-largest source of foreign exchange injected into Eritrea and have averaged around 37 percent of Eritrea's gross domestic product (GDP). The Eritrean government also sells bonds to Eritrean diaspora members and levies a 2 percent "income tax" on all registered Eritrean migrants abroad. Periodically, the Eritrean government launches campaigns or uses special appeals, for instance, during the war with Ethiopia from 1998 to 2000, to raise even more funds from Eritrean migrants abroad. In the absence of private sector financial providers, most of these remittance flows are channeled through the Bank of Eritrea and Eritrean embassies abroad. A PFDJ-affiliated firm, Himbol Financial Services, oversees and manages remittance flows.

Since the Ethiopian-Eritrean war, Eritrea has found itself in the throes of a spiraling socioeconomic crisis. Eritrea's worsening relations with its neighbors and, more importantly, international donors has further exacerbated the crisis. Rising levels of unemployment, poverty, inflation, an overvalued nakfa, food insecurity, and an expanding fiscal crisis have had significant social impacts, in particular leading to significant emigration. Our interviews and research suggest that Eritrea's increasing isolation from its neighbors and the international financial and trade systems has led the state to tolerate the smuggling of scarce goods and commodities and the emergence of a parallel market for U.S. dollars.

There are also rumors of the emergence of human trafficking networks. A 2007 study alleged that organizers of these trafficking rings charge individuals 3,000–7,500 nakfa (\$200–500) to be trafficked abroad. Other sources we interviewed indicate that the fees are often lower and more flexible and take into account other factors. A report by the UN Monitoring Group on Somalia and Eritrea, however,

states that the head price for each smuggled individual may amount to \$3,000 or more.<sup>19</sup> The Eritrean government also levies a significant "tax" on the families of those who emigrate, reported in 2007 to be 50,000 nakfa (\$3,300).

Eritrea's vulnerability to money laundering and terrorist financing lies not in private actors exploiting weakly regulated state institutions but, unusually, in the acquiescence or perhaps even participation of some state officials in the use of those institutions for the purpose of money laundering and terrorist financing. The situation is somewhat similar to that found in Iraq or Serbia while those countries were under international sanctions. As Peter Andreas has explained, such sanctions risk pushing the political leadership and traffickers together in a mutually convenient revenue-raising alliance.<sup>20</sup> Likewise, there is a danger that such sanctions, by weakening a beleaguered state's access to conventional military resources, may encourage that state to seek to project military power through nonconventional means, such as the financing of terrorist proxies outside its borders.

It may also lead to disturbing spillover effects. The UN monitoring group report in 2011 states that not only have violations of the Eritrean arms embargo taken place, but also that the Eritrean government is actively involved in arms trafficking across borders into neighboring countries.<sup>21</sup> These activities have allegedly occurred with the participation and protection of nationals and high-ranking officials of neighboring countries, testifying to the linkage between the emergence of transnational criminal networks and sanctions-busting activities.

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18. David Styan, "The Evolution, Uses, and Abuses of Remittances in the Eritrean Economy," 2007, <http://www.chathamhouse.org/sites/default/files/public/Research/Africa/200407eritrea.pdf>.

19. UN Security Council, *Letter Dated 18 July 2011 From the Chairman of the Security Council Committee Pursuant to Resolutions 751 (1992) and 1907 (2009) Concerning Somalia and Eritrea Addressed to the President of the Security Council*, S/2011/433, 18 July 2011, p. 110 (hereinafter 2011 Somalia and Eritrea monitoring group report).

20. Peter Andreas, "Criminalizing Consequences of Sanctions: Embargo Busting and Its Legacy," *International Studies Quarterly* 49, no. 2 (June 2005): 335–360.

21. 2011 Somalia and Eritrea monitoring group report, pp. 95–96.

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## Current AML/CFT Efforts

Eritrea has been on the receiving end of sanctions imposed by the UN Security Council. The first set of sanctions based on Resolution 1907 in December 2009 imposed an arms embargo, travel ban, and assets freeze on high-ranking Eritrean political and military figures. Recently, the UN Security Council passed Resolution 2023, which expanded the scope of the previously imposed sanctions. Resolution 2023 also introduced a new element in that it brings up the issue of the “diaspora tax,” the means used to collect this money, and the end use of the revenue generated. Moreover, the resolution requires member states with citizens or firms investing in the burgeoning mining sector of Eritrea to issue or develop “due diligence guidelines” to ensure that revenue accruing to the Eritrean government is not used in a manner that violates the provisions stipulated in Resolutions 1884, 1862, and 1907.<sup>22</sup>

The widening economic crisis in Eritrea, the shortage of foreign exchange, the monetary crisis, and the continued expansion of the sanctions regime may leave the Eritrean government little choice but to tolerate or even seek to control cross-border trafficking and money laundering activities. The research suggests that the Eritrean government may increasingly be seeking to use its economic and political isolation by the international community as a rallying point at home.

It is perhaps unsurprising that AML/CFT efforts within Eritrea are almost nonexistent. According to the limited sources available, Eritrea does not possess a legal definition of money laundering. Eritrea is not an FATF or an FSRB member. Eritrea has not signed the 2004 protocol to the 1999 Organisation of African Unity (OAU) Convention on the Prevention and Combating of Terrorism (the Algiers Convention), the UN Convention Against Transnational Organized Crime, the UN Convention Against Corruption, and the UN International Convention for the Suppression

of the Financing of Terrorism. Few external actors with a focus on AML/CFT issues have engaged or even considered Eritrea’s role on these issues. One exception is the U.S. State Department, which reported in 2011 that

due to its informal cash economy, limited regulatory structure, lack of enforcement, and proximity to regions where terrorist and criminal organizations operate, Eritrea is vulnerable to money laundering, trade-based value transfer, underground finance, terrorist financing and related activities. The Eritrean legal and regulatory systems are undeveloped and nontransparent. The constitution, ratified in 1997, has yet to be implemented. Currently, all laws are issued by proclamation from the [Eritrean government]. Regulations and procedures seem to be haphazardly created and irregularly enforced. Obtaining information about financial regulations is difficult; Eritrea is one of a few countries that do not publish their national accounts, budget, and trade statistics. Eritrean officials will not discuss the country’s ... (AML/CFT) regime.<sup>23</sup>

Our research and interviews indicate that Eritrea may have developed some kind of FIU-like structure and that its state-controlled banks may have developed financial reporting arrangements with this FIU. It remains unclear whether this unit operates like a traditional FIU, serving the purpose of stamping out money laundering and terrorist financing, or whether it serves more as a part of the PFDJ’s command economy intelligence apparatus.

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22. UN Security Council, S/RES/1862, 14 January 2009; UN Security Council, S/RES/1884, 27 August 2009; UN Security Council, S/RES/1907, 23 December 2009.

23. INL, U.S. Department of State, “2011 International Narcotics Control Strategy Report (INCSR)—Volume II: Money Laundering and Financial Crimes Country Database—Comoros Through India,” 20 May 2011, <http://www.state.gov/j/inl/rls/nrcrpt/2011/database/164076.htm> (hereinafter State Department 2011 INCSR, Comoros Through India).

## Entry Points and Priorities

Entry points for strengthening AML/CFT efforts in such a context are few and far between. Effective AML/CFT efforts will only truly become possible when Eritrea's relations with its neighbors and the rest of the international community are normalized. Eritrea's growing isolation and the escalating diplomatic, political, and economic costs of its actions over time may lead to a change of course. IGAD has a central role to play in helping to bring this to pass.

In the meantime, international pressure, through effective implementation of UN sanctions, may create some leverage. Careful attention should be paid to the recommendations made by the UN monitoring group in its report on Somalia and Eritrea regarding the strengthening of implementation of those sanctions.<sup>24</sup> The due diligence requirements imposed on mining firms operating in Eritrea by UN Security Council Resolution 2023 also offer an important new entry point in this respect. The states that host those firms, including Australia, Canada, China, Russia, the United Kingdom, and the United States, should take steps in line with Resolution 2023 and with their support for the UN Guiding Principles on Business and Human Rights, unanimously endorsed in the UN Human Rights Council in 2011, to supervise those mining firms' due diligence steps. This may help reduce the possibility of those firms' revenues being used for terrorist financing and, in time, may open up channels for further engagement with Eritrea on related issues.

Finally, there may be a number of other states who could potentially engage the Eritrean government on these issues, such as its major donors, including China, Qatar, and the UAE. Sudan is also currently developing a joint free trade and industrial zone with Eritrea on their common border, funded by Qatar. Effective AML/CFT arrangements will be important to protecting the Sudanese and Qatari investments in that venture. Building effective AML/CFT measures into that venture could have an important demonstration effect for the Eritrean government.

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24. 2011 Somalia and Eritrea monitoring group report, pp. 117–118.

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# 4. Ethiopia

## KEY FINDINGS AND RECOMMENDATIONS

Ethiopia is undergoing a period of very rapid economic growth, which is expected to last for a number of years. Its financial system, long closed to outside investment and influence and controlled by the state, is slowly liberalizing, as are other parts of the economy. This is increasing opportunities for corruption and money laundering related to trafficking, commercial fraud, tax evasion, and other criminal conduct, and Ethiopian institutions are lagging. Security institutions have paid more attention to terrorist financing issues, particularly in the context of hawalas, but counterterrorism arrangements remain a work in progress.

As a result, Ethiopia is currently among those countries of most concern to the international community on AML/CFT issues, as reflected by the continuing attention of the FATF International Cooperation Review Group (ICRG), which continues to express concern about Ethiopia's AML/CFT arrangements. This seems increasingly to presage possible actions by some FATF members recommending that financial institutions based in those countries cease business

with Ethiopia. Any such action would quickly and severely interrupt Ethiopian trading relationships and economic growth.

Fortunately, there are signs that the senior Ethiopian leadership recognizes these dangers. A number of steps have been taken in the last 18 months that suggest a serious commitment to strengthened AML/CFT arrangements in the country, including the creation of independent Financial Intelligence Center (FIC), the establishment of an interministerial board on AML/CFT, the initiation of a process for joining the ESAAMLG, and the approval by Parliament of the IGAD MLA and Extradition Conventions. Prime Minister Meles Zenawi also reportedly made commitments during the 2012 London Conference on Somalia to move this agenda forward.

Less fortunately, however, these processes are moving so slowly that the FATF ICRG continues to issue warnings about the situation. The problem seems not to be one of high-level political will, as our research suggests it may be in

other countries in the region, such as Kenya and Uganda, but of an insular, cumbersome, slow-moving, and still developing civil service with limited absorption capacity.

We advocate a dual-track approach, focusing on rapid, deep, institutional development of the FIC over the next two years and broad, long-term strengthening of AML/CFT-related skills in multiple parts of government, financial institutions, financial intermediaries, and remittance organizations. These efforts would include

- working with the National Bank of Ethiopia to develop effective supervision of banks, other financial intermediaries, and remittance organizations on KYC issues;
- training law enforcement and customs officials in AML/CFT-related analytical and investigative skills; and
- working with the interministerial board to develop a system for interagency information sharing and coordination.

## Risks and Vulnerabilities

Ethiopia is undergoing a period of rapid economic growth. Between July and December 2010, it attracted \$2 billion in foreign direct investment. It is reaping the benefits of a relatively long absence of armed conflict and a period of sustained institutional and market development. In 2010, *The Economist* predicted that Ethiopia would have the third-highest rate of growth during 2011–2015, after China and India.

This growth is bringing profound change to Ethiopia and many opportunities for money laundering and, regrettably, terrorist financing. In the last two decades, the ruling political coalition, the Ethiopian People's Revolutionary Democratic Front (EPRDF), has moved from a Maoist-inspired democratic socialism toward a more managed free market orientation. It has slowly opened up some sectors of the economy, allowing foreign investment in the hotels sector, some infrastructure and manufacturing projects, and, somewhat controversially, land purchases. The financial sector has remained closed to foreign investment but has undergone rapid growth as the real economy has also grown. Ten years ago, two or three banks operated in the country; now there are 17.

This rapid economic growth and steady integration into international financial and trading systems is also bringing new opportunities for criminal entrepreneurialism and money laundering. Government institutions consulted for this study suggested that they believe that bank fraud, electronic crimes, and money laundering through formal financial institutions will continue to rise. Other sources point to extensive tax evasion, commercial fraud, corruption, and cross-border smuggling as sources of illicit funds within the Ethiopian economy. Perceptions of corruption, in particular, have worsened dramatically over the last decade. One prominent organization that observes such trends, Transparency International recently rated Ethiopia "highly

corrupt." Numerous government officials interviewed for this study suggested there were growing signs of connections between official corruption and money laundering and that organized criminal activity was increasingly posing a risk to the integrity of state regulatory and law enforcement institutions. There is growing concern about transnational trafficking through Ethiopia. Most of Ethiopia's borders are highly porous, and Ethiopia may now be emerging as a source country and transit route for human traffickers and smugglers. Both UNODC and the U.S. State Department have expressed concern about a possible rise in drug trafficking through Addis Ababa's international airport and about the government's limited response.

Yet, opportunities for money laundering through formal financial institutions are perceived by local stakeholders as limited. Ethiopia's financial system remains relatively tightly controlled by the state. The U.S. State Department has suggested that "most of the proceeds of contraband smuggling and other crimes are not laundered through the official banking system" but are often instead channeled through the hawala system. The Ethiopian government has closed a number of illegal hawala operations and attempts to monitor hawala networks within the country.<sup>25</sup> Global Financial Integrity estimates that, between 2000 and 2009, some \$11.7 billion flowed illegally from Ethiopia, with just less than one-third of that amount exiting in 2009 alone.<sup>26</sup>

Ethiopia has weak AML/CFT arrangements in all of these areas: for banks, financial intermediaries, and money transfer businesses. Perceptions of the risks posed by money laundering and terrorist financing differ radically across different government institutions and beyond. Until recently, many senior government authorities have demonstrated low awareness of the risks posed by money laundering and terrorist financing in Ethiopia. Interviews conducted for a 2009 project suggested that officials believed that money laundering had little relevance to their daily work. With the exception of customs authority officials, researchers found that senior officials consulted for this study struggled to

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25. See State Department 2011 INCSR, Comoros Through India.

26. Dev Kar and Sarah Freitas, "Illicit Financial Flows From Developing Countries Over the Decade Ending 2009," Global Financial Integrity, December 2011, [http://www.gfintegrity.org/storage/gfip/documents/reports/IFFDec2011/illicit\\_financial\\_flows\\_from\\_developing\\_countries\\_over\\_the\\_decade\\_ending\\_2009.pdf](http://www.gfintegrity.org/storage/gfip/documents/reports/IFFDec2011/illicit_financial_flows_from_developing_countries_over_the_decade_ending_2009.pdf).



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describe the consequence of money laundering in the economy in a tangible manner. It remains an abstract and almost unreal concept to many of them, not a reality of contemporary Ethiopia.

The perception in law enforcement agencies of money laundering and terrorist financing is quite different. Terrorist financing receives increasing attention from law enforcement agencies, although some of the recent uses of existing Ethiopian counterterrorism laws have caused concern among the international community. Money laundering itself has received less attention. Some senior officials and experts in the Ethiopian Ministry of Justice clearly understand that money laundering can undermine the integrity of the financial sector and negatively affect the relationship of Ethiopia with the international community. Judges, prosecutors, and police, however, do not clearly understand the connections between the proceeds of predicate crimes and money laundering, according to our research. “Follow the money” tactics do not routinely form part of a criminal investigation, and an understanding of basic AML concepts among the police seems low. Likewise, officials in the Ethiopian Ethics and Anti-Corruption Commission did not associate corruption with money laundering. Furthermore, customs authority officers lack technical capacity of investigation and prosecution.

Private sector banks seem more aware of money laundering concerns but reticent to take steps to deal with them, absent clear guidance from the government. A number of the banks consulted for this study have adopted internal AML directives and set up compliance management teams, but their investment in compliance has been limited, while modalities for reporting to the country’s new FIC have remained uncertain. Beyond banks, however, awareness of money laundering and terrorist financing issues within the private sector appears to drop away steeply. It has received little attention from the Ethiopian Chamber of Commerce, and there are no civil society actors within Ethiopia active on the issue. Likewise, leading members of the media lacked a basic understanding of money laundering, many of them

apparently considering it analogous to the Ethiopian traditional concept of *arata*, perhaps best translated as “usury.”

## Current AML/CFT Efforts

Ethiopia is currently among the states of most concern to the international community in terms of money laundering and terrorist financing risks, as demonstrated by the attention of the FATF ICRG to it over the last couple of years. The FATF ICRG has characterized Ethiopia as having inadequate legal and institutional AML/CFT arrangements.<sup>27</sup> In November 2009, the Ethiopian Parliament adopted a law entitled *Prevention and Suppression of Money Laundering and Financing of Terrorism* (Proclamation 657/2009); and in March 2010, the National Bank of Ethiopia issued a directive mandating customer due diligence (CDD) by banks but not other financial intermediaries.<sup>28</sup> In June 2010, the Ethiopian finance minister adopted an action plan that committed Ethiopia to (1) implementing UN Security Council Resolutions 1267 and 1373; (2) introducing implementing regulations and directives for the new AML law; (3) establishing the FIC; (4) seeking technical assistance to conduct a review of AML/CFT laws; (5) raising awareness of AML/CFT issues within the law enforcement community; (6) implementing effective, proportionate, and dissuasive sanctions in order to deal with natural or legal persons that do not comply with the national AML/CFT requirements; and (7) obtaining full membership in a FSRB and submitting to a mutual evaluation.

Four steps in particular have been important in demonstrating the Ethiopian government’s seriousness about fulfilling these commitments. First, an interministerial committee was formed to address Ethiopia’s AML/CFT deficiencies, bringing together the Ministries of Foreign Affairs, Justice, and Finance and Economic Planning; the National Bank of Ethiopia; and the National Intelligence and Security Service. Second, Ethiopia has begun the process of joining the

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27. FATF, “FATF Public Statement,” 24 June 2010, [http://www.fatf-gafi.org/document/54/0,3746,en\\_32250379\\_32236992\\_48263734\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/54/0,3746,en_32250379_32236992_48263734_1_1_1_1,00.html).

28. National Bank of Ethiopia, Customer Due Diligence of Banks Directives No. SBB/46/2010.

ESAAMLG, with a decision having been taken by the ESAAMLG to allow it to join first as an observer. Third, in early 2012 the Ethiopian House of People's Representatives ratified the IGAD Extradition Convention and was poised to ratify the IGAD MLA Convention, demonstrating Ethiopia's seriousness in its commitment to rule of law-based law enforcement cooperation in the region. When the conventions are ratified by a third country (Djibouti was the first), they will come into force and create a codified legal basis for cross-border legal cooperation among Djibouti, Ethiopia, and that third country for the first time. In early 2012, Ethiopia also ratified the UN Convention on the Suppression of the Financing of Terrorism, another sign of its commitment to effective action on these issues.

Fourth and perhaps most importantly, the independent FIC was created, reporting directly to the prime minister (Regulation No.171/2009). It took more than a year, however, for the FIC to receive a budget allocation and begin hiring. It has only recently moved into designated premises and has not yet been staffed to operational levels. It has adopted no strategic plan, although it did recently adopt a work plan. Once fully active, it is expected to have as many as 63 staff, addressing data collection and analysis and investigation with a range of support staff. Although the FIC is not yet fully staffed, we were told by FIC leadership that they have recently started to receive hardcopy reports from banks on all transactions more than 200,000 Ethiopian birr (approximately \$11,500). In the first month, they received 65,000 such reports. Absent a system for digitizing and analyzing this data, the FIU is likely to face an uphill struggle identifying suspicious transactions, let alone linked transactions or systemic vulnerabilities.

As this suggests, AML/CFT progress in Ethiopia has been genuine but very slow. Progress was so slow that, in October 2011, FATF issued a statement signaling its dissatisfaction. Although not explicitly stated in this pronouncement, our research suggests that any further such statement from FATF would presage measures by FATF member states discouraging financial institutions in their countries from doing business with Ethiopia. The impact on Ethiopian trading relation-

ships and economy could be quick and severe.

Personal communications between researchers in the Project Team and senior Ethiopian leaders suggest that Ethiopia's slow progress on AML/CFT reform may have less to do with a lack of political will at the most senior levels of government than the generally slow pace of legal and institutional reform in a country with a still-developing civil service. Weak existing bureaucratic capacity may, our research suggests, be amplified by a perception among some civil servants that strong state control over the financial sector means that it is unlikely that money laundering and terrorist financing is present in the country and that the primary goal should be economic development, without too many questions being asked about the source of capital investments. Both attitudes appear slowly to be changing, but progress will be very slow without a broad awareness-raising and education campaign. Certainly, these attitudes do not reflect the official government position: the EPRDF is on the record stating that illicit finance is "anti-development" because it does not add sustainable value to the national economy.<sup>29</sup>

Some effort has been made to begin tackling these views through awareness-raising efforts. The Ministry of Justice has conducted nine training sessions on AML/CFT issues, both for its own personnel and for personnel of the Ministries of Finance and Economic Development, Foreign Affairs, Defense, and Federal Affairs; the Federal Police Commission; the Federal Ethics and Anticorruption Commission; government communication offices; and regional justice bureaus, totaling perhaps 400 people altogether. Roughly 20 financial institutions have also participated in these workshops. As recently as January 2012, the Ministry of Justice worked with Danish FIU officials to conduct additional AML/CFT training for law enforcement officials.

The real impact of these workshops is difficult to assess retrospectively, but there are certainly reasons to think that more awareness raising is needed. For example, the Ministry of Justice organized one workshop in collaboration with UNODC in February 2011 to raise the awareness of senior

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29. EPRDF, "Leadership Change and Rent Seeking," November–December 2010 (monthly Amharic newspaper).

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government authorities. The agenda focused on the effects of money laundering on economic development, international standards on AML/CFT issues, the role of national agencies in the fight against money laundering, national strategic coordination mechanisms, and the establishment of an effective FIU and its role and functions. We were informed, however, by Ethiopian government officials that many of those invited did not attend the workshop, according to Ethiopian government officials, and junior civil servants were sent to attend in their place. When we asked about efforts undertaken to raise the awareness of the broader public, our attention was called to a number of radio programs broadcast during 2010–2012. These described what money laundering is, which activities constitute money laundering, and how the public should react to money laundering.

Some commercial banks have begun to provide some training to their staff. The Ethiopian Commercial Bank, the largest bank in Ethiopia with 445 branches and more than 10,000 employees, provided training to 350 senior officials and branch and line managers. Training is given every quarter. The Dashen Bank, one of the largest private banks in the country, provided training on AML directives in four rounds to 600 employees out of the 2,900 employees in the bank. Many banks consulted pointed to difficulties in implementing CDD measures, however, particularly because of the absence of a reliable identification system. (Ethiopia does not issue national identity cards.) Comments from some commercial banks seem to indicate a reticence to implement the CDD directive and related STR obligations because of the costs involved and customer concerns about confidentiality. The Ethiopian Commercial Bank and Dashen Bank, which have each taken proactive steps to implement CDD measures, noted that they do not have AML software that can assist them to identify and report on all transactions greater than 200,000 Ethiopian birr, as required by law. Furthermore, the National Bank of Ethiopia has conducted no inspections to ensure that banks are complying with its CDD directive.

Our research and interviews and interviews with foreign stakeholders suggest that they also see weaknesses in some of the existing Ethiopian legal provisions. The 2009 AML law is seen as not being sufficiently comprehensive to address the full range and scope of money laundering practices. It is

also criticized for weaknesses in its provisions on asset freezing, seizure, and forfeiture, when compared to international standards. Our research suggests that some of these criticisms may be being addressed through work undertaken by the Ministry of Justice and UNODC, apparently resulting in draft revisions now being prepared for consideration by the Ethiopian House of Peoples' Representatives.

## Entry Points and Priorities

Ethiopia has made measurable, although very slow, progress in developing an AML/CFT system. Encouragingly, there are clear signs of political commitment at the most senior levels. The real test for Ethiopia comes with the process of acting on those commitments, operationalizing the legal standards it has put in place, and bringing to life the new institutions it has created.

Fortunately, some important building blocks are in place. A basic legal framework is currently undergoing a significant revision with international (UNODC) guidance. The FIU exists and is inching toward becoming operational. The civil service has begun to educate itself on AML/CFT issues. Banks are getting ready to implement KYC, CDD, and STR obligations. Ethiopia is in the process of joining the ESAAMLG and has taken steps, such as the ratification of the IGAD MLA and Extradition Conventions, that demonstrate its willingness to engage partners within the subregion in rule of law–based counterterrorism cooperation. The existence of an interministerial committee on AML/CFT issues may, in time, provide the basis for effective interagency coordination.

Yet, there is a long way to go before the money laundering and terrorist financing risks confronting Ethiopia could be said to be under effective management. Although senior political levels in Ethiopia are increasingly aware of the risks posed to Ethiopia's trading relationships and development by the dissatisfaction of the FATF ICRG, the civil service is essentially oblivious to these risks. The major obstacle appears not to be high-level political commitment, but a cumbersome, insular, slow-moving, and still-developing bureaucracy with limited absorption capacity. Additionally, to some extent,

there appears to be a reticence among those cadres to acknowledge that illicit finance may be, as the EPRDF itself has phrased it, “anti-development.”

Accordingly, AML/CFT strengthening efforts in Ethiopia are a long-term prospect but a real one. We advocate a dual-track approach, focusing on rapid, deep, institutional development of the FIC and broad, long-term strengthening of AML/CFT-related skills in multiple parts of government, financial institutions, financial intermediaries, and remittance organizations.

The FIC provides the key entry point. Our research suggests that it should be the focus of donor assistance in the next two years. Donors, IFIs, and subregional partners should work with the FIC to develop a coordinated package of assistance covering internal strategy and management, skills development, technology support, outreach to private sector stakeholders, and integration into the ESAAMLG. Donors might also consider working with other ministries involved in the interministerial committee to use that forum as a platform for closer interagency coordination on AML/CFT issues.

Even when the FIC is operational—some way off yet—there will be a need for a much broader and longer-term awareness-raising and skills-development strategy. This needs to encompass a range of issues, such as

- working with the National Bank of Ethiopia to develop effective supervision of banks, other financial intermediaries, and remittance organizations on KYC issues;
- training law enforcement and customs officials in AML/CFT-related analytical and investigative skills; and
- working with the interministerial committee to develop a system for interagency information sharing and coordination.

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# 5. Kenya

## KEY FINDINGS AND RECOMMENDATIONS

As the major financial center in East Africa, Kenya represents the primary source of money laundering and terrorist financing risk in the subregion, along with Somalia. Kenya has thriving informal and illicit sectors that the Kenyan government struggles to control. They are closely entwined with illicit flows in and through neighboring states including Somalia. FATF recently listed Kenya among a group of “jurisdictions that have not made sufficient progress in addressing strategic AML/CFT deficiencies.” Its inclusion of Kenya, alongside fellow IGAD member state Ethiopia, on the FATF ICRG process list is a significant indicator of how vulnerable Kenya is perceived to be to money laundering and terrorist financing by the international community.

Money laundering in Kenya services a number of predicate offenses, including political corruption; trafficking in drugs, wildlife, counterfeit goods, and humans; and import tax evasion. It occurs through a range of vehicles, including real estate investment, charitable trusts and foundations, casinos, bureaux de change, election finance, and remittance companies. The absence of effective AML controls has made Kenya particularly vulnerable to terrorist financing, which is a major

concern given the continuing presence and activity of terrorist cells in Kenya. Reporting by the UN Monitoring Group on Somalia and Eritrea makes clear, for example, that terrorist financing has occurred in recent years through a number of avenues in Kenya, including informal money transfers, cash couriers, and exploitation of charities and nonprofit organizations.

In December 2009, the Kenyan Parliament adopted a watershed AML law. As of April 2012, the first real steps toward implementation were just beginning to be taken. The FIU created by the law (the Kenyan Financial Reporting Centre [FRC]) was not yet operational and will not have the power independently to request evidence from foreign FIUs. The law includes no definition of terrorist financing and does not provide for asset seizure arrangements. Moreover, financial sector supervision and law enforcement authorities have been unable effectively to investigate and prosecute money laundering and terrorist financing offenses. The private sector in Kenya, including the finance sector, is anxious to see Kenya acquire an effective AML/CFT system. Law enforcement authorities are also enthusiastic, but the slow pace of implementation suggests limited

political will, perhaps partly because money laundering currently plays a significant role in financing electoral campaigns. Given the atmosphere of uncertainty that currently pervades Kenyan politics, elites are unwilling to foreclose financing options.

To date, neither the ESAAMLG nor FATF have been able to stimulate the necessary political will in Kenya. A concerted, coordinated effort is needed from local and external stakeholders to make clear to Kenya’s political elites that improved financial governance, including strengthened AML/CFT arrangements, are a strictly necessary precondition for Kenya’s continuing participation in the global financial and trading system.

Forward progress on the FRC will not be feasible until such political will is mustered. In the meantime, therefore, steps should be taken to strengthen Kenya’s regulatory capacity wherever possible, through engagement with the FRC but also outside the FRC. This could include training financial investigators, reforming electoral finance law, and revising the existing AML law to address terrorist financing and asset seizures.

## Risks and Vulnerabilities

As the major financial center in East Africa, Kenya represents the primary source of money laundering and terrorist financing risk in the subregion, along with Somalia. Kenya has thriving informal and illicit sectors that the Kenyan government struggles to control. They are closely entwined with illicit flows in and through neighboring states, including Somalia. FATF recently listed Kenya among a group of “jurisdictions that have not made sufficient progress in addressing strategic AML/CFT deficiencies.” Its inclusion of Kenya, alongside fellow IGAD member state Ethiopia, on the FATF ICRG process list is a significant indicator of how vulnerable Kenya is perceived to be by the international community to money laundering and terrorist financing. A recent ESAAMLG mutual evaluation report (MER) identifies the major predicate offenses for money laundering in Kenya as political corruption, drug trafficking, robbery, and theft. Other major sources of illicit funds that are laundered in and through Kenya include maritime piracy, resource smuggling, import tax evasion, and trafficking in wildlife, humans, and arms.<sup>30</sup>

Perhaps the greatest concern is Kenya’s endemic corruption. Kenya ranks 154 out of 182 countries on the 2011 Transparency International Corruption Perceptions Index. Predatory patrimonial relations<sup>31</sup> have become so pervasive in Kenya that one political scientist describes it as having a “bandit economy.”<sup>32</sup> High-level corruption is by now well documented. The 2004 Kroll Report, commissioned by the Kibaki government during its first term (2002–2007), revealed multiple webs of intermediaries and corporate vehicles during the last days of the Moi regime that were used to siphon up to \$2 billion from public funds to private asset portfolios. Assets acquired included numerous properties and other real estate locally and in Australia, Europe, South

Africa, the United States, and possibly Namibia. The 2005 Goldenberg Report, which emanated from a judicial inquiry into a daring export subsidy fraud, revealed that more than \$500 million was stolen from the state and stashed abroad in destinations not conclusively established. Neither report has prompted unequivocal action from government to recover the proceeds or prosecute the perpetrators. Some prosecutions have been brought after the recent Anglo-Leasing scandal, but numerous individuals suspected of involvement in criminal activity in that scheme and the recent Charterhouse Bank money laundering controversy have avoided judicial process.

Import tax evasion is another important source of illicit funds. Under current market-integration arrangements fostered by the EAC, on entry through the port of Mombasa, goods destined for an inland foreign country such as Uganda are not taxed. The tax is to be levied by Ugandan authorities on the goods’ entry into that country. If the goods are subsequently diverted into the Kenya economy, the result is a loss of tax due to Kenya. Their influx also distorts the market and may drive prices to unsustainably low levels for legitimate business. One of the most frequently diverted commodities is sugar, imported from outside the Common Market for Eastern and Southern Africa region. Diversions during the last quarter of 2010 were reported to be worth almost 2 billion Kenyan shillings (\$23.5 million).<sup>33</sup> This network is also central to the trade-based movement of money integral to regional remittance systems.

Resource smuggling has also been prevalent. The Goldenberg inquiry revealed a scam for smuggling gold consignments from the Democratic Republic of the Congo (DRC) into and through Kenya to various destinations in Europe and Asia.<sup>34</sup> Later, the murder in February 2011 of a senior investigator from the Kenya Revenue Authority while investigating the smuggling of 2.5 tons of gold prompted public outrage.

30. See especially Peter Gastrow, “Termites at Work: Transnational Organized Crime and State Erosion in Kenya,” International Peace Institute, September 2011, [http://reliefweb.int/sites/reliefweb.int/files/resources/Full\\_Report\\_2562.pdf](http://reliefweb.int/sites/reliefweb.int/files/resources/Full_Report_2562.pdf).

31. See Makau Mutua, *Daily Nation*, 31 December 2011.

32. Mutahi Ngunyi, “Liberalising the Bandit Economy,” *Daily Nation*, 9 July 2000, <http://www.zaimoni.com/KenyaCorruption.htm>.

33. See Patrick Mayoyo, “Kenya: Sugar Crisis Blamed on Low Imports,” *Daily Nation*, 29 August 2011, <http://allafrica.com/stories/201108300016.html>.

34. Peter Warutere, “The Goldenberg Conspiracy: The Game of Paper Gold, Money and Power,” *ISS Occasional Paper*, no. 117 (September 2005).



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Among the facts revealed was the involvement of transnational criminal networks comprising Congolese, Kenyan, Lebanese, Nigerian, and Zimbabwean nationals. The commodity is often smuggled in the form of partially refined nuggets, destined for refineries in Dubai, Israel, South Africa, or Switzerland. Some of the smuggling rings include Congolese militias based in the eastern DRC, who use part of the proceeds from the disposal of the gold along the value chain to replenish military supplies. Some of the gold is sold to dealers in Nairobi. As Cuvelier noted, “[C]ross-border gold trading networks have managed to attract international gold buyers to the Kenyan capital with promises about the availability of large quantities of minerals of Congolese origin.”<sup>35</sup> The DRC government estimates that 80 percent of the value of gold output from the eastern DRC is lost to the formal system through smuggling. An official source has valued the smuggled gold at \$128 million. Case studies from the last two years indicate that gold with a much higher value may be involved.<sup>36</sup> A significant amount of tanzanite is also apparently smuggled from the mining location in Merelani near Arusha into Kenya, by Maasai and Luo buyers from Kenya. It is then allegedly sold to brokers based in Nairobi for reexport to Jaipur, India. The Central Bank of Kenya has recorded some of the reexports. Twenty-five percent of Kenyan exports for 2004 were comprised of reexports, with minerals smuggled from Tanzania forming a large portion.<sup>37</sup>

There is also evidence of growing drug trafficking through Kenya. With the exception of *qaat* and cannabis, Kenya is not a major producer of narcotics, but it has become an important transit territory for hard drugs originating from Southeast Asia and Latin America destined for European and U.S. markets. UNODC has estimated that tens of tons of heroin is trafficked from Pakistan and Iran into East Africa annually. The drug trafficking industry in and through Kenya is operated by sizeable transnational criminal networks

allegedly acting in collusion with some state officials.<sup>38</sup> Corruption plays a catalytic role in facilitating the flow of drugs imported through the Kenyan entry hubs of Mombasa, the Jomo Kenyatta International airport, southern coastal towns such as Shimoni and Vanga, and remote islands in the Lamu archipelago off the north coast. Kenya’s geographical position and long historical experience as a trade route linking three continents—Asia, Africa, and Europe—coupled with large communities closely affiliated to various parts of each of these continents explains its attraction to various illicit trades, including drug trafficking. Maritime ports dotted on the long coast of Africa have provided critical connecting points between the continent and the rest of the world for centuries. To this day, they are the most significant entry and exit points for cargo and passengers on certain routes of trade and traffic. Mombasa handles an annual average of 19 million tons of cargo, serving several countries in the hinterland, including Burundi, the DRC, Rwanda, Uganda, and to some extent South Sudan. Ample proof of the naval trafficking of heroin and cocaine into and through Kenya is provided by periodical interceptions of large drug shipments. In March 2011, a heroin consignment worth more than \$2.3 million was discovered on a ship anchored close to Kenyan territorial waters.

Kenya is also implicated in the burgeoning trade in counterfeit commodities of all descriptions. There are indications that the counterfeit commodity trade yields massive proceeds for the money laundering industry. Some estimates have quoted figures of \$84–490 million annually in lost revenue.<sup>39</sup> Most of the high-value commodities originate from beyond the shores of Kenya, which suggests that most of the proceeds are likely to be laundered abroad.

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35. Jeroen Cuvelier, “Kenya’s Role in the Trade of Gold From Eastern DRC,” International Peace Information Service, August 2011.

36. Ibid.

37. Sebastian Paschal Sanga, “The Role of Poor Governance in the Tanzanite–al Qaeda Link Controversy and Policy Options for Tanzania Enabling It to Escape From “Curses” in the Mining Industry,” Open Society Foundation, December 2007, <http://pdc.ceu.hu/archive/00003720/01/sebastian.sanga.pdf>.

38. See Gastrow, “Termites at Work.”

39. The Kenya Revenue Authority estimates the loss to be \$84 million. The Kenya Institute for Public Policy Research and Analysis gives the higher figure.

Trafficking in wildlife products from Kenya, particularly ivory and rhino horns, continues unabated in response to the escalation in their value on the market. The interception of 247 ivory tusks in Thailand smuggled from Kenya at the end of March 2011 indicated the scale of the challenge. Much of the value of the smuggled ivory is captured abroad, when the tusks are carved into pieces of sculpture and marketed in China, Hong Kong, and Thailand. Most of the laundering therefore occurs beyond Kenya. The proceeds generated in Kenya are probably swallowed up within the cash economy for subsistence purposes. Kenya lies along the route of migrants seeking to travel out of East Africa southward to the southern Africa subregion. Their voyage requires them to pay not only the brokers that facilitate their transit, but also corrupt officials in immigration and the police.<sup>40</sup> The industry that has arisen as a result is significant enough to be included among the predicate factors to money laundering in Kenya. Individual payments are unlikely to be large, but add up to high volumes.

Kenya's heavy reliance on cash transactions is central to all of these criminal activities. One analyst concluded in 2006 that cash transactions in Kenya are "so substantial that authorities cannot with certainty determine which transactions are for genuine business and which may relate to money laundering operations."<sup>41</sup> The standard *modus operandi* is to use illicit funds to purchase readily disposable assets, notably, second-hand motor vehicles, motor vehicle spare parts, building materials, construction hardware, and computers. Prior to being used to pay for imports, the cash is converted into hard currencies, especially U.S. dollars, either informally on the parallel market through bureaux de change or through remittance organizations, many of them Somali *xawilaad*. An innovative money launderer may even obscure the trail of dirty money by raising a loan from a bank, ostensibly to

cover the costs of imports, and thereafter utilizing the proceeds of crime to repay the loan. Casinos also play a key role in placing illicit funds into the licit economy.

Real estate is equally susceptible to the infusion of proceeds of domestic criminality and corruption because cash transactions are ubiquitous in that sector as well. A survey by the Central Bank of Kenya found that as of May 2010, there were only 15,049 mortgages in the property sector.<sup>42</sup> This suggests that the vast majority of real estate transactions in Kenya are not financed through formal lending. Investment in undeveloped land, as well as older buildings, is known in many cases to attract sales transactions in cash. Properties in prime locations in the major cities can be paid for in cash. Interviewees knowledgeable in the fixed property market in East Africa were unanimous that transactions settled in cash were preferred to those that required third-party intermediation.<sup>43</sup>

There is particular concern that real estate investments around Nairobi may be used to launder the proceeds of Somali piracy.<sup>44</sup> Recent years have seen an expansion of Somali real estate holdings from their traditional base in Eastleigh into neighboring areas, including Pangani, Outer Ring, and Pumwani. The public institutions engaged for this study, including the police and Kenyan Department of Lands, expressed widely diverging views about whether this reflects organized money laundering and what steps the state might take to ascertain whether that is the case. Trusts and foundations are also commonly used as a money laundering vehicle, as exposed in some detail in the Kroll Report. Lawyers are used in setting up the trusts and occasionally administering them as well. Local development foundations are sometimes used because of limited audit requirements and because they may help to shield politicians' assets from scrutiny.<sup>45</sup>

40. Gastrow, "Termites at Work."

41. Peter Warutere, "Detecting and Investigating Money Laundering in Kenya," ISS Monograph Series, no. 124 (June 2004), <http://www.isn.ethz.ch/isn/Digital-Library/Publications/Detail?ots591=0c54e3b3-1e9c-be1e-2c24-a6a8c7060233&lng=en&id=118248>.

42. Business Daily (Kenya), "Kenya: Future of Real Estate Market Uncertain As Nation Walks Economic Tightrope," 30 October 2011, <http://allafrica.com/stories/201110310933.html>.

43. These views were expressed consistently in interviews in Nairobi, Kampala, and Dar es Salaam. The latter city was toured in an earlier study.

44. George Kegoro, "Update Report on Money Laundering in Kenya, January–June 2009" (unpublished); Phineas R. Moloto, "Africa Must Combat Money Laundering to Ensure Its Wealth Benefits the People," *East African*, 24 January 2011, <http://allafrica.com/stories/201101240375.html>; Gladys Mirugi-Mukundi, "Money Laundering Control in Kenya—New Dawn or False Promise?" 13 July 2010, [http://www.iss.co.za/iss\\_today.php?ID=982](http://www.iss.co.za/iss_today.php?ID=982).

45. Alvin Mosioma, interview with author (Tax Justice Network).

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Another increasingly important and lucrative money-making investment that appears to be used by some money launderers in Kenya, however, is the financing of political campaigns. Part of the explanation lies in the relatively lucrative spoils that come with political office. Interview subjects suggested that Kenyan parliamentarians are the best remunerated in Africa. Competition to attain elective or appointed political office tends to be quite intense and therefore quite expensive. For instance, our research suggests that a credible campaign for one of the Nairobi constituencies costs roughly 25 million Kenyan shillings (\$285,000).<sup>46</sup> It is estimated that a candidate seeking the governorship of Nairobi County may have to spend almost 100 million Kenyan shillings (\$1.14 million).<sup>47</sup> Yet, there is no structured, transparent system for financing electoral campaigns. This may lead to the use of illicit funding mechanisms, such as tax evasion, drug trafficking, and corruption. It is almost impossible for a candidate relying on income earned from a salary to afford an election campaign without access to alternative revenue streams. They are almost inevitably sucked into a money-laundering trap, which they enter either using proceeds from their own illicit activity or under the sponsorship of one or more benefactors.

This obviously places huge obstacles in the path not only of effective AML efforts, but also effective CFT efforts. The absence of effective AML controls has made Kenya particularly vulnerable to terrorist financing, which is a major concern given the continuing presence and activity of terrorist cells in Kenya. Reporting by the UN Monitoring Group on Somalia and Eritrea makes clear, for example, that terrorist financing has occurred in recent years through a number of avenues in Kenya, including informal money transfers, cash couriers, and exploitation of charities and nonprofit organizations.<sup>48</sup>

## Current AML/CFT Efforts

AML initiatives in Kenya have largely been driven by the civil service, with some complementary work being done by the financial sector. Legislative reforms have moved slowly, apparently under pressure from external actors such as FATF. For the last decade, a Kenyan national Task Force on Money-Laundering (TFML) has coordinated the country's official AML efforts. Its membership is drawn from various government departments and regulatory agencies.<sup>49</sup> As in Uganda, this interagency task force has struggled to overcome parliamentary reluctance to establish a comprehensive AML/CFT framework. Unlike Uganda, however, the Kenyan Parliament has recently shown important forward movement on these issues.

On 10 December 2009, Kenya's legislature enacted AML legislation of general application for the first time, entitled the *Proceeds of Crime and Anti-Money Laundering Act, 2009* (POCAML). This bill was originally introduced into Parliament in mid-2004. Kenya had had a law criminalizing money laundering previously, but it had only been applicable to proceeds of drug trafficking.<sup>50</sup> In several respects, POCAML can be regarded as a watershed. It adopts a definition of money laundering consistent with the UN Convention Against Transnational Organised Crime, although it applies only to the laundering of proceeds of crimes committed after POCAML came into force, in June 2010. It does not, however, create a definition of terrorist financing. It creates a number of potentially important new AML/CFT mechanisms, including a new FRC.

Progress appears largely to have stalled there. A number of the pillars on which new AML structures would depend, such as the Kenyan Anti-Corruption Commission (KACC),

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46. Much of the information on campaign costs was based on actual figures for the 2007 election in Nairobi, adjusted for inflation. They were gathered and kindly made available by researcher Okero Otieno.

47. Ibid.

48. 2011 Somalia and Eritrea monitoring group report.

49. At the time of the study, the task force comprised the Ministry of Finance as the coordinating ministry, the Kenya Police Service, the National Security and Intelligence Service, the attorney general's office, the Central Bank of Kenya, the Capital Markets Authority, the Kenya Revenue Authority, Immigration Department, Insurance Regulatory Authority, the Kenya Bankers' Association, and the Ministry of Trade and Industry.

50. Narcotic Drugs and Psychotropic Substances (Control) Act No. 4 of 1994.

appear to be in a state of paralysis. The entire top leadership of the KACC was recently removed following the adoption of new legislation to replace the current structure. It was only on 12 April 2012 that a decision was taken by the interagency advisory board that oversees the FRC to operationalize it. The Ministry of Finance and the central bank have agreed to second an unspecified number of staff to the FRC and provide office space, but to our knowledge, the FRC has not received a budget allocation from Parliament. Moreover, it is unclear whether POCAMLA provisions will give the FRC independence from the attorney-general on MLA matters with foreign FIUs.

Existing institutions lack the capacity to control money laundering and terrorist financing. The central bank does not distribute UN sanctions lists to financial institutions but simply refers all banks to the public lists posted on the Internet, which are obliged to confirm twice a year to the central bank that they have ensured none of their clients are on any of the lists.<sup>51</sup> Forensic auditors interviewed for this study pointed to some of the weak links in the existing AML infrastructure, as managed by the central bank and the police. They highlighted the underdevelopment of capacity to profile risk or analyze suspicious transactions, using the example of the failure by the central bank to explain the surplus money supply observed in 2009–2010, which saw a rise in “errors and omissions” in national accounts from \$1.1 billion to \$2.1 billion.<sup>52</sup> The criminal justice system has proven itself unable to investigate and prosecute money laundering and terrorist financing offenses. (POCAMLA has never been used to prosecute any crime.) After the KACC began to demonstrate some capacity to identify and investigate corruption and money laundering, its capacities were curtailed. Interview subjects repeatedly raised concerns too that the existing framework gave the state insufficient control over lawyers, who were seen as key actors in money laundering schemes. An example raised related to a lawyer who refused to disclose the identity of his client during

inquiries into the infamous corruption scandal that became known as the Anglo-Leasing procurement case.

Our research revealed a broad consensus that this lack of progress is due to limited political will among the political class that controls Kenya’s parliamentary and executive institutions. AML/CFT reforms threaten to constrain electoral financing options and the spoils that come from political office. Such a reform project is made even less attractive by the atmosphere of uncertainty that has surrounded Kenyan politics in recent years, with the country’s constitution and political settlement being renegotiated and the shadow of the International Criminal Court looming over Kenyan political governance. In such an uncertain context, it pays to keep your financing options open. Our researchers were repeatedly told that AML/CFT efforts are not a priority for Parliament with an election looming (currently scheduled for late 2012). Many of our research subjects went even further, noting that, in spite of the indications of corruption by political elites, Kenya has not developed a culture of CDD actions for Politically Exposed Persons (PEPs). Respondents emphasized the sensitivity of this critical issue, echoing remarks made in an earlier study commissioned by the ESAAMLG.<sup>53</sup> POCAMLA does not require enhanced due diligence action for PEPs.

Political elites’ reluctance to implement POCAMLA stands in stark contrast to the strong appetite demonstrated by other stakeholders. Much of the banking sector, including the Central Bank of Kenya, appeared keen to implement POCAMLA, which is seen as creating greater legal certainty for reporting arrangements as well as a level playing field. Interview subjects in the financial sector said that, at present, customers forum-shop: financial institutions risk losing their customers if they impose due diligence obligations that the customers perceive as too invasive. Some of the regulatory bodies also appear to be ready to implement POCAMLA. One example was the Insurance Regulatory

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51. See INL, U.S. Department of State, “2011 International Narcotics Control Strategy Report (INCSR)—Volume II: Money Laundering and Financial Crimes Country Database—Indonesia Through Mongolia,” 20 May 2011, <http://www.state.gov/j/inl/rls/nrcrpt/2011/data-base/164077.htm>.

52. Mirugi-Mukundi, “Money Laundering Control in Kenya.”

53. The research examined the links between corruption and the implementation of AML measures. ESAAMLG, *An Assessment of the Links Between Corruption and the Implementation of Anti-Money Laundering Strategies and Measures in the ESAAMLG Region*, 18 May 2009, [http://www.esaamlg.org/userfiles/Corruption\\_and\\_AML\\_Systems.pdf](http://www.esaamlg.org/userfiles/Corruption_and_AML_Systems.pdf).

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Authority, which has already sent out guidelines to the regulated sector.

International actors have had a subtle impact on the pace of AML/CFT reforms. Kenya is a long-standing member of the ESAAMLG, but the group has had no discernible impact on AML/CFT efforts in the country. The first ESAAMLG MER of Kenya was carried out only in 2011 and came to a fairly cautious conclusion: “The AML system in ... Kenya is still in an early stage of development, and much work needs to be done with regard to the implementation of the AML measures, capacity building, and awareness raising within the reporting community and the general public.”<sup>54</sup> This rather generous conclusion reflects an even more generous assessment that Kenyan authorities were not aware of proceeds of crime being laundered in or through any particular sector of the economy.

FATF has slowly ratcheted up its rhetoric regarding its concern at the slow pace of reforms in Kenya. As recently as October 2011, FATF concluded that “[d]espite Kenya’s high-level political commitment to work with ... FATF and [the] ESAAMLG to address its strategic AML/CFT deficiencies, Kenya has not made sufficient progress in implementing its action plan, and certain strategic AML/CFT deficiencies remain.” FATF called on Kenya to take a number of steps to overcome these deficiencies, including criminalizing terrorist financing, setting up a fully operational FIU, building an effective asset-freezing framework for terrorist assets, raising awareness in the law enforcement community, and improving sanctioning powers. Perhaps in response to this pressure, Kenyan authorities in March 2012 announced the appointment of an interim FRC director and the limited steps toward its operationalization described above.

## Entry Points and Priorities

Although the very recent forward movement on the operationalization of the FRC is positive, Kenya’s central problem remains one of political will. A concerted, coordinated effort is needed from local and external stakeholders to make clear to Kenya’s political elites that improved financial governance, including strengthened AML/CFT arrangements, are a strictly necessary condition for Kenya’s continuing participation in the global financial and trading system. This will require a broad advocacy effort by diplomatic, political, security, law enforcement, civil society, and even business actors. Foreign, subregional, and multilateral donors, other states in the region, the ESAAMLG, IGAD, and the EAC should make clear that, without effective legal protections and basic law enforcement capabilities relating to AML/CFT, Kenya will get left behind and, with it, the prospects of Kenya’s political and business elites.

Forward progress on the FRC will not be feasible until such political will is mustered. In the meantime, steps should be taken to strengthen Kenya’s regulatory capacity wherever possible outside the FRC, even as strenuous efforts are taken to convince Kenya’s political leaders to accelerate the operationalization of the FRC. The TFML offers a particularly valuable point of entry for efforts to build awareness, capabilities, and coordination around AML/CFT issues within the Kenyan civil service. In the near term, it may be leading a national money laundering risk assessment. That provides an important opportunity for external actors, including the EAC, the ESAAMLG, IGAD, and other relevant stakeholders, to engage with local actors to emphasize the importance of building an effective AML/CFT regime.

The training of financial investigators in the full range of law enforcement authorities is a matter of urgency. Expertise appears to be concentrated in three sectors at this stage, namely, the police, the Banking Fraud Investigation unit, and the forensic audit profession. The FRC envisaged will be an administrative FIU with no independent investigative or prosecution competence. For the FRC to be able to guide

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54. ESAAMLG, Mutual Evaluation Report: *Anti-Money Laundering and Countering the Financing of Terrorism: Republic of Kenya*, September 2011, [http://www.esaamlg.org/userfiles/Kenya\\_Mutual\\_Evaluation\\_Detail\\_Report\(2\).pdf](http://www.esaamlg.org/userfiles/Kenya_Mutual_Evaluation_Detail_Report(2).pdf).

the investigating agencies, however, it needs the capacity to conduct basic investigations itself and to work with those investigators and foreign law enforcement agencies.

The Kenyan Ministry of Finance, mandated to lead on these issues, should be encouraged to mobilize other sections of the state to agree on aligning preexisting laws, for example, on corruption, with POCAMLA. The security and police services also need to be more proactive in arguing for improved CFT legislation. Parliament should review the provisions of POCAMLA to include lawyers as reporting institutions and to create provisions for AML/CFT-related asset seizure. Electoral finance reform should also be a high priority.



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# 6. Somalia

## KEY FINDINGS AND RECOMMENDATIONS

After decades of war and state collapse, Somalia now represents the most significant source of money laundering and terrorist financing risk for the whole IGAD subregion, alongside and linked with Kenya. It is an “economy without a state” and the most corrupt country in the world, according to Transparency International. It has no effective national financial regulatory institutions and essentially no formal banking system. Its economy operates through a mixture of licit trade and revenue extraction from illicit financial flows, including public corruption, piracy, arms and human trafficking, and trade-based money laundering, especially in the export of charcoal and livestock and the import of basic foodstuffs and consumer goods.

Different political authorities within Somalia benefit from these flows in different ways. Some of these authorities are legitimate and recognized; others have simply taken advantage of effective, internationally recognized governance structures. In south and central Somalia, al-Shabaab controls and taxes many of these flows, using them as a source of terrorist financing. Neither the TFG, the Somaliland authorities, nor the Puntland authorities have the capacity to control money

laundering and terrorist financing in the areas they control. Indeed, there are some signs that some officials in each place are implicated in or at least benefit from money laundering.

The absence of effective federal institutions and a formal banking sector inside Somalia means that efforts to build an effective AML/CFT system inside Somalia will require long-term commitment from international partners. In the meantime, there are four main entry points for improving AML/CFT capacities.

First, partners should work with authorities in Mogadishu, Puntland, and Somaliland to build effective financial regulatory institutions and criminal justice capacity, especially basic investigative and prosecutorial capacity. Such efforts should not be undertaken piecemeal, or they risk stoking fragmentation. Instead, international partners should look to work with the central banks of Somalia, Somaliland, and Puntland to develop a system of policy coordination and perhaps even information sharing on financial supervision issues, perhaps in coordination with the proposed new Joint Financial Management Board. Likewise, now that the TFG is taking increasing responsibility for governance

in Mogadishu and there are signs of a federalized constitutional settlement emerging, there is scope for greater coordination between these authorities on criminal justice capacity-building efforts.

Second, building on discussions recently held in Mogadishu under the auspices of the UN Political Office for Somalia (UNPOS), which produced the “Mogadishu Roadmap,” international partners should work with these authorities to develop a common maritime security policy, which should include a shared strategy for the development of governance of Somalia’s coastline and key ports—Berbera, Bosaso, Mogadishu, and Kismaayo. Governance of these ports and the revenues associated with them, as well as Somalia’s coastal space more generally, will be crucial not only to developing a stable political settlement for Somalia, but also for addressing money laundering and terrorist financing issues because so much money laundering and terrorist financing in the country currently occurs through seaborne trade and piracy.

Third, there is a need to engage Somali remittance organizations (SROs). As the CGCC has recently explored at length in its study “Capitalizing on Trust: Harnessing Somali Remittances for

Counterterrorism, Human Rights and State Building,” developing effective AML/CFT strategies with those organizations may go a long way toward addressing Somalia’s and other East African and Horn states’ money laundering and terrorist financing risks and vulnerabilities. Additionally, that study suggests that SROs offer an important source both of social and financial capital for Somali reconstruction, which could be harnessed through the development of a Somali financial

reconstruction plan or even the offering of diaspora bonds to support local infrastructure projects.

Fourth, much more attention needs to be paid to reducing the opportunity for Somali actors to launder money offshore. There is increasing attention to the possibility of the UN Security Council adopting targeted sanctions against those involved in laundering the proceeds of piracy offshore. The council has also adopted sanctions

restricting the charcoal trade. States already have a range of diplomatic and criminal law tools at their disposal to buttress the new UN sanctions on the Somali charcoal trade. A coordinated effort to reduce these money laundering opportunities through bilateral cooperation, IGAD, the Gulf Cooperation Council, the Global Counterterrorism Forum (GCTF), and the Contact Group on Piracy Off the Coast of Somalia is within reach.

**NOTE ON THIS CHAPTER:** Due to concerns about the physical security of our researchers and to limited resources, no field visit was conducted inside Somalia. A limited number of interviews with officials and other stakeholders were conducted outside Somalia and through intermediaries inside Somalia. The analysis for Somalia should be read with additional caution because the modified methodology used may reduce the comparability of results for this jurisdiction and others treated in this Baseline Study. Results presented here may require further verification before they can serve as the basis for policy development.

## Risks and Vulnerabilities

Somali ingenuity and resilience in the financial sphere is remarkable, having sustained the Somali nation through decades of war and famine. Yet, the result of prolonged conflict and state collapse has been the absence of effective central state institutions in Somalia, which allows money launderers and terrorist financiers to operate almost entirely unhindered. By some assessments, Somalia is an “economy without a state.”<sup>55</sup> Emerging regulatory capacity in Somaliland and, to a lesser extent, Puntland does offer some prospect of change; but at present, much of the Somali economy remains deeply entwined with criminal activity, including piracy, especially in Puntland, and terrorism, especially in south and central Somalia, where Harakat al-Shabaab al-Mujahideen (al-Shabaab/HSM) and Hizb ul-Islam have their economic base.

Somalia has been in a situation of extended political instability, economic dislocation, and humanitarian crisis since the collapse of the Somali state in 1991 and has been transformed into the most volatile and insecure country in the Horn region. Somalia now represents the most significant source of money laundering and terrorist financing risk for the whole IGAD subregion, not only because of the absence of effective state institutions and the power of criminal and terrorist elements, but also because the Somali economy is surprisingly well integrated into the broader subregional and international economy. This is primarily a result of the key role played by the Somali diaspora in subregional informal money transfer arrangements.<sup>56</sup>

Conditions differ across Somalia, however, due to dissimilar economic and institutional arrangements, evolving along different political and institutional paths over the last 20

55. See Peter D. Little, *Somalia: Economy Without State* (Bloomington, Ind.: Indiana University Press, 2003).

56. Cockayne and Shetret, “Capitalizing on Trust.”

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years. Regional administrations have emerged in Puntland and Somaliland, and new administrations may now be emerging in parts of south and central Somalia, particularly around Gulmudug, Ximan, and Xeb and south of the Juba river. In this chapter, we separately analyze three different geographic areas and institutional settings: south and central Somalia, Puntland, and Somaliland.

Pastoralism is the main mode of subsistence for the bulk of the population across most of Somalia, and ports play a particularly important role in Somalia's political economy, as the interface between its domestic economy and regional and global trade. In the areas of the south abutting the Shebelle and Juba rivers and the coastal areas, agriculture and fishing, respectively, are important sources of livelihood. The ports of Mogadishu, largely controlled today by the TFG and the AU Mission to Somalia (AMISOM), and Kismaayo, controlled by militia affiliated with al-Shabaab, are central to the import/export economy of south and central Somalia. Berbera in Somaliland and Bosaso in Puntland play a similar role in those regions.

South and central Somalia, including much of Mogadishu, lacks a centralized functioning administrative apparatus. Local administrative authorities have begun to emerge in some communities, variously allied with the TFG or al-Shabaab. None of them exercises anything more than the most basic financial regulatory functions, in contrast to the regional administrations in Somaliland and Puntland. The plethora of competing authorities, coupled with the absence of a functioning criminal justice system, has led to *de facto* impunity for most illicit activities.

Money laundering is consequently unchecked. That said, the range of predicate offenses undertaken within south and central Somalia may be narrow. Although the trade in qaat is significant, it is entirely legal in Somalia and not a controlled substance as it is in most other states. The most

significant sources of money laundering are therefore probably piracy, human smuggling, informal charcoal trade, and corruption.<sup>57</sup>

In 2011 the country was rated by Transparency International as the most corrupt country in the world. The TFG, the internationally recognized government of Somalia that has until recently operated from neighboring Kenya, receives funding primarily from Western and Middle Eastern donors. In addition, a number of Western states, Arab League members, and some African countries provide bilateral security and relief assistance. The OECD estimates that the net value of these income streams amounted to \$384 million in 2007, \$758 million in 2008, and \$662 million in 2009. Recent research and reporting suggests that the vast majority of these flows cannot be tracked to their ultimate beneficiaries and that huge sums disappear from government coffers, often into private pockets.<sup>58</sup> This had been viewed as a relatively minor price to pay for political progress.<sup>59</sup> The 2012 London Conference on Somalia, however, suggests that donor patience has worn thin and that there is now an expectation of significantly improved financial governance in donor and political assistance to Somalia going forward, for example, through the creation of a Joint Financial Management Board.

Terrorist financing is also a major concern in its own right in south and central Somalia. Al-Shabaab's military control of large parts of south and central Somalia allows it to extract revenues almost at will from local licit and illicit economic activity. In particular, it has profited from trade-based money laundering through the port of Kismaayo.<sup>60</sup> In the Hobyo and Xarardheere area, the local al-Shabaab leader, Sheikh Hassan Afrah, has reportedly taxed piracy revenues. Some analysts suggest there may be growing operational links between pirate militias and al-Shabaab, both to move foreign fighters to and from Somalia and for arms trafficking purposes.

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57. Corruption includes misappropriation of TFG funding and tax receipts from Mogadishu air and seaports. See Ali Issa Abdi, "Somalia: Crisis in Economic and Financial Management," Horn Economic and Social Policy Institute, 2011.

58. See especially Jay Bahadur, "TFG Corruption: An Exclusive Report." *SomaliaReport.com*, 21 February 2012, [http://www.somaliareport.com/index.php/post/2855/TFG\\_Corruption\\_An\\_Exclusive\\_Report](http://www.somaliareport.com/index.php/post/2855/TFG_Corruption_An_Exclusive_Report).

59. ICG, "Somalia: The Transitional Government on Life Support," *Africa Report*, no. 170 (21 February 2011), pp. 13–14.

60. 2011 Somalia and Eritrea monitoring group report. On Kismaayo, see Ken Menkhaus, "After the Kenyan Intervention in Somalia," Enough Project, January 2012, <http://www.enoughproject.org/files/MenkhausKenyaninterventionSomalia.pdf>.

Pirates have a great amount of room to maneuver in laundering their proceeds. Although the precise amounts of ransom payments annually are a matter of guesswork, a recent FATF study estimated that ransoms rose from an average of \$150,000 per ship/crew in 2005 to \$5.2 million per ship/crew in 2010. Another estimate suggests that, in 2010 alone, approximately \$180–238 million was paid out in ransom payments. Some of this revenue appears to be spent immediately on consumer goods, but some is apparently being invested in real estate, especially in Puntland, Somaliland, and possibly further afield, including Djibouti, Kenya, the UAE, and perhaps Ethiopia. Studies suggest that some of these revenues are moved through cash couriers, others through xawilaad (SROs), and in a few cases, through direct deposit of ransoms into offshore bank accounts. There is strong anecdotal evidence that some officials, especially in Puntland, may be involved in or at least benefit from these activities.<sup>61</sup> There is an emerging strand of thinking that sees criminalizing the laundering of the proceeds of piracy as providing another means to deter and punish pirates and their collaborators.<sup>62</sup> UN Security Council Resolution 1976 opens up the possibility that, in the future, members states may be able to impose targeted sanctions on those offshore criminal networks who engage in or support Somali piracy money laundering.

The same criminal networks may be increasingly involved in maritime and transborder trafficking, including of humans and commodities. Both UNODC and the UN Office for the Coordination of Humanitarian Affairs have suggested that Somalia may be a transit country for East African and Horn trafficking routes to the Middle East.<sup>63</sup> UNODC argues that Somalia is the entry point for many of the small arms and light weapons trafficked throughout the subregion.<sup>64</sup> Trade in small arms and light weapons generates revenues

that constitute a source of support to insurgent groups and terrorist movements in Somalia and in neighboring countries. These networks are also integral to the cross-border trade in cattle; camels; agricultural goods, such as fruits and vegetables; qaat; and arms between eastern Ethiopia, northern Kenya, and Somalia. Much of this informal trade operates on the margins of legality, often involving tax evasion and cross-border price arbitrage but supporting Somali livelihoods.

Cross-border trade in sugar and charcoal is particularly lucrative and may be important from a terrorist financing perspective. Charcoal prepared by Somalis and exported to Persian Gulf states, mostly to the UAE, has been an important source of revenue for al-Shabaab, with a total trade volume ranging of 3.5–4.5 million sacks per year and representing about \$15 million a year in revenue to al-Shabaab. Because these sales occur in the UAE and elsewhere in the Gulf, this may provide an important entry point for short-term, focused AML/CFT efforts. Acting on a proposal from its Somalia monitoring team, the UN Security Council has recently imposed a ban on charcoal imports from Somalia.<sup>65</sup> The impacts on Somali livelihoods deserve close attention.

Charcoal is often traded in the Persian Gulf region for sugar and other basic foodstuffs, which are then imported back into al-Shabaab-controlled areas, primarily through the port of Kismaayo. Sugar imports, estimated to be 20,000–40,000 metric tons per year, are then smuggled overland to neighboring countries, particularly Kenya, where they are sold at a significant markup. Sales are not only used to reimburse charcoal exporters, but are also taxed by al-Shabaab. Kismaayo is thus a key node in the trade-based money laundering chain that sustains al-Shabaab.<sup>66</sup> This raises queries about whether states neighboring Somalia are doing enough to police the provenance of sugar and other goods imported

61. See UN Security Council, *Letter Dated 10 March 2010 From the Chairman of the Security Council Committee Pursuant to Resolutions 751 (1992) and 1907 (2009) Concerning Somalia and Eritrea Addressed to the President of the Security Council*. S/2010/91, 10 March 2010.

62. For instance, see Antonio Maria Costa, “Assisting Somalia to Deal With Its Pirates” (statement to the UN General Assembly, 14 May 2010), <http://www.un.org/ga/president/64/thematic/piracy/Antonio.pdf>; FATF, *Terrorist Financing*, 29 February 2008, <http://www.fatf-gafi.org/media/fatf/documents/reports/FATF%20Terrorist%20Financing%20Typologies%20Report.pdf>.

63. UNODC, *Organised Crime and Trafficking in Eastern Africa*, 2009, [http://www.unodc.org/documents/easternafrika/regional-ministerial-meeting/Organised\\_Crime\\_and\\_Trafficking\\_in\\_Eastern\\_Africa\\_Discussion\\_Paper.pdf](http://www.unodc.org/documents/easternafrika/regional-ministerial-meeting/Organised_Crime_and_Trafficking_in_Eastern_Africa_Discussion_Paper.pdf); UN Office for the Coordination of Humanitarian Affairs, “Human Smuggling and Human Trafficking in Somalia,” May 2006, <http://www.somali-jna.org/downloads/Human%20Trafficking.pdf>.

64. UNODC, *Organised Crime and Trafficking in Eastern Africa*, p. 24

65. See UN Security Council, S/RES/2036, 22 February 2012.

66. 2011 Somalia and Eritrea monitoring group report.

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via Kismaayo and to regulate the proceeds of sales of those goods. Still, as with charcoal, any restrictions on the sale of sugar or other foodstuffs for the purpose of AML/CFT efforts must be very carefully balanced against other significant public policy objectives, including the protection of livelihoods and the human security risks posed by the current drought and humanitarian emergency in the region.

## Current AML/CFT Efforts

The TFG's ability to constrain such activities is very weak. Any effort to build an effective AML/CFT system in Somalia must therefore be viewed as a very long-term prospect. At the federal level, Somalia lacks even the most basic building blocks of such a scheme, such as a law criminalizing money laundering and terrorist financing, effective police services that could enforce such a law, and financial regulators and banks that could prevent violations in the first place through collaborative risk analysis. A functional federal FIU remains, at this point, a pipe dream.

Although a Somali central bank was formally established under the TFG in 2006 and recently opened an office in Mogadishu,<sup>67</sup> it has no real operational capacity or reach. The financial actors that do have real reach into Somalia are the xawilaad, informal remittance organizations that evolved from traditional Somali financial practices. These institutions, however, cannot be expected to employ the centralized regulatory functions, such as analysis of STRs, investigation, and enforcement of criminal law norms, that are essential to the effective operation of an AML/CFT regime.

The absence of centralized regulatory authorities across much of Somalia has left economic policy at the discretion of local strongmen and clan leaders and in a highly fragmented state. As with other state-building interventions, any AML/

CFT effort for Somalia must grapple with the cost and benefits of supporting local and federal institutions. In many cases, local institutions currently show more promise in the short term, but supporting them risks undermining federal institutions and stoking Somali balkanization.

This is as much the case in financial regulation as anywhere else. The common Somali currency, the shilling, is entirely free floating, and its stability is affected by the ubiquity of other currencies. Since 1991, there have been frequent instances of private groups printing and importing new batches of Somali shillings. In response, large parts of the Somali economy have become dollarized. Since 1994, Somaliland has had its own currency, the Somaliland shilling. Mobile money is increasingly ubiquitous, with large parts of even rural Somalia enjoying surprisingly high levels of mobile penetration,<sup>68</sup> arguably giving private telecoms operators more regulatory power than territorially limited regional administrations. The UN Security Council recently imposed targeted sanctions on a Djiboutian national, in part on the basis that he founded a mobile money service (Zaad) as a conduit for financing al-Shabaab, taking advantage of the lax application of KYC standards in that business environment.<sup>69</sup>

The AML/CFT capacities of these administrations require some scrutiny. The Puntland's administrative capacity is relatively firmly embedded in the northeastern Somalia area it controls. The Puntland sociopolitical situation is stable compared to other regions of Somalia. The Puntland administration does not seek to secede from Somalia and sees itself as part and parcel of the Somali state to be reconstituted on a federal basis.<sup>70</sup> Yet, its administrative capacity is not substantially more sophisticated or effective than the capacity of the TFG. Puntland's coastline is more than 1,600 kilometers long, and it is the base for a significant livestock trade and increasingly piracy. The Puntland coastline provides many bases and safe havens for the operation of pirates who target international shipping in the Gulf of Aden and western

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67. See Central Bank of Somalia, "Properties," n.d., <http://somalbanca.org/>.

68. See Cockayne and Shetret, "Capitalizing on Trust."

69. See UN Department of Public Information, "Security Council Committee on Somalia and Eritrea Adds One Individual to List of Individuals and Entities."

70. See Transitional Puntland Constitution, art 2.4.

Indian Ocean. Puntland has received assistance from some international donors to combat piracy, but its capacity to tackle broader money laundering and terrorist financing issues is nascent at best. A Puntland central bank was established in 1999 in Bosaso, but its relationship with the Somali central bank is unsettled. For example, a recent agreement between the TFG and Sudan to print 5 billion Somali shillings (roughly \$150,000) led to criticism from the Puntland central bank because of its perceived inflationary impact. The independence of the central bank from local political authorities is difficult to gauge. It seems to have limited authority over private actors as well, as our researchers were informed that it had suggested enacting regulations governing remittances but had been forced to halt its efforts when remittance organizations complained to senior Puntland political leaders. Even if the central bank were to attempt to develop the capacity to identify money laundering and terrorist financing, it would likely find it difficult to act on any such analysis for at least two reasons. First, Puntland lacks a functioning criminal justice system. Both police and judicial services are in their early stages of development.<sup>71</sup> Second, some senior and local leaders in Puntland may benefit from piracy and associated money laundering.<sup>72</sup>

The most developed institutions can be found in northwest Somalia, in Somaliland.<sup>73</sup> Somaliland declared itself independent from Somalia in 1991 but has yet to receive formal recognition internationally. Its economy depends primarily on livestock exports, fishing, agriculture, and remittance flows from abroad. Its coastline extends 740 kilometers. The port of Berbera is beginning to develop rapidly, and it may assume a role similar to Djibouti in coming years as a gateway to the Ethiopian market, if current plans for its development come to fruition. There appears to be relatively little piracy activity in Somaliland, but it may be a site for

the laundering of piracy proceeds. Somaliland's lack of international recognition as a sovereign entity has affected Somaliland's access to international donor assistance and financial and capital markets. Its relative political stability, however, has led it to be perceived in recent years as an increasingly promising potential partner for external assistance. Somaliland has managed in the last 15 years to tax remittances flowing into Somaliland and use the resulting revenues to build increasingly effective public institutions. A Somaliland central bank was created in 1994, with several branches in different Somaliland cities. Somaliland has a developing police force, but as with Somaliland's other public institutions, its capacities remain fairly rudimentary. The Somaliland police publish reports on crime on an annual basis and, to date, have recorded no indications of any financial crime, including money laundering and terrorist financing.<sup>74</sup> This reflects the underdeveloped nature of Somaliland's formal financial sector. Commercial banking remains extremely limited, and no formal legislative framework governs it. Recent reports indicate that the Somaliland central bank was negotiating with the Banque pour le Commerce et l'Industrie, based in neighboring Djibouti, and two other private lending institutions to grant them licenses to operate in Somaliland. Most financial activity occurs in the informal sector, including through xawilaad. While this situation continues, the scope for effective AML/CFT activities will remain extremely limited.

Somaliland has demonstrated a growing awareness of the importance, at least to international donors, of AML/CFT issues. In 2004 an international conference and training workshop on AML measures was held in Somaliland, sponsored by the largest SRO, Dahabshiil.<sup>75</sup> Somaliland has included provisions in its penal code that criminalize certain forms of financial crimes, such as tax evasion and corruption on the

71. See IGAD, *Somalia Inland Strategy and Action Plan to Prevent and Counter Piracy 2010–2015*, 2010.

72. FATF, *Organised Maritime Piracy and Related Kidnapping for Ransom*, July 2011, <http://www.fatf-gafi.org/media/fatf/documents/reports/organised%20maritime%20piracy%20and%20related%20kidnapping%20for%20ransom.pdf>; Nicole Stracke and Marie Bos, "Piracy: Motivation and Tactics: The Case of Somali Piracy," Gulf Research Center, 19 February 2009.

73. References to "Somaliland" and "authorities of Somaliland" does not imply support or endorsement of the political claims of Somaliland.

74. See Qalinle Hussein, "Somaliland Annual Crime Statistics Released—2009," *Somaliland Press*, 20 March 2009, <http://somalilandpress.com/somaliland-annual-crime-statistics-released-2009-16866>; Qalinle Hussein, "Somaliland: Police Reveal 2010 Annual Crimes—Surge in Rape, Murder," *Somaliland Press*, 7 November 2010, <http://somalilandpress.com/somaliland-police-reveal-2010-annual-crimes-surge-in-rape-murder-19050>.

75. "International Conference on Anti-Money Laundering Held in Hargeisa," *Somaliland Times*, 7 August 2004, <http://somalilandtimes.net/2003/133/13303.shtml>.



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part of public officials but not, our research suggests, money laundering based on other predicate crimes. The presence of international actors working on related issues in Somaliland, such as the UN Development Programme (UNDP)—Rule of Law and Security Programme and UNODC, may offer entry points for working on such issues.

Discussions of AML/CFT issues in the Somali context are inevitably seen through the lens of interclan and interregional rivalries. In Somaliland, for example, media and official references to money laundering and terrorist financing are almost invariably framed with reference to piracy and extremist forces in the rest of Somalia. They are represented as “their” problem or a problem that outsiders are causing Somaliland rather than an issue involving activity emerging from within Somaliland.

An assessment of AML/CFT efforts must take into consideration the perception by local actors that much of the informal economic and financial activity described above is not illicit but is a legitimate source of income and livelihoods. The most immediately obvious issue is piracy. Many in Somalia deplore piracy and view the activities of the pirates as criminal and even contrary to Islam, but at the same time, widely believe that, in its inception, piracy was a defensive reaction to the uncontrolled overfishing and dumping of chemical wastes in Somali waters.<sup>76</sup> Similarly, trade in agricultural and consumer goods across Somalia’s borders may be perceived as a reflection of existing needs and the traditional economic links tying together people of Somali ethnicity, notwithstanding their separation by an international border. Likewise, AML/CFT efforts in relation to the remittance industry are perceived very differently by various local and international stakeholders. This has created pervasive distrust that has undermined AML/CFT regulatory efforts and may even have served to drive some xawilaad organizers away from effective regulation.

## Entry Points and Priorities

The absence of effective federal institutions and a formal banking sector inside Somalia means that efforts to build an effective AML/CFT system inside Somalia will require long-term commitment from international partners. In the meantime, there are four main entry points for improving AML/CFT capacities.

First, partners should work with authorities in Mogadishu, Puntland, and Somaliland to build effective financial regulatory institutions and criminal justice capacity, especially basic investigative and prosecutorial capacity. Such efforts should not be undertaken piecemeal, or they risk stoking fragmentation. Instead, international partners should look to work with the central banks of Somalia, Somaliland, and Puntland to develop a system of policy coordination and perhaps even information sharing on financial supervision issues, perhaps in coordination with the proposed new Joint Financial Management Board. Likewise, now that the TFG is taking increasing responsibility for governance in Mogadishu and there are signs of a federalized constitutional settlement emerging, there is scope for greater coordination between these authorities on criminal justice capacity-building efforts.

Second, building on discussions recently held in Mogadishu under the auspices of UNPOS, which produced the “Mogadishu Roadmap,” international partners should work with these authorities to develop a common maritime security policy for Somalia, which should include a shared strategy for the development of governance of Somalia’s coastline and key ports—Berbera, Bosaso, Mogadishu, and Kismaayo. Governance of these ports and the revenues associated with them, as well as Somalia’s coastal space more generally, will be crucial not only to developing a stable political settlement for Somalia,<sup>77</sup> but also for addressing money laundering and terrorist financing issues because so much money laundering and terrorist financing in the country currently occurs through seaborne trade and piracy.

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76. ICPAT, *Report on the Impact of Piracy on the IGAD Region, 2009*; IGAD, *Somalia Inland Strategy and Action Plan to Prevent and Counter Piracy 2010–2015*.

77. See Menkhaus, “After the Kenyan Intervention in Somalia.”

Third, there is a need to engage SROs. Developing effective AML/CFT strategies with those organizations may go a long way toward addressing Somalia's and other East African and Horn states' money laundering and terrorist financing risks and vulnerabilities. Additionally, however, SROs offer an important source both of social and financial capital for Somali reconstruction. International partners should work with them to harness that capital, for example, by developing a plan for the rollout of formal banking services across Somalia with AML/CFT standards and practices incorporated. A partnership among international donors, IFIs, and SROs to offer diaspora bonds to finance local reconstruction projects might offer an innovative way to leverage the diaspora's access to capital, willingness to finance Somali reconstruction, and low aversion to currency and political risk, when compared to international capital markets.

Fourth, much more attention needs to be paid to reducing the opportunity for Somali actors to launder money offshore. There is increasing attention to the possibility of the UN Security Council adopting targeted sanctions against those involved in laundering the proceeds of piracy offshore. The council has also adopted sanctions restricting the charcoal trade. States already have a range of diplomatic and criminal law tools at their disposal to put pressure on individuals who facilitate the financing of al-Shabaab through such money laundering activities; they should use these tools to buttress the new UN Security Council sanctions. A coordinated effort to reduce these money laundering opportunities, through bilateral cooperation, IGAD, the Gulf Cooperation Council, the GCTF, and the Contact Group on Piracy Off the Coast of Somalia is within reach.

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# 7. South Sudan

## KEY FINDINGS AND RECOMMENDATIONS

The newest state in the world, South Sudan has a number of characteristics that may make it especially vulnerable to money laundering, if not terrorist financing. It has extremely weak financial governance capacity and very low AML/CFT awareness, although it recently criminalized money laundering. High-value cash transactions are common. Foreign exchange bureaus are proliferating and largely unregulated. There is growing alarm about corruption, especially in the oil sector and public procurement processes.

Yet, there appears to be a disconnect between these high-risk indicators and the attention being paid both by

national regulators and international actors to AML efforts. Despite growing international concern around corruption, there appears to be only limited international effort to block the avenues through which the proceeds of corruption may be being laundered, including through cross-border transfers out of South Sudan. There are even some signs that South Sudan may be becoming a conduit for money laundering from other jurisdictions in the region.

AML/CFT efforts in South Sudan are in their infancy. An AML bill was apparently approved by the Cabinet in March 2012, but its text is not yet publically

available, and our research suggests that it may not contemplate the creation of an FIU. Regardless, the awareness of government officials on AML/CFT officials is extremely low.

Our research suggests three particularly promising entry points for strengthening AML/CFT efforts in South Sudan: (1) influencing the development of the AML bill as it proceeds to parliamentary approval, including to provide for the creation of an FIU; (2) developing a narrative connecting AML/CFT efforts to effective anticorruption efforts; and (3) long-term institutional strengthening, particularly to improve governmental supervision of the financial sector.

**NOTE ON THIS CHAPTER:** South Sudan joined IGAD in late November 2011, only weeks before this study was conducted. Its regulatory and political environment is highly fluid. In contrast to other IGAD member states, little background material or desk research existed on South Sudan's financial systems and regulatory capacity. Most resources did not sufficiently disaggregate analysis or information between the former regions of northern Sudan and southern Sudan (now the Republic of South Sudan) or had an almost exclusive focus on the north, historically the more advanced economic area of the country. As such, the primary basis for the analysis in this report is the interviews conducted by the researcher in Juba, South Sudan, in December 2011.

## Risks and Vulnerabilities

National government authorities in the Republic of South Sudan have a very limited understanding of money laundering. From government ministries to the security services to the central bank, few interlocutors interviewed for this study could articulate a comprehensive definition of money laundering or understand its practical implications for the economy, let alone claim familiarity with FATF recommendations or regional AML conventions. Of the state institutions interviewed, the Office of the Auditor-General was most conversant with the concept of money laundering.<sup>78</sup> Even officials who have helped draft a new AML bill, recently approved by the Cabinet, had difficulty articulating a comprehensive definition. Within existing legislation, there is no formal legal definition of money laundering,<sup>79</sup> though the new AML bill, once approved by Parliament, will provide one and apparently set up an FIU.<sup>80</sup>

Still, the same interlocutors understood that, with an almost exclusively cash-based economy, weak regulatory systems, and the apparatus of state still formative, South Sudan is extremely vulnerable to money laundering. Without any serious monitoring of financial flows, on what scale and to what degree money laundering is or could be occurring was beyond the imagination of most interlocutors consulted. This perception of vulnerability was not specific to money laundering offences, as it existed with regard to most other criminal offenses, which South Sudan is presently ill-equipped to address. Money laundering did not appear to be a greater worry than other types of national or transnational crime.

The most common understanding of money laundering by local authorities and the public sector was itself revealing. The majority of interviewees thought that money laundering was a crime exclusively related to the money supply itself, i.e., forging or tampering with currency notes. The introduction

of the new South Sudanese pound shortly after independence in July 2011 is commonly believed to have made the currency a target for forgers, given the population's limited familiarity with the new money. The heavy dollarization of the economy was further cited as a risk, where forged U.S. dollars could be easily introduced into circulation. This misunderstanding of money laundering stems in part from a lack of knowledge of more appropriate terminology. More fundamentally, our research suggested a lack of appreciation of the possibility that separate crimes could be linked, that a primary, predicate crime could be coupled with a secondary act of money laundering. This deficiency in understanding reinforced the belief that financial crimes were about the money supply itself.

Those with a more developed understanding of money laundering were not particularly worried about the prevalence of the problem in South Sudan. Staff at the Anti-Corruption Commission noted that "one or two cases" had involved money laundering but that the practice was far from common and the majority of their complaints lay elsewhere. The Anti-Corruption Commission's 2010 annual report takes a similar line. Technocrats who drafted the AML bill at the central bank felt that money laundering was "primarily an international problem." Although South Sudan was "very much exposed," money laundering was not a significant issue, but compliance international standards made adoption of such regulations necessary. South Sudanese Ministry of Justice officials could not recall a single case of money laundering investigated, let alone prosecuted, since 2005.

When predicate crimes were discussed, the most commonly cited offense after currency fraud was institutional and petty corruption. By officials and citizens alike, corruption is perceived to be one of South Sudan's greatest problems.<sup>81</sup> By some estimates, billions have been embezzled or stolen from the state treasury since South Sudan gained initial semiautonomous self-rule from the government in Khartoum in 2005.

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78. Our research did not include an interview with the Ministry of Finance, where no appointment was granted.

79. The nearest current reference to money laundering is found in section 386 of the Penal Code, pertaining to illegal drugs.

80. "South Sudan Criminalizes Money-Laundering," *Sudan Tribune*, 17 March 2012, <http://www.sudantribune.com/South-Sudan-criminalizes-money,41936>.

81. National Democratic Institute and U.S. Agency for International Development, "South Sudan Post-Referendum Study: Preliminary Findings," 2011, <http://www.ndi.org/files/Post-Referendum-South-Sudan-Study-Preliminary-Results.pdf>.

82. Southern Sudan Audit Chamber, "Report of the Auditor General, 2005," 2011; Southern Sudan Audit Chamber, "Report of the Auditor General, 2006," 2011.

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Our research also suggested that South Sudan may only become more vulnerable to such activities in the initial years of the new state's independence. Following independence from Sudan in July 2011, the size of the state's treasury and the possibility of further theft from the state has grown. Poor procurement practice, including the awarding of contracts of inflated value and a heavy reliance on uncompetitive, sole source tendering, and bribery in tender selection are problems across all government ministries, as the auditor-general identified in his published annual reports for 2005 and 2006. Several interviewees noted incidents where senior officials had been caught crossing the border into Uganda with millions of dollars of cash, the provenance of which was suspicious. Presumably, with few sources of independent wealth, such transactions could only have occurred as a result of the looting of state resources, meaning that proceeds of predicate crimes committed in South Sudan are laundered abroad.

The final concern expressed by several interviewees on the question of money laundering did pertain directly to the financial sector. Many, including central bank officials, cited the proliferation of foreign exchange bureaus in recent years as suspicious and felt that the low capital-reserve requirements had encouraged more bureaus to open.<sup>83</sup> Many suspected that operating licenses had been granted on the basis of connections with senior ruling party officials as an effective license to print money because bureaus can obtain foreign exchange at the official and effectively fixed central bank rate and achieve a hefty and rapid profit through leakage to the heavily patronized black market.<sup>84</sup> One official asserted that foreign exchange bureaus were, by volume, handling a greater turnover of transactions than the commercial banks. Little evidence of actual leakage from foreign exchange bureaus was offered, although many people offered anecdotes that they believed proved sufficient demonstration that the practice existed, citing, for example, common rumors that certain bureaus were owned by close relatives of central bank officials.

On all fronts, the private sector, principally the banks, demonstrated a stronger understanding of money laundering. Most business people, however, did not believe money laundering had much relevance to their commercial activities, seeing the problem as one exclusively for the financial sector and the regulatory agencies. Most of the bankers interviewed, even those from local South Sudanese banks, are career professionals from outside South Sudan. Their understanding of money laundering and AML activities was a result of their past professional experience and regulations at the parent bank or financial group with which their South Sudan subsidiary was associated, rather than as the result of local regulation or information sharing with South Sudanese authorities. KYC and AML policies were internally adopted on the basis of the need to comply with international regulations to maintain correspondent banking relationships and commercial viability, not because of any legislative requirement imposed in South Sudan.

Despite the bankers' professional experience, there were differences in perception about the scale of money laundering. Several suggested that South Sudan had no money laundering problem because the majority of transactions were of modest value and that money laundering could only be defined as transactions of "millions" of dollars. Some posited that the crime was of a level of financial sophistication not currently possible in South Sudan. Others suspected money laundering was taking place, but that if it were, the banking sector had no part in it. Those holding this view blamed the lax controls at foreign exchange bureaus and other informal banking institutions.

One banker did cite general commerce as being a possible avenue for money laundering vulnerabilities. Hard currency transfers out of the country are permitted on the basis of import invoices. Without verification that the same imports actually arrive in South Sudan and without verification of the price and value quoted on the supporting documents, money could easily leave the country under false pretences. Customs controls are perceived as being weak and easily

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83. According to the Bank of South Sudan, 75 foreign exchange bureaus are currently licensed to operate, although there are up to 140 different companies rumoured to be operating. The minimum capital reserve required is \$300,000.

84. The prevailing black market rate in December 2011 was approximately 3.7 South Sudanese pounds/U.S. dollar versus an official exchange rate of 2.7. Leakages of hard currency would achieve a return of approximately 40 percent.

manipulated, and there is little confidence in the aggregation of information from different agencies (banks to customs to regulators). Customs agencies are also viewed with some suspicion: James Yuang Anyieth, the former customs director-general, was removed in 2010 after corruption allegations were raised although no charges have yet been proven.

Larger regional macroeconomic implications were discussed in the context of overall state stability, which continues to challenge South Sudan. There was little concern that South Sudan could become an attractive jurisdiction for illicit financial flows if its regulatory system was perceived to be much weaker than that of neighboring states. In fact, the opposite concern was raised: some feared that Sudan, now suffering from a decline in national revenue due to the loss of most oil fields to South Sudan, was trying to destabilize its former territory by depriving Juba of hard currency. In this narrative, South Sudan, rather than being a jurisdiction responsible for money laundering due to weak internal controls, was instead a victim of a predatory Khartoum regime, which, as an international financial pariah, needed to channel resources through other jurisdictions.

It was impossible to assess national perceptions of the implication of noncompliance with FATF recommendations, as no single interlocutor in the public sector could be found with prior familiarity with FATF. The bankers interviewed dismissed FATF regulations as being far too advanced for South Sudan to consider at this stage.

Overall, awareness and knowledge of money laundering and money laundering risks and vulnerabilities in South Sudan is low. The understanding of the issues appears to be confined to a very small number of officials, not all of whom are in positions of decision-making, as well as to the managerial levels of private sector financial institutions.

Those we consulted in the diplomatic community did not believe that money laundering was presently a widespread

problem for South Sudan, citing a lack of financial sophistication and a relatively rudimentary banking and financial transfer system. Most were careful to not rule out the occurrence of money laundering, citing limited transparency in the financial sector, sparse reporting data from the central bank and Ministry of Finance, and a general lack of knowledge concerning financial flows outside the national capital.

Most interlocutors worried that weak financial controls and the limited capacity of the state to govern and oversee the financial sector amounted to serious deficiencies that could be exploited. The limited capacity of the state was a key concern. One diplomat noted that the central bank has yet to produce an annual report and only recently began holding advisory meetings. Another noted that although banking enforcement directives do exist, banking supervision is either absent or done poorly, and the central bank lacks a supervisory relationship with the financial sector, instead working as a commercial actor rather than a regulator.<sup>85</sup> Some suggested that the leading Kenyan commercial bank in the South Sudanese market plays an effective policymaking role in banking regulation and financial policy.<sup>86</sup>

Commenting on the foreign exchange bureaus, external observers believe the volume of legitimate local commercial activity could not require so many separate companies and that there was a high probability of irregular transactions occurring behind the counter of reputable business. International actors question why the central bank has been reluctant to tighten controls on the informal financial transfer sector and validate the claim that powerful political figures are insulated from any regulatory action.

In terms of revenue, South Sudan's economy is dominated by the oil sector. Ninety-eight percent of 2010 GDP was derived from the oil sector. The risk of money laundering arising from oil transactions was not raised by interlocutors in direct interviews, but a news article quoted an anonymous U.S. official, when talking about South Sudan, saying that

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85. For a detailed overview of the capacity of the financial sector in South Sudan, see BMB Mott MacDonald, "Financial Management Agent Capacity Building Trust Fund, Quarterly Progress Report (July–September 2011)," October 2011, [http://www.cbt-southsudan.org/sites/default/files/fma\\_progress\\_report\\_september\\_2011\\_0.pdf](http://www.cbt-southsudan.org/sites/default/files/fma_progress_report_september_2011_0.pdf).

86. This bank denies its influence, but its competitors allege that its dominant position in the banking sector in South Sudan makes it an extremely powerful actor in the economy, and there are perceptions that the bank is manipulating the market. Anonymous sources interviews with researcher, December 2011.



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“[h]igh money laundering risks, especially in countries and regions with a history of conflict and corruption, and with the oil industry are not unusual, and U.S. financial institutions involved in that business should be familiar with controls that can mitigate these sorts of risks.”<sup>87</sup>

International actors tend to agree that, despite these risks, money laundering is not yet a serious problem in South Sudan and that the state itself does not perceive the problem to be a top priority among many other urgent issues. There is an interesting disconnect, as most international actors also concur that state corruption is already endemic in South Sudan and probably getting worse. The mechanisms of how officials and politicians have been able to divert funds and state resources are not seen as the key foci for anticorruption efforts.

Some internationals suggested South Sudan was a conduit for money laundering activity originating elsewhere in East Africa and possibly also with West African criminal networks. Two interlocutors noted that some evidence suggested proceeds arising from Somali piracy were entering South Sudan. South Sudan was an attractive destination for surplus cash given market saturation elsewhere in East Africa; as part of a diversification strategy; because lucrative returns on investment in the new capital of Juba could be realized; and because large cash transactions are not seen as particularly unusual or alarming and are actually the preferred means of doing business.

## Current AML/CFT Efforts

At best, money laundering ranks as a midlevel priority compared to other matters of crime prevention in South Sudan, in part due to the limited understanding of what constitutes the crime of money laundering. Nevertheless, there is apparent political willingness to introduce AML

measures in the form of national legislation, despite many competing political priorities in the few months since independence and the general sentiment that fighting money laundering is not a particularly urgent law enforcement priority. Indeed, it was recently reported that the Cabinet had approved an AML bill criminalizing money laundering and seeking to establish an FIU. The draft bill was not available for public review.

Addressing the predicate crime of corruption is certainly perceived by national and international actors as a critical priority, and although AML/CFT efforts have not been frequently understood to be linked to anticorruption efforts in South Sudan, the nature of corrupt practices relies on access to the financial system to launder the proceeds of crime. On numerous occasions, South Sudanese President Salva Kiir has reiterated a strict anticorruption agenda and promised action.<sup>88</sup> Equally, the newly appointed chair of the South Sudan Anti-Corruption Commission has vowed to take a more activist line. Yet, there is widespread disappointment at the ability of the commission to act since its formation in 2005–2006, and individuals we interviewed expressed suspicions that the government has little interest in seriously pursuing senior figures implicated in corrupt practices.

The first test of this political commitment will be its translation into legal requirements. Having inherited most of the national regulatory and legislative framework from (northern) Sudan, South Sudan is embarking on the wholesale drafting and adoption of new legislation. As part of this legal reform, an AML law has been drafted by the central bank in consultation with legal advisors and apparently recently approved by the Cabinet. It will now move to the National Assembly for adoption. Given the volume of legislation pending and the historical record of the National Assembly to move slowly, it may be some time before the AML act is promulgated. Central bank officials confirmed that they are working on further interim regulations in the absence of a formal law, although they were unwilling to disclose the scope and detail of these regulations.

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87. TrustLaw, “Oil-Related Corruption in South Sudan Poses ‘High’ Laundering Risk, U.S. Treasury Official Says,” 21 July 2011, <http://www.trust.org/trustlaw/news/oil-related-corruption-in-south-sudan-poses-high-laundering-risk-us-treasury-official-says/>.

88. For example, see “South Sudan’s President Salva Kiir to Fight Corruption,” *BBC News*, 21 September 2011, <http://www.bbc.co.uk/news/world-africa-15000900>.

The creation of an AML bill does not indicate that the South Sudanese government anticipates further AML/CFT efforts. Principal contributors at the central bank to the draft AML act were unfamiliar with the concept of an FIU, although reports suggest one is contemplated by the draft bill. Central bank interlocutors requested the researcher provide them with further details of FIUs in other IGAD member states.

Three law enforcement agencies hold primary responsibility for AML activities: the Ministry of Justice; the Ministry of Interior, under which the police service and customs department fall; and the National Security Agency. The Anti-Corruption Commission involves itself in AML issues, but it has worked reactively in response to complaints received rather than taking the initiative to begin new inquiries. The primary investigative work seems to have been conducted by the central bank, with the police service involved at the central bank's direction. Again, most investigative activity has focused on currency forgery, although recently there have been attempts to curb black market trading of foreign currency, primarily through sweeps of street traders.

Apparently, no standard operating procedures, guidelines, or mechanisms for reporting suspicious transactions currently exist. The banking and nonbanking supervision departments of the central bank consist of a handful of staff, with neither the investigative capacity nor the resources to investigate suspicious transactions. There are no formal institutional state mechanisms to coordinate AML activities. The National Security Agency was keen to insist it was playing a leading role in economic investigations, but this did not appear to be substantiated.

Moreover, no efforts have been made to engage public stakeholders, the business community, or civil society organizations. Local civil society has no awareness of AML efforts. Law enforcement agencies readily conceded the lack of a systematic AML effort but generally believe that one is not yet required and refer again to the lack of cases arising over the last six years. Outside of the banking community,

there was almost no familiarity with the activities of the central bank to police AML issues. During our research, no one from the business community was aware that a draft AML law had been submitted to the Ministry of Justice. The overall perception in the business community appears to be that South Sudan has no capacity to realistically pursue AML efforts. Most banks have a negative view of the capacity of the central bank to act as an effective regulatory or supervisory agency and place primacy on their own KYC and AML internal regulations. Consequently, the banks believe that other, less reputable financial institutions, such as money transfer companies and foreign exchange bureaus, are easily able to circumvent central bank regulation.

The picture is not very different among the international actors present in South Sudan, who are well aware of the weakness of AML efforts in South Sudan. No one in the diplomatic corps appears to be specifically following AML efforts, and no one interviewed had heard about the draft AML law. This lack of awareness is not unusual, as the current reform and transition process is haphazard and often non-transparent.

Most international actors are sympathetic to the challenges of the new nation, even as they are worried or critical about its progress so far. Most concur that the central bank and Ministry of Finance are not yet ready to play a meaningful oversight role. This sentiment extends far beyond AML policy and is felt on all matters of economic management.<sup>89</sup> Similarly, law enforcement agencies, which are still struggling with state-wide insecurity and basic questions of policing, are seen as having little ability or capacity to address more sophisticated economic crimes.

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89. For example, Norway, the United Kingdom, and the United States recently sent a formal complaint to South Sudan on what they viewed as an irregular and irresponsible foreign exchange rate policy.

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## Entry Points and Priorities

Our research suggests three particularly promising entry points for strengthening AML/CFT efforts in South Sudan. First, as the government is currently developing an AML bill, it should seek expert advice and input from relevant international partners, including the UN Mission in the Republic of South Sudan (UNMISS), UNODC, bilateral partners, and FATF if possible, to ensure it reflects international standards and best practices.

Second, there may be scope for international actors to begin a coordinated effort to create a narrative framing AML/CFT efforts as a necessary component and even a fast-track path to effective anticorruption arrangements. Explaining the connections between AML/CFT and anticorruption issues will help ensure that AML/CFT issues receive attention, given the growing concern about corruption. At the same time, it will help ensure that anticorruption efforts benefit from the significant resources available through AML/CFT donor assistance channels. Such an effort might be taken through outreach by the diplomatic corps, but it may be useful for international institutions, including UNMISS and IGAD, and the IFIs to look for opportunities to engage South Sudanese officials in discussions of AML/CFT and anticorruption issues, in South Sudan and abroad. Respected international civil society organizations, such as the CGCC or Transparency International, or the Financial Services Volunteer Corps may also have a role.

Third, there will be scope for long-term capacity-building to strengthen supervision of South Sudan's financial sector. The focus here should be on strengthening institutions, rather than individual training. The absorption capacity of all national counterparts is limited, and there is a danger that more classical training efforts will overwhelm recipients. Greater facilitation of partnerships with regional counterparts, such as other central banks, FIUs in the region, and the ESAAMLG, would provide institutions in South Sudan with a genuine opportunity to learn best practices while integrating them into emerging regional cooperation efforts on these issues.

# 8. Sudan

## KEY FINDINGS AND RECOMMENDATIONS

Sudan's isolation from the international financial system and the apparently continuing interpenetration of the commercial sector, the ruling party, and the state make it difficult to assess the true state of financial governance in the country. Many external observers remain deeply concerned about its vulnerabilities to money laundering and terrorist financing, given its heavy reliance on cash transactions, its porous borders, and the opacity of some commercial dealings.

Yet there are also some promising signs of institutional reform. In 2010, Sudan

adopted the *Money Laundering and Terrorist Financing Act*, which has created an independent and functional FIU. That FIU has plans to adopt an electronic STR system and works smoothly in a formalized interagency coordination framework. Also, Sudan has reportedly created a presidential committee to tackle corruption. There remain some signs of weak AML/CFT capacity in law enforcement institutions. The extent of the involvement of customs and border control authorities in AML/CFT discussions was difficult to establish conclusively, but evidence of pro-AML/CFT reforms points to

meaningful opportunities for supportive engagement by external actors.

Priority should be given to strengthening the FIU. Given Sudan's continuing financial ties to the Middle East and North Africa, these efforts may perhaps be best led by MENAFATF, of which Sudan is already a member. There may also be a role for other supportive actors, such as the Egmont Group, which Sudan has applied to join, and the GCTF Horn of Africa Region Working Group.

**NOTE ON THIS CHAPTER:** Interviews for this study regarding topics involving Sudan were conducted by a non-Sudanese researcher in Khartoum from early to mid-December 2011. Due to logistical constraints, it was not possible to meet a number of important actors, including officials from the state audit chamber, the economic intelligence department of the National Intelligence and Security Service, or the customs department. The banking sector was underrepresented in interviews. A number of other interviews were chaperoned, possibly limiting the scope of the interviews and the authoritativeness of certain findings in this report. Sudanese officials have provided extensive commentary critiquing an earlier draft of this report. Where appropriate, their concerns about our methodology and findings have been noted below.

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## Risks and Vulnerabilities

Sudan, among Africa's largest and least-developed countries, has long been considered by financial sector regulators to be highly vulnerable to terrorist financing. After the United States and other international actors imposed comprehensive economic and financial sanctions, Sudan has had significantly limited access to the international financial system. This financial isolation and a largely agricultural economy dominated by the state have left Sudan's financial system potentially vulnerable to manipulation and potentially to money laundering and terrorist financing in various forms.

Nevertheless, foreign observers engaged for this study inside and outside Sudan offered only cautious analysis of specific money laundering and terrorist financing risks and vulnerabilities in the country. A lack of economic transparency in Sudan, coupled with state control over a large swath of the private sector, makes it difficult for external actors to offer informed opinions on the prevalence of financial crime. Our findings in this section of the report must therefore be received with heightened caution. Diplomats interviewed for this study would not offer firm opinions on the prevalence of money laundering in Sudan and on the most likely predicate crimes. Some individuals interviewed and secondary analysis reviewed for this study raise suspicions that some financial crimes in Sudan may involve politically connected figures. Yet, these claims have not been conclusively verified by this study. Sudanese officials that reviewed an earlier draft of this study emphasized their belief that our reliance on a foreign researcher in developing the analysis presented in this section undermines the reliability of this analysis, as it amounts to a series of "impressions rather than referenced and documented evidence."

That analysis suggests that some risks and vulnerabilities to money laundering and terrorist financing in the country may stem from structural conditions. There was consensus among the foreign and Sudanese interview subjects that Sudan's financial sector continues to encounter serious

challenges despite significant recent reform efforts. Public sector debt remains at worryingly high levels, and tackling the budget deficit has required severe budget cuts to public expenditures. Macroeconomic concerns raised the possibility of a return to war with South Sudan and increased military expenditures in the ongoing conflicts in Darfur, South Kordofan, Abyei, and Blue Nile. Affecting business, government, and citizens alike, the current foreign exchange shortage, due to a substantial reduction in oil revenues following the secession of South Sudan and changes to revenue sharing agreements, has caused the black market in foreign exchange to resurge, and a parallel rate of exchange has now developed. The recent departure of the UN Mission in Sudan and the termination of employment for thousands of local staff have further decreased the inflow of foreign exchange. Inflation has risen to 19 percent, which is higher than government targets. These factors do not necessarily correlate with increased money laundering, but interview subjects expressed concern that overall weakness in the economy could open the door to increased money laundering activity. Understandably, Sudanese officials expressed significant reservations about whether such a correlation could be established on available evidence.<sup>90</sup>

Particular concern exists about the robustness of controls within Sudan's banking sector. Sudan's commercial retail banking system remains undeveloped. Some interviews conducted for this research suggested that state-owned banks are occasionally subject to political pressure, although this historically has proven difficult to document because in part many banks operate with only partially computerized systems and reliance on paper records is still substantial. More financially significant, Sudan's banks struggle with a high rate of nonperforming loans, many of which are rumored to be held by influential politicians and their supporters. IMF figures show recent improvement, with the proportion of nonperforming loans falling to 17 percent at the end of September 2010, down from 20 percent a year earlier and from 22 percent in 2008.<sup>91</sup> The IMF had warned that, "[i]n particular, the financial position of Omdurman National Bank—which accounts for nearly half of the [nonperforming

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90. Sudanese counterterrorism officials, written communication with editors, April 2012 (on file with editors).

91. IMF, "Sudan: Second Review Under the 2009–10 Staff-Monitored Program—Staff Report; Staff Supplement; and Statement by the Executive Director for Sudan," *IMF Country Report*, no. 11/86 (April 2011), <http://www.imf.org/external/pubs/ft/scr/2011/cr1186.pdf>.

loans] and 25 percent of bank lending—remains difficult.”<sup>92</sup> Sudanese officials suggested that this case was unique and did not represent a broader weakness in the Sudanese financial system.

Researchers for this study concluded that bank weaknesses in general operations and lending decisions are mirrored in bank regulatory compliance issues. In 2005 the World Bank and IMF Financial Sector Assessment Program (FSAP) found that the Bank of Sudan “does not enforce the requirement to pay special attention to unusual transactions. There has not been a single enforcement action taken against non-compliant banks.”<sup>93</sup> This situation may have changed. Interviewees felt that, in recent years, the central bank had improved its supervisory oversight of the banking system, and privatization of a number of state banks has taken place. Sudanese officials argued that the government has taken extensive steps to improve oversight.

Indeed, more than a decade of pressure from the international community appears to have led to an awareness of AML/CFT issues in Sudan that appears to be demonstrably higher than that found in many other IGAD states. The concept of money laundering was frequently and spontaneously raised in interviews conducted with Sudanese officials in the context of terrorist financing activity, which appears to be a major preoccupation of security and police officials. Sudanese technocrats and financial sector officials are familiar with the concept of money laundering, but awareness of the crime at more operational levels of government, particularly in law enforcement, appears to be weaker. With the notable exception of FIU officials, in interviews with regulatory and law enforcement officials, money laundering is perceived as a relatively “new” crime and not an endemic problem in the Sudanese economy.

Still, policymakers accept that Sudan is vulnerable to money laundering and appear to be making a serious effort to strengthen Sudan’s AML/CFT arrangements. Legislation adopted in 2010 updated the definition of money laundering.

There shall be deemed to commit the offence of money laundering any person whose conduct entails acquiring proceeds, possession, disposal of, use, transfer, administer, keep, exchange, deposit or investment by cheating its value, movement, or lead to conceal, camouflage its source, real nature, place, way of disposal, ownership, rights relating thereto whether the offence occurred from which proceeds resulted inside or outside the Sudan on condition that it is punishable in the Sudanese law and the law of the country in which the offence committed.<sup>94</sup>

Terrorist financing is defined in the same section of the act. These definitions appear to broadly comply with international norms. The Sudanese government has stressed its belief that it is complying with international standards. In its 2011 report to the UN Security Council on implementation of Resolution 1624, it stated, “The Sudan has tried to ensure that its counter-terrorism laws are consistent with international requirements and in accordance with the relevant international counter-terrorism instruments. That is particularly clear in the 2001 Counter-Terrorism Law and the 2010 Anti-money Laundering and Financing of Terrorism Law.”<sup>95</sup>

Sudanese officials stressed similar points, but our research suggests that the adoption of these laws may be aimed primarily at an external audience rather than being pursued as a basis for internal reform. Most of the individuals interviewed for this study were preoccupied by larger, structural weaknesses in the economy and had little desire to dwell on

92. IMF, “Sudan: Article IV Consultation—Staff Report; Debt Sustainability Analysis; Staff Statement; Public Information Notice on the Executive Board Discussion; Statement by the Executive Director,” *IMF Country Report*, no. 10/256 (June 2010), <http://www.imf.org/external/pubs/ft/scr/2010/cr10256.pdf>.

93. IMF and World Bank, *Financial Sector Assessment Program: Sudan: Detailed Assessment of Observance of the AML/CFT Standard*, April 2005, [http://inweb90.worldbank.org/FPS/fsapcountrydb.nsf/\(attachmentwebSC\)/Sudan\\_DAweb.pdf/\\$FILE/Sudan\\_DAweb.pdf](http://inweb90.worldbank.org/FPS/fsapcountrydb.nsf/(attachmentwebSC)/Sudan_DAweb.pdf/$FILE/Sudan_DAweb.pdf) (hereinafter FASP 2005 report).

94. Money Laundering and Terrorism Financing Act, 2010, art. 33. This act replaced the Combating Money Laundering Act, 2003. Quotation is from the official English translation provided by the Ministry of Justice.

95. UN Security Council, *Letter Dated 17 May 2011 From the Chair of the Security Council Committee Established Pursuant to Resolution 1373 (2001) Concerning Counter-Terrorism Addressed to the President of the Security Council*. S/2011/324, 23 May 2011.



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money laundering. When engaged, former and current central bank officials stressed their belief that money laundering was not a systemic problem in Sudan. The primary motivation, they told us, behind tightening money laundering regulations was to ensure international cooperation and compliance. Law enforcement officials agreed, citing the few cases they had to investigate. Sudanese counterterrorism officials commenting on this conclusion in an earlier draft of this Study disagreed, arguing that the intent of these reforms was serious and that foreign observers' lack of understanding of internal reform efforts does not warrant such a conclusion.

During our interviews, only officials from Sudan's FIU explicitly worried about the possible scale of money laundering in Sudan. Forty suspected cases are under investigation, but the FIU feared there could easily be more that have not yet been identified. Still, the FIU was proud of its progress, having only been established in 2010, and felt that although Sudan may not be deemed to be fully compliant with FATF recommendations, the country was well on its way to achieving broad compliance. Central bank and FIU officials were not concerned by the implications of noncompliance with FATF recommendations. Given Sudan's substantial progress since 2005, there was an expectation that the upcoming FATF mutual evaluation would be positive.

The FIU felt that, among the financial sector, awareness of money laundering issues was not very high. In the view of FIU officials, the private sector presents a high source of risk, given this lack of awareness among the commercial class. One of the primary concerns cited by the FIU was the attitude among banks that reporting requirements for suspicious transactions were unduly burdensome. Although complaints had decreased following an increase in the threshold for reporting suspicious transactions, FIU officials worried that some banks failed to report all transactions to avoid additional paperwork, meaning some potential money laundering activity never came to the attention of the FIU.

At least part of the relatively minimal concern about money laundering seems to be linked to awareness of the issue among law enforcement personnel. Even senior-level law enforcement officials were unaware of the 2010 AML act.

The police offered suggestions for what they saw as the most common predicate crimes: tax evasion, drug and arms trafficking, and human trafficking. Some smuggling of commodities was thought to occur, but the police did not have statistics available, suggesting that the customs department might have kept more comprehensive information. The police's general lack of concern about smuggling seemed to clash with their seemingly linked concern about porous borders, with Chad, Eritrea, Ethiopia, and Libya being cited as the most problematic. Illicit cross-border activity was thought to be a key driver of money laundering activity, but the police had no statistical evidence to support this assertion. Sudanese officials consulted on an earlier draft of this report stressed that customs authorities have collaborated with the FIU to restrict cross-border currency movements.

The business community had a similar preoccupation with structural economic issues. With a current hard currency shortage, the black market has become visible again in urban centers, and businesses have little choice but to seek hard currency outside official channels to continue to finance imports. As a practically driven measure necessary to ensure the survival of the business, interviewees accepted that there is little inclination to investigate or worry about the source of such hard currency. These dynamics would seem to create vulnerabilities to money laundering.

Most interviewees saw Sudan's primary economic interests and financial flows as connected with Persian Gulf and Middle Eastern countries, rather than with East African and Horn states, IGAD member countries, or OECD countries. Middle Eastern countries have substantial investments in Sudan, and there is a sizeable Sudanese diaspora in Saudi Arabia, Jordan, and the UAE responsible for substantial remittances. These links and Sudan's emphasis on *shari'a*-compliant financial systems led many to opine that money laundering could not exist in an economy so closely tied to Islamic principles and to the Islamic world. As one Sudanese official explained, in Sudan, *shari'a* law and "Islamic monitoring bodies ... strongly prohibit money laundering, usury, and money stemming from wine trafficking, prostitution, cheating, and fraud." He stressed that Sudan faces a reduced money laundering risk because the application of *shari'a*

throughout the economy “improves general behavior and individual conduct.”<sup>96</sup>

External factors may also have an effect. U.S. sanctions, although officially targeting “any property or interests in property” of the Sudanese government,<sup>97</sup> in practice have a broader chilling effect on the Sudanese economy as a whole. The recent fines levied against U.S. and UK banks for violations of U.S. Office of Foreign Assets Control regulations make many foreign financial institutions wary of transactions involving Sudan.<sup>98</sup> Consequently, access to foreign markets and foreign capital, particularly U.S. dollars, is a challenge for Sudan’s banks, again raising the risk that when foreign currency is available or required, few questions are asked about the source of funds. Even if potentially generated from the proceeds of crime, for the sake of necessity, the funds would be accepted to allow business to continue.

## Current AML/CFT Efforts

As the differing views suggest, Sudan’s true progress on AML/CFT efforts is difficult to gauge. Significant institutional and legislative reform measures have been adopted in the last year, but deeper concerns about interlinkages between corruption, money laundering, and illicit financial flows remain.

On the one hand, there is a strong international view that Sudan’s economy is deeply corrupt. In its most recent Corruption Perceptions Index, Transparency International ranks Sudan 177 out of 182 countries. A recent UNDP study ranked Sudan in the top 10 countries worldwide for

illicit financial outflows during 1990–2008 valued at \$6.7 billion, citing corruption, trade mispricing, and poor tax calculation as general factors affecting illicit flows.<sup>99</sup> Yet, the same study showed that, as a percentage of GDP, illicit financial flows in Sudan ranked well below the mean average of 4.78 percent for least developed countries, with a figure of 2.37 percent. There has been little actual analysis of what constitutes these illicit outflows in Sudan. Sudanese officials stressed the importance of recent reform efforts, such as the creation of a presidential committee charged with tackling corruption.

With limited transparency and no state agencies publicly reporting on their corruption investigations, it is difficult to assess the scale, typology, and magnitude of corruption in the country. A recurring concern among international observers of Sudan relates to the role in the economy of the ruling National Congress Party (NCP). Party, economy, and government are so closely intertwined that it is difficult to draw clear boundaries. The private sector is very much enmeshed in these dynamics, as economist Osman Suliman describes the historic privatization process: “While ostensibly claiming the efficiency gains, and public finance imperatives of privatization, the ruling party in Sudan expediently used privatizing state-owned enterprises ... to acquire more economic and political power for the NCP.”<sup>100</sup> Suliman explains the impact this has on broader corporate and financial governance:

Indirect methods of over[-]taxation and confiscation threats also exist. Selective tax audits have become a potent political weapon against businesses that are not supportive of the NCP. Further, the lack of appropriate institutions discourages workers’ ownership and public participation. Falsified books

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96. Sudanese official, written communication with editors, April 2012 (on file with editors).

97. U.S. President, “Blocking Property and Prohibiting Transactions With the Government of Sudan, Executive Order 13412,” *Federal Register* 71, no. 200 (17 October 2006): 61369, <http://www.treasury.gov/resource-center/sanctions/Documents/13412.pdf>.

98. For example, JP Morgan Chase paid \$88 million to settle violations arising from transactions with Cuba, Iran, Liberia, and Sudan. U.S. Office of Foreign Assets Control, “JPMorgan Chase Bank N.A. Settles Apparent Violations of Multiple Sanctions Programs,” August 2011, <http://www.treasury.gov/resource-center/sanctions/CivPen/Documents/08252011.pdf>.

99. UN Development Programme, *Illicit Financial Flows From the Least Developed Countries: 1990–2008*, May 2011, <http://content.undp.org/go/cms-service/download/publication/?version=live&id=3273649>. The study notes an “assumption that illicit flows from these countries are in the same proportion to GDP as are outflows from other reporting [least developed countries] with complete data.” *Ibid.*, p. 3.

100. Osman Suliman, “Current Privatization Policy in Sudan.” *William Davidson Institute Policy Brief*, no. 52 (April 2007), [http://www.quebec.ca/observgo/fichiers/75871\\_ep1.pdf](http://www.quebec.ca/observgo/fichiers/75871_ep1.pdf).

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preclude strong public capital markets. Companies that are deliberately allowed to get away with tax avoidance cannot report honestly to investors. Hidden transactions also preclude using the courts to enforce contracts.<sup>101</sup>

Although the state pledges compliance with international standards on money laundering and objective technical assessments may validate this progress, the deep involvement of the government and the ruling party in the commercial sector and the low levels of financial transparency in that sector make it difficult to assess true progress in AML/CFT efforts. Sudanese officials strongly contested our conclusions in this regard, suggesting that our analysis of the involvement and impact of the ruling party on the national economy was not truly evidence based.

Our research identified signs of potentially significant institutional reform emerging over the last two years. In 2010, Sudan adopted the *Money Laundering and Terrorism Financing Act*, although implementation of that act remains unclear. Since its adoption, Sudanese government agencies have been working to develop procedures for identifying and freezing terrorist assets; to develop a functioning FIU, including applying to join the Egmont Group; to create an effective STR regime; and to improve regulatory supervision. The central bank, among other agencies, has clearly played a constructive role in these efforts. Yet, having taken these steps and given the limited policy and political influence of the FIU, it is questionable whether AML/CFT efforts will be significantly furthered. This is all the more questionable if, as many Sudanese we interviewed suggested, some of these steps were taken not to strengthen internal controls but rather to satisfy external audiences.

The prospects of the AML/CFT efforts now under way in Sudan merit closer examination. The FIU does have an independent budget, allocated from the central bank, and is primarily responsible for formulating the strategy to tackle money laundering problems. The central bank appears to have devolved most responsibility for this task to the FIU.

Financial institutions are required to notify the FIU of any transactions that exceed ₪0,000, which the FIU confirmed is now taking place routinely, although the volume of data is currently beyond the FIU's capacity to process to the level of detail they believe necessary. Sudan's FIU currently has eight staff, seconded from other government departments, including the central bank, national intelligence service, customs administration, Ministry of Justice, and the police. The FIU director plans to increase the staff to 15, citing the current number as inadequate. The FIU director has substantial professional experience. The main goal of the FIU in the coming period is to move to a system whereby financial data and STRs from the banks are transmitted electronically rather than on paper and analyzed by customized software. This should dramatically improve the FIU's ability to manage and assess the information it receives; the FIU director conceded that the current capacity to investigate was limited and that very possibly not all suspicious transactions were investigated sufficiently. The FIU has yet to publish a public report. It plans to do so by November 2012, following the FATF mutual evaluation process scheduled for early 2012.

Sudan is currently party to 12 international counterterrorism agreements, including the UN Convention Against Transnational Organized Crime, the UN International Convention for the Suppression of the Financing of Terrorism, and the Algiers Convention. It is a signatory to the 2004 protocol to the Algiers Convention.<sup>102</sup> It has not ratified the IGAD MLA and Extradition Conventions, although it was a driving force behind their drafting and adoption.

There has been some progress in developing law enforcement institutions related to money laundering and terrorist financing. Although the FSAP found in 2005 that "[t]here are currently no law enforcement units responsible for the investigation" of either money laundering or terrorist financing, two dedicated entities now investigate money laundering offenses: the FIU, with a mandate derived from section 10 of the AML act, and a division within the national police's criminal investigation directorate. Under

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101. Ibid., p. 5.

102. See UN Security Council, *Letter Dated 17 May 2011 From the Chair of the Security Council Committee Established Pursuant to Resolution 1373 (2001) Concerning Counter-Terrorism Addressed to the President of the Security Council*. S/2011/324, 23 May 2011.

the AML act, the FIU has the mandate to share information with law enforcement.

The financial crimes unit of the criminal investigation directorate of Sudan's national police service has 13 officers and 83 noncommissioned officers. Money laundering, fraud, forgery, and other bank crimes form the unit's remit. Most resources are dedicated to cases of fraud and embezzlement. The unit's personnel are based solely in Khartoum. If and when a case arises outside of Khartoum, staff are dispatched from the capital. Of the 96 personnel in the police department, only 26 have received training on the concept and principles of money laundering. The national police do not lack capacity or manpower, but familiarity with legal definitions and the concept of predicate and secondary crimes could be improved.

The general prosecutor also has responsibility for financial crimes. Four cases have been referred for prosecution, but no trials have begun. One suspect has fled Sudan, but three remain and were scheduled for prosecution in December 2011. These will be the first offenses prosecuted under the 2010 law and the law's first practical test. The prosecutor responsible for financial crimes noted that "one or two" convictions had been made under the 2003 money laundering law.<sup>103</sup> Sudanese officials noted that this may offer evidence that money laundering is a very limited problem in Sudan.

Steps have been taken to ensure effective interagency coordination. The 1373 administrative committee, under the chairmanship of the Sudan National Counterterrorism Centre, plays an advisory role to the FIU and serves as an information coordination forum among ministries, the security services, and the central bank on money laundering issues as well as broader counterterrorism issues. The 1373 administrative committee is the overall formal mechanism to coordinate AML activity, but in practice, the FIU has assumed this role, as the agency most invested in money laundering issues. This working arrangement seems to suit the agencies interviewed, who are happy for the FIU to take the lead. However, the FIU is limited by its own modest

staff resources, in comparison to the large institutions—the police, customs—that it must coordinate in these efforts.

The division of labor between the FIU, police, and prosecutors seems clear, and with the strong leadership of the FIU driving investigations, the need for independent investigative work by police and prosecutors is less demanding. What is less clear is how information held by the customs administration is shared with other stakeholders. Both the police and prosecutor's office did not appear to have sufficient information about the activities of the customs department. Moreover, customs offenses fall under a different prosecutor in the Ministry of Justice, further complicating information sharing if not addressed proactively. The FIU has taken the lead in raising awareness in the financial sector, focusing on the obligation and benefit of reporting suspicious transactions, as well as the most appropriate procedures for reporting. It had focused its attention on bank compliance officers and plans further outreach to bank staff in 2012.

Significantly, Sudan is already part of MENAFATF but has no relations with the ESAAMLG. Primary relationships are with counterparts in the Middle East and North Africa region and not IGAD or East African and Horn neighbors. This was confirmed by current and former central bank officials, as well as the FIU. Sudan's FIU, for example, has frequent contact with the FIUs in Bahrain and the UAE but no working relations with FIUs in the IGAD member states. Although the central bank and the FIU have an interest in establishing relationships with IGAD member state FIUs, there was some implicit indication that Sudan's position in the Middle East and North Africa region was more important and that further cooperation with East Africa would be of secondary value.

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103. The FSAP 2005 report states that no one was prosecuted under the 2003 law. It is unclear when the referenced prosecutions occurred or the outcomes of these cases.

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## Entry Points and Priorities

Sudan's efforts to build an effective AML/CFT structure deserve support from MENAFATF and the broader international community. In time, Sudan may even be seen as a leader on these issues within IGAD and may have important experience and expertise to share with other IGAD members.

The priority entry point must be the new FIU. Strengthening its capacity and operational capability will have important effects within the Sudanese interagency AML/CFT process because it is already well regarded within the Sudanese government. As a relatively new organization, it has demonstrated a desire to receive assistance from external partners and a willingness to seek advice, even as it has made limited efforts itself to reach out to its counterparts. The planned move to an automated, electronic reporting system for suspicious transactions is a timely opportunity for external assistance, and if done correctly, could do more to further strengthen Sudan's preventive AML regime than any other action. New FIU staff are ideally positioned to receive comprehensive, in-depth training.

Greater interagency coordination between various stakeholders and within the region is also important. IGAD should encourage MENAFATF to take the lead in this regard but should also look to other external partners, such as the GCTF Horn of Africa Region Working Group, to provide expertise and support. There is a particular need for the Sudanese interagency AML/CFT process to work more closely with Sudan's customs authorities and border control agencies.

Finally, there is an ongoing opportunity to support the development of the national police's investigative capacity. The police service has the capacity to absorb further training, and an obvious gap would be addressed if those police personnel responsible for financial crimes understood the fuller range of financial crimes. Given that the police play a fairly reactive role in investigating money laundering activity, however, greater impact would initially be gained through targeting immediate assistance at the FIU.

# 9. Uganda

## KEY FINDINGS AND RECOMMENDATIONS

Uganda is deeply vulnerable to money laundering and terrorist financing and has a well-established record of both. In the course of our research for this study, Ugandan law enforcement officials told us explicitly that money laundering is “rampant” in the country and closely linked to Uganda’s endemic public corruption. Ugandan AML/CFT efforts are at almost a complete standstill. It has no FIU. An AML bill was drafted in 2003, approved by the Cabinet in 2005, and introduced to Parliament in 2009 and has gone nowhere since then. The national interagency AML committee has stopped meeting, out of frustration with the legislative process. The ESAAMLG has written to Uganda expressing its concern at slow pace of reform.

The result of this lack of forward progress is a growing sense of alarm within Ugandan law enforcement authorities and the Ugandan business community, especially the financial sector. Law enforcement authorities

expressed frustration with the absence of an effective AML/CFT system. Private sector actors see the absence of effective legal frameworks as offering competitive advantage to firms with political influence, distorting markets. AML measures are frequently portrayed by members of the political and business elite as “anti-investment.” The opposite is the case: AML/CFT measures are a necessary precondition to Uganda’s participation in the subregion’s accelerating economic integration and growth.

The basic problem is one of political will. Unlike other East African and Horn countries, therefore, the priority should not be on investment in the creation of an FIU or similar institution-strengthening measures, but rather on a coordinated and broad push by diplomatic, political, security, law enforcement, and even business actors to create the will among Uganda’s political and business elite to get serious about AML/CFT issues.

Foreign, subregional and multilateral donors, other states in the region, the ESAAMLG, IGAD, and the EAC should all make clear that, without effective legal protections and basic law enforcement capabilities relating to AML/CFT matters, Uganda will get left behind and, with it, the prospects of Uganda’s ruling classes.

AML/CFT reforms should be framed not just in technical terms and not in terms of demands from foreign actors, but expressly in public policy terms. It is also important, given the concerns raised with us by civil society organizations, that any such intervention be framed as part of a broader push for comprehensive rule of law-based governance reforms in Uganda. Otherwise, based on evidence from events surrounding the recent Ugandan elections, there is a danger that AML/CFT tools will be used not to fight crime, but rather to silence political dissent.



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## Risks and Vulnerabilities

A 2007 ESAAMLG evaluation of Uganda found that Uganda is very vulnerable to being used by criminals to launder money.<sup>104</sup> Around the same time, the ESAAMLG found that Uganda was fully compliant with only two of FATF's 49 AML/CFT recommendations. A number of factors expose Uganda to the threat of money laundering, ranging from geographical to legal.

Perhaps most significant is corruption, widely seen as endemic in Uganda. The Transparency International Corruption Perception Index for 2011 ranked Uganda 143 out of 182 countries.<sup>105</sup> Public and official opposition to corruption is growing, and our research suggests a growing acknowledgment by officials that money laundering and public corruption are closely linked.<sup>106</sup> Officials identified a range of predicate offenses underpinning growing money laundering in the country: tax evasion, corruption and misappropriation of public funds, procurement fraud, land speculation, and arms and natural resource smuggling. Procurement fraud during the organization of the 2007 Commonwealth of Nations heads of government meeting has received particular attention. Cybercrime, our interviewees suggested, is also on the rise.

Our research pointed to a number of structural weaknesses in financial and economic governance that appear to be related to these problems. Most of the economy is informal and cash based. Only a small percentage of the population has bank accounts, and the percentage of those owning insurance policies and securities is even lower. The use of cash for most transactions makes it difficult to have a paper trail, which may help in the detection and investigation in cases of money laundering. Ugandan currency is frequently used as a second currency in parts of the eastern DRC, Rwanda, and South Sudan, and there are no restrictions or mechanisms to monitor the amount of money that is

brought into or taken out of Uganda. Border control is difficult, given the long and porous borders with the DRC, Kenya, Rwanda, South Sudan, and Tanzania. This also makes trade monitoring difficult, which has led to Uganda becoming entangled in cross-border smuggling and trade-based money laundering, especially for resources extracted in the eastern DRC.

A number of our interviewees pointed to other structural weaknesses, both in legislative frameworks and in institutional management and performance, that may incentivize corruption and money laundering. Low pay within the civil service was frequently cited. Others mentioned the absence of a national registration or identification scheme, which weakens the implementation of KYC and related practices. Other officials highlighted weaknesses in the underlying legal frameworks: numerous analyses, including by the ESAAMLG, suggest that existing Uganda legislation does not criminalize the full range of money laundering and terrorist financing conduct required by the FATF Recommendations.

At the same time, Ugandan officials feel an acute concern regarding terrorist financing. Uganda has had a history of terrorist groups operating within its borders, including the Allied Democratic Forces, the Lord's Resistance Army, and more recently cells connected to al-Shabaab. Due to Uganda's leading military role in AMISOM, al-Shabaab has targeted Uganda in particular, carrying out bombings in Kampala on 7 July 2010 that killed 79 people and left many more injured. There are continuing allegations that foreign fighters transiting to Somalia are passing through Uganda.

Neither money laundering nor terrorist financing appears to be a priority concern in Uganda. Issues such as electricity power rationing, high inflation, a struggling economy, demands for more democratic space, a framework to manage the development of recently discovered oil assets, and unemployment take more attention. This is reflected in

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104. ESAAMLG, *Mutual Evaluation/Detailed Assessment Report: Anti-Money Laundering and Combating the Financing of Terrorism: Republic of Uganda*, August 2007, para. 36, [http://www.esaamlg.org/userfiles/UGANDA\\_MER1.pdf](http://www.esaamlg.org/userfiles/UGANDA_MER1.pdf).

105. Transparency International, "Corruption Perception Index 2011," 2011, <http://cpi.transparency.org/cpi2011/results/>.

106. See World Bank, *Uganda: Report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*, n.d., [http://www.esaamlg.org/userfiles/UGANDA\\_Executive\\_Summary1.pdf](http://www.esaamlg.org/userfiles/UGANDA_Executive_Summary1.pdf).

glacially slow progress on AML reforms in the country. A bill to criminalize money laundering was drafted in 2002, but has yet to be enacted. *The Financial Institutions Act* of 2004 adopted a definition of money laundering as “all activities and procedures designed to change the identity of illegally obtained money so that it appears to have originated from a legitimate source,”<sup>107</sup> but Uganda has no FIU.

The Uganda Anti-Money Laundering Committee (UAMLC) was established in August 2000, bringing together several ministries and chaired by the Bank of Uganda.<sup>108</sup> It worked with external advisors to draft a comprehensive AML bill, which was completed in 2003, and approved by the Cabinet in 2005. It was not introduced to Parliament until 2009 and has still not been put to a vote. The UAMLC stopped meeting a year ago due to lack of progress on the legislative front. The ESAAMLG chairperson wrote a letter to the Ugandan minister of finance, planning, and economic development in late November 2011 expressing dissatisfaction with the slow pace in implementing an AML legal framework in Uganda and urging Uganda to expedite implementation of the ESAAMLG Post Evaluation Implementation Plan.

The basic problem is a deep-seated lack of political will among the political class and senior civil servants to tackle money laundering. The Uganda Revenue Authority recently introduced a requirement that individuals registering property declare the source of funds used to purchase the property and whether they had paid tax on those funds prior to acquisition of the property. This requirement has met stiff opposition from the political class. Some policymakers we engaged viewed such requirements as “discourag[ing] investment in Uganda.”

In contrast, the officials we interviewed who operate on a technical level expressed real frustration at the lack of progress on AML/CFT issues. Law enforcement officials described money laundering as “rampant.” Law enforcement authorities

consider enactment of AML legislation achievable and indicate they “simply do not understand why” the AML bill and other relevant bills have been stuck in Parliament for so long. Law enforcement authorities spoke of cases where they have arrested individuals exporting large sums of money from the country but had to release the suspects due to lack of legislation to deal with money laundering.

Similarly, private sector financial players in the country perceive that the absence of progress on AML/CFT issues is posing a growing risk to their businesses. They see this risk stemming not only from damage to their name as Uganda gains a growing reputation for vulnerability to money laundering and terrorist financing, but also from being outcompeted by other firms in the Ugandan market who can rely on political connections and illicit subsidies of one form or another. The financial sector expressed particular alarm, pointing out that they must comply with international AML/CFT requirements but frequently lack a basis in Ugandan law to undertake these steps.

Civil society organizations engaged for this study, by contrast, were somewhat more ambivalent. They expressed concern at the absence of effective AML/CFT arrangements but described this as reflective of deeper governance problems. Some argued that the introduction of forceful AML/CFT measures without addressing broader governance issues could be counterproductive because AML/CFT tools might be used to limit fundraising by opposition political parties and silence political dissent rather than fight crime. They cited a case in the recent elections where electoral financing laws were used in this way, arguing that efforts to pass AML/CFT legislation should go hand in hand with broader initiatives to improve governance and rule of law.

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107. Financial Institutions Act, 2004, *Uganda Gazette* 47, no. 14 (26 March 2004), sec. 130, [http://www.bou.or.ug/export/sites/default/bou/bou-downloads/acts/supervision\\_acts\\_regulations/FI\\_Act/FIAct2004.pdf](http://www.bou.or.ug/export/sites/default/bou/bou-downloads/acts/supervision_acts_regulations/FI_Act/FIAct2004.pdf).

108. The UAMLC includes the Bank of Uganda; the Ministry of Finance, Planning and Economic Development; the President's Office (Internal and External Organizations); the Ministry of Justice and Constitutional Affairs; the Directorate of Public Prosecutions; the Uganda Police Force; the Capital Markets Authority; the Uganda Revenue Authority; the Uganda Bankers Association; the Uganda Institute of Bankers; the Immigration Department (Ministry of Internal Affairs); and the Non-Governmental Board (Ministry of Internal Affairs).

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## Current AML/CFT Efforts

The UAMLC has developed and published a national AML/CFT strategy for Uganda.<sup>109</sup> A review of its six key strategic objectives shows just how bogged down Uganda's AML/CFT efforts have become.

1. Introduction and implementation of comprehensive AML/CFT legislation
2. Establishment of effective enforcement structures and resources
3. Effective regulation of the financial sector and other accountable institutions
4. Effective international cooperation
5. Effective strategic management controls
6. Engagement with stakeholders

None of these objectives are close to being met. Even the most basic step—the adoption of an AML act—seems to be out of reach. In the absence of legislation criminalizing money laundering, financial sector regulators such as the Bank of Uganda and the Capital Market Authority are relying on regulations and guidance notes as a stopgap measure. In 2010 the Bank of Uganda issued *Financial Institutions (AML) Regulations 2010*, creating requirements for banks and other financial institutions to introduce KYC, CDD, and AML/CFT-related recordkeeping. These regulations, however, only cover the entities supervised by the Bank of Uganda, limiting their application to, for example, remittance organizations and the real estate sector, both of which are thought to be involved in money laundering. Annual remittances are Uganda's largest single source of foreign currency and totaled \$414 million in 2008–2009. The regulations' legality is also uncertain, given the absence of primary legislation, and their alignment with international standards such as the FATF Recommendations remains unclear.

These regulations do not address other deficiencies that have been highlighted in the past. ESAAMLG analysis between 2005 and 2007 found that Ugandan legislation did not criminalize the full range of conduct outlined in the

FATF Recommendations and failed to address other issues adequately, including the absence of an FIU; the absence of a regime for freezing, seizing, and confiscating money laundering and terrorist financing assets; and the absence of arrangements for interagency information sharing and operational cooperation in response to detected money laundering and terrorist financing.

Very limited steps have been taken to remedy these deficiencies in the years since that analysis. Legislative provisions exist for seizure and confiscation when dealing with corruption and terrorism cases when proceeds and instrumentalities of crime are identified, but Uganda still lacks laws regarding confiscation of assets on request of a foreign government. Uganda continues to rely on its outdated *Extradition Act* of 1968 when dealing with extradition matters, which does not appear to provide a basis for extradition on money laundering and terrorist financing offenses, given the absence of dual criminality. Uganda has not given any indication that it plans to ratify the IGAD MLA and Extradition Conventions. The absence of effective extradition arrangements has arguably contributed to Uganda's reliance on extrajudicial processes in terrorism cases, further undermining public and regional confidence in Uganda's ability to cooperate in rule of law–based sub-regional cooperation arrangements to counter money laundering and terrorism.

Numerous other parts of the legislative framework required to tackle money laundering and terrorist financing are also problematic. The authority of Uganda's law enforcement agencies to require production of documents and to undertake search and seizure is limited to old legislation contained in the *Police and Evidence Acts* and the Criminal Procedure Code, which were designed to deal with traditional crimes and are ill-suited to deal with emerging complex crimes. The list of designated terrorist organization in the *Anti-Terrorist Act* of 2002 has remained static in the face of the changing threat and new terrorist groups. There is no mechanism to freeze and unfreeze assets of legal or physical persons listed by the UN Security Council.

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109. "Uganda: AML/CFT Strategy," April 2010, [http://www.esaamlg.org/userfiles/UGANDA\\_AML\\_CFT\\_STRATEGY\\_REVISIED\\_APRI\\_2010.pdf](http://www.esaamlg.org/userfiles/UGANDA_AML_CFT_STRATEGY_REVISIED_APRI_2010.pdf).

Cooperation between the Bank of Uganda and law enforcement authorities seems limited and at times even confused. Section 130 of the *Financial Institutions Act* of 2004 requires financial institutions to report promptly to the national law enforcement agencies any “suspected money laundering activity related to any account held in the financial institution.” The Bank of Uganda receives a hard copy of the STR that is sent to the national law enforcement agencies, but there is no clear guidance on how the bank should handle these STRs. It lacks the material and human resources to properly analyze these STRs, and we were told that only very limited information is shared with law enforcement agencies and certainly not in anything approaching a systematic manner. Currently, no law enforcement agencies are specifically tasked with investigating AML/CFT matters. The Bank Fraud Investigation Department has undertaken some investigations into money laundering, and the joint Directorate of Public Prosecutions/Police Unit and the Joint Anti-Terrorism Task Force has investigated some terrorist financing cases, but reported that they were hampered by limited technical, material, and human resources; a lack of training in this area; and the weak legal framework. The Directorate of Public Prosecutions has a specialized fraud unit that could potentially be used in prosecuting money laundering and terrorist financing offenses once the AML act is enacted. Our research suggests, however, that this unit currently lacks the skills required.

Various stakeholders have received AML/CFT awareness training from development partners working with the Ugandan government through the UAMLC. These development partners include the U.S. Department of the Treasury Office for Technical Assistance, IMF, and the World Bank. The trainings have not been based, insofar as we could ascertain, on a whole-of-government needs assessment.

## Entry Points and Priorities

Very little will be achieved in Uganda on AML/CFT issues until Parliament enacts its languishing AML bill. Yet, that will be only one forward step. The deeper problem is one of political will. Unlike other East Africa countries, therefore, the priority should not be on investing in an FIU or similar institution-strengthening measures, but on a coordinated and broad push by diplomatic, political, security, law enforcement, and even business actors to create the will among Uganda’s political and business elite to get serious about AML/CFT issues.

The entry point for such engagement is the fact that effective AML/CFT action is a necessary precondition to Uganda’s participation in the subregion’s accelerating economic integration and growth. Foreign, subregional and multilateral donors, other states in the region, the ESAAMLG, IGAD, and the EAC should all make clear that, without effective legal protections and basic law enforcement capabilities relating to AML/CFT matters, Uganda will get left behind and, with it, the prospects of Uganda’s ruling classes.

Notably, in early 2010 the World Bank and the ESAAMLG organized some sensitization training for the relevant parliamentary committees, but the composition of Parliament has since changed following the February 2011 parliamentary elections. It is important that any such sensitization be presented not merely in technical terms and not in terms of demands from foreign actors, but expressly in public policy terms. It is also important, given the warnings we received from civil society organizations, that any such intervention be framed as part of a broader push for comprehensive rule of law-based governance reforms in Uganda. Otherwise, based on evidence from events surrounding the recent Ugandan elections, there is a danger that AML/CFT tools will be used not to fight crime but to silence political dissent.

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# 10. Regional Initiatives

## KEY FINDINGS AND RECOMMENDATIONS

A variety of regional and subregional institutions active in East Africa address AML/CFT issues in one way or another. None of them has shown a clear ability to create increased political will in the region to tackle these issues. Many of them struggle to ensure states implement their rhetorical commitments on AML/CFT issues.

The AfDB is potentially a useful programming partner in the limited context of its lending arrangements, although some concerns raised by its rhetoric seem to suggest that FATF standards are not suited to the African context.

The AU is a key partner in AML/CFT norm development on the continent but has not demonstrated a capacity to ensure implementation of these norms. Appropriately equipped, however, the African Centre for Studies and Research on Terrorism (ACSRT), the AU's research center on counterterrorism, might be a useful partner in AML/CFT training efforts.

The EAC and, to a lesser extent, the EADB offer an important entry point for

efforts to strengthen AML/CFT efforts in Kenya, Uganda, and perhaps South Sudan, as well as Burundi, Rwanda, and Tanzania. The EAC offers an important source of political leverage because of those states' apparent appetite for market integration through the EAC and because the EAC has been able to connect that process of market integration to those states' meaningful engagement with other subregional partners who can help them build AML/CFT and related (e.g., criminal justice) capacities.

Clearly, the ESAAMLG will be a crucial player in any effort to drive forward AML/CFT efforts in East Africa and the Horn, although only three IGAD members are currently involved (Kenya and Uganda as members, Ethiopia as an observer). As a subregionally owned initiative, it has unique legitimacy and access, but its emphasis to date on local ownership may be unnecessarily limiting its impact and the quality of its services. FATF has expressed concerns about its mutual evaluation process, follow-up arrangements, and typologies. Consideration may need to be given to amending the ESAAMLG memorandum of understanding (MOU)

to allow it to receive external funding support. It may also be worth revisiting an earlier idea for a partnership among the ESAAMLG, academia, the financial sector, and external government and IFI donors to create a regional center of excellence on AML/CFT and anticorruption in the region.

Finally, the ISSP may have an important role to play, although it is as yet largely unproven on AML/CFT issues. Its precursor, the IGAD Capacity Building Program Against Terrorism (ICPAT), had a demonstrable track record of helping IGAD states build their counterterrorism capacities, in part through leveraging effective partnerships with external actors, including the United Nations and civil society actors such as the CGCC and the Institute for Security Studies (ISS) in South Africa. Unlike ICPAT, the ISSP is being implemented from within IGAD intergovernmental structures (ICPAT was a joint venture with the ISS). That may impact ISSP access to human and financial resources.

## Introduction

This chapter focuses on regional AML/CFT initiatives by organizations that work in multiple IGAD member countries. These initiatives are contextualized with an analysis of the structure, mandate, and strategies of the organizations, with a focus on identifying entry points for partnerships with these subregional initiatives in AML/CFT capacity building. The initiatives discussed are those undertaken by African Development Bank Group (AfDB), African Union (AU), East African Community (EAC), Eastern and Southern Africa Anti-money Laundering Group (ESAAMLG), IGAD and Interpol.

## African Development Bank (AfDB)

The AfDB aims to contribute to the sustainable economic development and social progress of its regional member countries through provision of loans and grants. It also provides advice to these countries on developmental issues and is an important potential partner for the development of AML/CFT capacities in its regional members countries.

AfDB AML/CFT activities are undertaken in the context of its fiduciary duties to its regional member countries as clients of the bank, as well as in the context of its wider good governance agenda, combating corruption and supporting financial sector reforms. The AfDB's 2007 *Strategy for the Prevention of Money Laundering and Terrorist Financing in Africa* aims, *inter alia*, to facilitate AML/CFT efforts in these countries through support for nationally led and FSRB-supported legislative reform and FIU-development projects. It also aims to support the development of FSRBs

themselves. The AfDB includes AML/CFT issues in its policy dialogue with regional member countries; supports research into African AML/CFT issues, including typology exercises; and has developed a database of AML/CFT tools and instruments for use by African practitioners.

Yet, despite its rhetorical commitment to international AML/CFT standards, some AfDB statements call that commitment into question by setting the need for local ownership at odds with the requirements of the global AML/CFT regime. In its 2007 Strategy, the AfDB argues that “[c]urrent FATF recommendations and other international standards do not appear to advance practical and realistic methods of preventing and detecting [money laundering and terrorist financing] in predominantly cash[-]based economies, or in countries where reliance on a parallel banking system and informal value transfer methods is the norm. These are issues that are very relevant to most African countries and call for African solutions.”<sup>110</sup>

## African Union (AU)

The AU has developed an extensive normative framework addressing terrorism in the region,<sup>111</sup> including a range of norms relating to AML/CFT issues. Its unique authority within Africa makes it an important actor in AML/CFT promotion efforts in the region, but questions about its operational capacity suggest that it may have a more important role to play in promoting AML/CFT norms than in institution-building efforts on the ground.

The Algiers Convention requires states-parties to refrain from financing terrorism, prevent the establishment of support networks, and share information on terrorist sources of

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110. AfDB, “Bank Group Strategy for the Prevention of Money Laundering and Terrorist Financing in Africa,” May 2007, para. 2.42, [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/10000012-EN-STRATEGY-FOR-THE-PREVENTION-OF-MONEY-LAUNDERING\\_01.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/10000012-EN-STRATEGY-FOR-THE-PREVENTION-OF-MONEY-LAUNDERING_01.pdf).

111. See OAU, Resolution AHG/Res.213 (XXVIII), 1992, [http://www.africa-union.org/official\\_documents/Heads%20of%20State%20Summits/hog/2HoGAssembly1992.pdf](http://www.africa-union.org/official_documents/Heads%20of%20State%20Summits/hog/2HoGAssembly1992.pdf); OAU, *OAU Convention on the Prevention and Combating of Terrorism*, 1999, [http://www.africa-union.org/root/au/Documents/Treaties/Text/Algiers\\_convention%20on%20Terrorism.pdf](http://www.africa-union.org/root/au/Documents/Treaties/Text/Algiers_convention%20on%20Terrorism.pdf); AU, *Plan of Action of the African Union High-Level Inter-Governmental Meeting on the Prevention and Combating of Terrorism in Africa*, Mtg/HLIG/Conv.Terror/Plan.(I), 2002, [http://www.iss.co.za/AF/RegOrg/unity\\_to\\_union/pdfs/oau/keydocs/PoAfinal.pdf](http://www.iss.co.za/AF/RegOrg/unity_to_union/pdfs/oau/keydocs/PoAfinal.pdf) (hereinafter AU 2002 Plan of Action); AU, *Protocol to the OAU Convention on the Prevention and Combating of Terrorism*, 2004, <http://www.africa-union.org/root/au/Documents/Treaties/Text/The%20Protocol%20on%20Terrorism%2026July2004.pdf>.



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funding and calls for seizure and confiscation of funds or “other instrumentalities of crime used to commit a terrorist act or intended for that purpose.” The 2002 AU plan of action for the prevention and combating of terrorism links terrorist financing and money laundering and requires their criminalization and the regulation of charities to ensure their nonexploitation or misuse by terrorists. The plan of action specifically calls for the adoption of AML/CFT measures such as the establishment of FIUs, enactment of provisions for freezing and seizing terrorist property, and increased cooperation and information exchange on issues of terrorist financing.

The plan of action led to the establishment of the ACSRT in Algeria to “centralize information, studies, and analyses on terrorism and terrorist groups and develop training programs by organizing, with assistance of international partners, training schedules, meetings, and symposia.”<sup>112</sup> The ACSRT was inaugurated in 2004 and has organized a number of AML/CFT-related initiatives. It has routinely carried out seminars and other training relating to money laundering and terrorist financing in collaboration with various partners and ran a series of trainings in 2009 on enhancing the capacity of FIUs. It also prepared the African Model Law on Counter Terrorism, which includes a number of provisions relating to AML/CFT issues.

The other key assault of the AU on terrorist financing is the condemnation by the AU Assembly of ransom payments to terrorist groups in exchange for hostages as constituting a main source of funds for terrorists.<sup>113</sup> This action was informed by the kidnap for ransom perpetrated by al-Qaida affiliate Al-Qaida in the Maghreb but is increasingly being considered in the context of piracy ransoms. In Kampala in

2010, the AU Commission was mandated by member states to mobilize international support toward ending the payment of ransom.<sup>114</sup> The AU has adopted a number of instruments relating to AML, including the AU Convention on Combating Corruption<sup>115</sup> and the Revised AU Plan of Action on Drug Control and Crime Prevention (2007–2012).<sup>116</sup>

The operational impact on the ground of these norm-promotion efforts remains limited. In his 2010 report to the AU Peace and Security Council, the AU peace and security commissioner noted the failure by member states to submit annual reports to the council and the failure to share information with the ACSRT.<sup>117</sup> The 2004 protocol to the Algiers Convention gave the council a mandate to review states’ implementation of the plan of action and give subregional mechanisms, including IGAD, an explicit mandate to harmonize and coordinate counterterrorism efforts in their regions and report counterterrorism measures to the AU Commission. The protocol has not yet been brought into force because it has not been ratified by a sufficient number (15) of states. The AU Commission has one desk officer in the Peace and Security Council following counterterrorism issues, and no system has been developed to solicit, collate, or analyze reporting from member states on AML/CFT or other counterterrorism-related issues.

Our research suggests that given existing resources and capacity, the AU Commission has limited capacity to participate in operational AML/CFT-strengthening exercises in the IGAD region. Equipped with appropriate resources, the ACSRT might be in a position to play a more constructive role.

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112. AU 2002 Plan of Action, arts. 19 and 20.

113. AU, Assembly/AU/Dec.256 (XIII) Rev.2, 3 July 2009, [http://www.africa-union.org/root/au/Conferences/2009/july/summit/decisions/ASSEMBLY%20AU%20DEC%20243%20-%20267%20%28XIII%29%20\\_e.pdf](http://www.africa-union.org/root/au/Conferences/2009/july/summit/decisions/ASSEMBLY%20AU%20DEC%20243%20-%20267%20%28XIII%29%20_e.pdf).

114. AU Peace and Security Council, *Report of the Chairperson of the Commission on Measures to Strengthen Cooperation in the Prevention and Combating of Terrorism*, PSC/PR/2(CCXLIX), 22 November 2010, <http://www.africa-union.org/root/au/Conferences/2010/November/situationroom/Terrorism%20report-PSC%2022%2011%2010.pdf>.

115. AU, *Convention on Preventing and Combating Corruption*, 11 July 2003, [http://www.africa-union.org/official\\_documents/Treaties\\_%20Conventions\\_%20Protocols/Convention%20on%20Combating%20Corruption.pdf](http://www.africa-union.org/official_documents/Treaties_%20Conventions_%20Protocols/Convention%20on%20Combating%20Corruption.pdf). It entered into force on 6 June 2002 and has been ratified by 40 of 54 AU member states.

116. AU, *Revised AU Plan of Action on Drug Control and Crime Prevention (2007–2012)*, CMDCCP/EXP/3(III), December 2007.

117. AU Peace and Security Council, *Report of the Chairperson of the Commission on Measures to Strengthen Cooperation in the Prevention and Combating of Terrorism*.

## East African Community (EAC) and East African Development Bank (EADB)

The EAC is a subregional intergovernmental organization comprising Burundi, Kenya, Rwanda, Tanzania, and Uganda. It operates from Arusha, Tanzania, and has primarily focused on economic and political union among these countries. A 1967 treaty establishing the EAC (then Kenya, Tanzania, and Uganda) was based on their common colonial administrative arrangements and a monetary union. That community collapsed in 1977 largely as a result of the ideological differences between its member states, but the concept was revived in 1999. A new treaty came into effect on 30 July 2000 with Kenya, Tanzania, and Uganda again as members. Burundi and Rwanda joined the community in 2007. Sudan's application to join the group was recently rejected, but South Sudan may soon be invited to join. The EAC founding treaty seeks political federation of the partner states as the end goal and charts a path that begins with customs union, common market, monetary union, and ends with political federation of the community.

Within the EAC, money laundering issues are addressed as security issues and issues of monetary policy and market integration. The EAC monetary and fiscal affairs committee is mandated, *inter alia*, to address AML issues and has urged all EAC members to enact AML legislation. The committee periodically receives reports on efforts by members to enact AML laws and deficiencies noted in ESAAMLG evaluations. All EAC members except Uganda have enacted AML laws of varying kinds. The committee also purports to give the EAC a monitoring and evaluation role with regard to these AML measures.

The EAC tends to seek to promote its agenda through other existing East African subregional institutions that have a more operational role, including the EADB, the ESAAMLG, and the Eastern Africa Police Chiefs Cooperation Organization (EAPCCO).<sup>118</sup>

The EADB is a regional public-private bank offering financial services in the member states of Kenya, Rwanda, Tanzania, and Uganda for purposes of promoting economic development and regional cooperation.<sup>119</sup> Partly owned by the four member states,<sup>120</sup> it is a key economic partner of the EAC, supporting public and private sector projects within the community<sup>121</sup> with emphasis on projects that have regional orientation. The bank perceives itself to be home grown and to have an understanding of the region “perhaps better than any other development finance institution operating in East Africa.”<sup>122</sup> Managed by the heads of finance ministries from the member countries and supported by an international advisory board, the bank does not have a unique strategy for countering money laundering and terrorist financing.

EAC officials have sought to promote an AML/CFT agenda through support for the ESAAMLG. The EAC has undertaken extensive efforts to achieve ESAAMLG membership for Burundi and Rwanda and was scheduled to hold an AML conference in Kigali in March 2012 to sensitize the technical and political leadership of Burundi and Rwanda to the ESAAMLG, the need for evaluations for FATF compliance, and the use of national action plans in building national AML capacities. In its further support of the ESAAMLG, the EAC has applied pressure on partner states for national action plans by adopting the position that AML measures are part and parcel of the EAC common market protocol. Additionally, the EAC has sought the harmonization of AML legislation within the community, a process that was to form part of the Kigali agenda.

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118. EAPCCO has a limited role on AML/CFT issues. It operates alongside the Interpol subregional bureau in Nairobi, which has only one AML/CFT desk officer, focused on collating and sharing information with Interpol headquarters in Lyon.

119. EADB, “Background,” <http://www.eadb.org/index.php/about-us/history>.

120. Other key shareholders include the AfDB; the Netherlands Development Finance Company; the German Investment and Development Company; SBIC-Africa Holdings; Commercial Bank of Africa, Nairobi; Nordea Bank of Sweden; Standard Chartered Bank, London; and Barclays Bank Plc., London. *Ibid.*

121. Excluding Burundi, which is not a shareholder.

122. East African Investment Conference, “Report of the Conference,” 27–30 April 2010, [http://www.eac.int/invest/index.php?option=com\\_docman&task=doc\\_download&gid=16&Itemid=70](http://www.eac.int/invest/index.php?option=com_docman&task=doc_download&gid=16&Itemid=70).

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The EAC Peace and Security Division perceives money laundering and terrorist financing as a new generation threat to East African peace and security. It frames its role in AML/CFT efforts as part and parcel of its broader role in fostering EAC cooperation against these threats and has recently begun to convene EAC security officials, including member country interior ministers, to discuss cooperation on these issues. Our research suggests, however, that it has not specifically undertaken or supported on-the-ground capacity-building efforts.

## Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)

The ESAAMLG is an FSRB launched in 1999 and now comprising 14 members. The creation of the ESAAMLG was premised on the need to fulfill obligations to Commonwealth of Nations heads of state and government on implementing the FATF Recommendations. This “Commonwealth” provenance has limited the willingness of some of its members to see it expand beyond members of the Commonwealth. Partly as a result, only three IGAD states are currently involved: Kenya and Uganda are members and Ethiopia has observer status (Sudan is a member of MENAFATF, another FSRB).

The ESAAMLG mandate is to support and promote the implementation of the FATF Recommendations in individual countries and at the regional level. The MOU that established the ESAAMLG mentions concerns about the adverse effect of “money launderers and financiers of terrorism” and

the need for social, economic, and political stability. In particular, in the foreword to the 2005–2008 Strategic Plan, the chair to the ESAAMLG Ministerial Council identifies corruption as the center of regional AML efforts.<sup>123</sup> This focus on corruption and, by extension, governance and development, as opposed to criminality, is also reflected in ESAAMLG statements linking AML efforts to actions to achieve the Millennium Development Goals, particularly No. 8, which calls for commitment to “a rule based, predictable, nondiscriminatory and open trading and financial system including a commitment to good governance.” The MOU requires member states to adopt and implement the FATF Recommendations, apply AML measures to all serious crimes, and domesticate AML/CFT legislation.<sup>124</sup> Members also agree to implement ESAAMLG decisions.<sup>125</sup> The MOU establishes a four-tier structure composed of the ESAAMLG Council of Ministers, a task force, the ESAAMLG Secretariat at the regional level, and National Multi-Disciplinary Committees in member states, comprised of experts in law, finance, and law enforcement.<sup>126</sup>

ESAAMLG strategies have focused on building national AML/CFT frameworks in member states, establishing regional AML/CFT priorities, and extending ESAAMLG membership to all countries in eastern and southern Africa. ESAAMLG documents tend to present its role as a broker of AML/CFT reform in its member states, using its analytical faculties to help explain to states why AML/CFT reforms are needed and then working with them to implement those reforms.<sup>127</sup> It aims to connect more-advanced members to less-advanced members in what the ESAAMLG references as mutually supportive action. Yet, this reliance on AML/CFT capacity within the region may create a chicken-and-egg problem: its ability to drive the regional AML/CFT agenda forward is hampered by the same low attention, priority, and resourcing that it seeks to address. FATF has

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123. ESAAMLG, *Strategic Plan 2005–2008*, ESAAMLG/TFX, 25 August 2005, [www.esaamlg.org/documents\\_storage/2009-5-5-4-36-59\\_sp\\_05-08.pdf](http://www.esaamlg.org/documents_storage/2009-5-5-4-36-59_sp_05-08.pdf) (foreword).

124. ESAAMLG, *Memorandum of Understanding of the Eastern and Southern Africa Anti-Money Laundering Group*, August 2008, art. I, [http://www.esaamlg.org/documents\\_storage/2009-3-3-8-31-23\\_esaamlg\\_mou\\_as\\_amended\\_by\\_council\\_of\\_ministers\\_mombasa\\_kenya\\_august\\_2008.pdf](http://www.esaamlg.org/documents_storage/2009-3-3-8-31-23_esaamlg_mou_as_amended_by_council_of_ministers_mombasa_kenya_august_2008.pdf) (hereinafter ESAAMLG MOU).

125. *Ibid.*, art. II.3.

126. *Ibid.*, arts. VI–XI.

127. For example, see ESAAMLG, *From Arusha to Maseru: ESAAMLG at Ten*, 2010, [http://www.esaamlg.org/userfiles/ESAAMLG\\_10\\_Year\\_Report.pdf](http://www.esaamlg.org/userfiles/ESAAMLG_10_Year_Report.pdf).

expressed concern at the weaknesses in the quality and timeliness of the FATF MERs, poor preparations for ESAAMLG plenary discussions, and the ESAAMLG's low capacity to follow up on implementation of the recommendations in MERs. FATF has also sought improvements in the quality of typology reports.<sup>128</sup>

Much of its analytical work, including its typology reports to date on cash couriers, corruption, and, soon, on drug trafficking and human trafficking, has been carried out by using expertise seconded from member states. Only \$50,000 is allocated each year to typology exercises. By August 2011, all 14 ESAAMLG members had been assessed under this process of mutual evaluation or under FSAP,<sup>129</sup> but it is difficult to assess what impact these evaluations have had. Clearly, some ESAAMLG member states, such as Uganda, have not made substantial progress on AML/CFT issues, despite repeated ESAAMLG urgings and having undergone an ESAAMLG evaluation. Few member states have developed national AML/CFT strategies, and the shortage of skilled AML/CFT professionals at the national and regional level has persisted.

The ESAAMLG's capacity is further limited by provisions in the MOU that restrict its funding sources to subscriptions from states formally associated with the process and in-kind contributions.<sup>130</sup> As a result, for its first decade the ESAAMLG Secretariat had very few staff: an executive secretary, one or two professional staff, and four administrative assistants.<sup>131</sup> A 2010 review led to some steps to strengthen the secretariat, including recruiting additional expertise—the secondment of a staff member from the South African Financial Intelligence Centre and a legal officer. There was a small rise in member state subscriptions.

FATF has called for improvements to the ESAAMLG's post-MER monitoring process. It sees the current annual progress reports as “mere annual updates” and wants the same subjected to substantial investigations by ESAAMLG members at plenary where they are discussed, and substantial “peer pressure” applied to seek further compliance by the reporting members to the AML/CFT regime.<sup>132</sup> FATF sees this peer pressure mechanism as enabling members to learn from each other, such lessons being preferable to case studies from regimes outside the region. FATF has noted that low-level implementation by ESAAMLG members risks them being placed within the FATF ICRG process in which their “progress is closely and regularly monitored” and the reports of this monitoring made public, affecting how the global financial system perceives their level of risk.<sup>133</sup> Ethiopia and Kenya are currently in this group.

The ESAAMLG will be a crucial player in any effort to drive forward AML/CFT efforts in East Africa. As a sub-regionally owned initiative, it has unique legitimacy and access, but its emphasis on local ownership may be unnecessarily limiting its impact. For example, it has not been involved in training national-level officials on AML/CFT issues generally; ESAAMLG training activities have focused on providing the necessary skills to ESAAMLG evaluators and member state officials to participate in ESAAMLG mutual evaluations. Consideration may need to be given to amending the ESAAMLG MOU to allow greater funding support from development partners. In the past, the ESAAMLG has contemplated creating a regional center of excellence on AML/CFT and anticorruption issues. This could be established through a partnership among the ESAAMLG, one or more IFIs, and an appropriate civil society or academic partner, perhaps with financial support from foreign government donors and the financial sector, which stands to benefit substantially from such an initiative.

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128. FATF, “FATF President Giancarlo Del Bufalo's Address to ESAAMLG in Grand Baie, Mauritius,” 8 September 2011, [http://www.oecd.org/document/59/0,3746,en\\_32250379\\_32236879\\_48645627\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/59/0,3746,en_32250379_32236879_48645627_1_1_1_1,00.html).

129. *Ibid.*

130. ESAAMLG MOU, art. 5.

131. ESAAMLG, *From Arusha to Maseru*, annex 1.

132. FATF, “FATF President Giancarlo Del Bufalo's Address”.

133. *Ibid.*

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## Intergovernmental Authority on Development (IGAD)

IGAD is one of the AU's recognized regional economic communities. Established in 1986 as the Intergovernmental Authority on Drought and Development, it was transformed into IGAD in 1996 with an expanded mandate that included peace and security as well as economic cooperation and integration. Its seven member states are Djibouti, Ethiopia, Kenya, Somalia, South Sudan, Sudan, and Uganda. Eritrea's membership is suspended.

The IGAD peace and security agenda is encapsulated in a strategy whose objectives embrace promoting cooperation to address emerging common threats, including transnational organized crime and terrorism.<sup>134</sup> Over the past two years, IGAD has begun to address AML/CFT issues specifically in this context, having previously focused on terrorist financing issues within ICPAT. That initiative was created in June 2006 as a joint venture between IGAD and the ISS with a mandate to support IGAD member states to strengthen national capacities in counterterrorism and begin to develop regional structures and institutions against terrorism.<sup>135</sup> ICPAT focused on the enhancement of judicial capacities, strengthening of national interagency cooperation, enhancement of border security and management in IGAD's internal borders, training of law enforcement agencies in counterterrorism, and the building of strategic relationships in counterterrorism between the IGAD region and the national, continental, and global counterterrorism community.<sup>136</sup>

ICPAT's AML/CFT mandate was found within the enhancing judicial capacity mandate. In seeking to enhance the judicial capacity of member states to counter terrorism, ICPAT conducted research on the AML/CFT arrangements within member states. The study sought to identify the extent of their compliance and harmonization with international counterterrorism standards, not to ensure the existence of AML/CFT laws that were compliant with international standards.

ICPAT can count among its achievements the enactment and signing of the IGAD MLA and Extradition Conventions, developed in cooperation with the CGCC. Other achievements include professional development of law enforcement experts in terrorism, creation of knowledge on border security challenges and solutions, creation of templates for coordination of counterterrorism agencies at national level, and the development of regional thinking in counterterrorism. In the process, ICPAT developed partnerships, trust, access, and networks regionally and internationally, working with diverse partners such as the UN Counter-Terrorism Committee and the UN Counter-Terrorism Committee Executive Directorate, UNODC, the ACSRT, Interpol, EAPCCO, the International Organization for Migration, the World Customs Organization, the Office of the UN High Commissioner for Refugees, the Commonwealth of Nations Secretariat, the London Metropolitan Police Service, the U.S. Army, and FATF.

The primary tools used by ICPAT in its support of member states were seminars, workshops, training, and applied research to inform and influence policy. AML initiatives were limited to ensuring harmony with counterterrorism laws and did not include advocacy for their enactment or evaluation of their efficacy *vis-à-vis* international AML legal standards. More explicit attention was paid to CFT issues. ICPAT partnered with UNODC, the Commonwealth Secretariat, and the ISS in seeking that member states of IGAD enact counterterrorism legislation that had adequate CFT provisions. ICPAT promoted, in seminars and workshops, the ratification of all international conventions against terrorism, including the UN International Convention for the Suppression of the Financing of Terrorism. These exercises entailed training member states together with partners on the international instruments against terrorism, including all UN Security Council resolutions that have strong CFT requirements. In these forums, the extent of ratification or otherwise by all member states would be openly discussed to create subtle peer pressure on member states lagging behind to ratify. ICPAT was able to undertake these activities

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134. IGAD, *IGAD Peace and Security Strategy 2010–2014 (Final Draft)*, December 2010 (on file with editors). The IGAD Council of Ministers has not yet endorsed this strategy.

135. IGAD, *Memorandum of Understanding Between IGAD and ISS*, 2005 (on file with editors).

136. *Ibid.*

because, as an IGAD organ, it had broad political acceptance in the IGAD countries and leveraged this position to enlist partners with the relevant expertise, such as ISS, the Commonwealth Secretariat, and even legal consultants.

In October 2011, ICPAT's mandate was revised to conform with the IGAD peace and security strategy. ICPAT was terminated, and in its place, the ISSP was launched. The ISSP covers counterterrorism as well as organized crime, maritime security, and capacity building for security institutions. The objective is to develop regional legal and cooperation frameworks in all four of these focus areas and to strengthen human and institutional capacities.

ICPAT's past success likely flows from the combination of IGAD's political influence and convening power in the region and the advantages brought through cooperation with professional external implementing partners such as the ISS and the CGCC. The institute's management of ICPAT gave credibility to a startup organization and facilitated initial contacts with the international counterterrorism community. The CGCC's later involvement helped expand these efforts from Africa to the global counterterrorism community and helped ICPAT develop from a training-focused enterprise into one that increasingly set the policy agenda for the subregion. In contrast, the ISSP is being implemented fully within IGAD, not as a joint venture with an external partner as ICPAT was.



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# Overall Conclusions and Recommendations

**T**HE LASTING IMPRESSION PROVIDED BY THE interviews conducted for this Baseline Study is that the weakness of AML/CFT initiatives at the national and regional levels in East Africa reflects limited political will to tackle these issues as a matter of public policy and good governance. To a greater or lesser extent, stakeholders we engaged across the region indicated that they perceive official policies and arrangements to treat AML/CFT activities as a technical exercise, seeking the adoption of FATF-compliant technologies and methodologies aiming to appease development partners without actually internalizing AML/CFT norms as a necessity for economic growth and a reflection of other public policy priorities.

Weaknesses in political commitment to AML/CFT efforts play out in a number of ways at the regional level too, for example, in the lack of policy pronouncements by the AU on AML/CFT issues other than in broader discussions of corruption, drug trafficking, and terrorism or in the ESAA-MLG's narrowly technical focus. The EAC, with its compliance committees and linkage of the AML issue to the question of market integration, has made substantially more progress. The AfDB makes pronouncements on the economic importance of AML issues but has little capacity to turn these rhetorical commitments into institutional reform at the national level. IGAD is only newly moving into this territory.

A stronger AML/CFT effort for the region will require greater emphasis on the political and development significance of AML/CFT actions. Furthermore, although local ownership

is important, improved implementation may require creating a broader web of partnerships with external supporters, including nontraditional partners such as civil society, the financial sector, and, in some cases, other commercial actors.

Different strategies will be needed in three groups of countries, relating to the unique political, social, and economic circumstances in each country, as identified by the stakeholders we engaged.

The first group, comprising Djibouti, Kenya, and Uganda (and possibly Eritrea, to the extent that our research can be validated), will require broad, coordinated diplomatic, political, and business pressure to get serious about AML/CFT issues as a basis for their inclusion in the region's economic integration and growth before substantial forward progress is likely to be visible on the ground. A coordinated effort is needed to make clear to political and business elites in these countries that they stand to benefit more from the increased growth that respect for property rights, the rule of law, and market-based solutions will offer than they can expect to gain from patronage-based economic governance and tapping into illicit and even criminal financial flows. Foreign business investors with strategic interests in these countries should be recruited into this effort. In Djibouti, for example, Dubai Ports has a strategic interest in the development of the port and the stable development of Djibouti's financial governance. In Eritrea, about a dozen foreign mining firms from around the world could exercise leverage. In Kenya, numerous foreign business actors could

play such a role. In Uganda, the oil sector might need to be engaged.

The second group of countries, namely Ethiopia and Sudan, has recently demonstrated significantly higher levels of political commitment to building their AML/CFT capacities. (In time, Kenya might also join the ranks of these groups, given the recent approval of the operationalization of its FRC.) In these countries, the emphasis should be on holding governments to their AML/CFT promises by offering them large, coordinated packages of AML/CFT capacity-building assistance with a particular focus on strengthening FIUs. In each case, the beneficiary country is already part of an FSRB, so that FSRB should be intimately involved in the delivery process—in Ethiopia, it would be ESAAMLG; in Sudan, MENAFATF.

The third group—Somalia and South Sudan—are in a different situation altogether. In those countries, state institutions are in their infancy, and the priority must be on building relevant institutions, especially the basic capacity of the justice sector, from the ground up. In both places, regional and subregional organizations have an opportunity to create an operational presence, alongside UNMISS in South Sudan, for example, through the IGAD Liaison Office; or alongside AMISOM in Somalia. These cells would work with local officials to strengthen criminal justice institutions including police, prosecutors, and the judiciary, as well as financial regulatory institutions. They would be staffed by personnel from IGAD member states, which would serve a secondary purpose of creating personal networks between these officials, which may in time facilitate cross-border cooperation on these issues throughout the subregion.

Finally, there is a need to consider whether some cross-cutting issues might best be addressed through regional-level processes or forums. Two stand out. First, as the CGCC has argued in its report “Capitalizing on Trust,” there may be an opportunity to strengthen AML/CFT efforts in the subregion by organizing a series of confidence-building roundtables focusing on the role of remittance organizations and how they are regulated. Remittances and informal money transfers play a key role in the mixed formal/informal political economy of the region. Improving their capacity to discharge KYC and CDD obligations, to identify and manage the risks associated with

PEPs, and to work cooperatively with regulators could go a long way toward dealing with the region’s pervasive AML/CFT risks and vulnerabilities.

Second, serious thought should be given to setting up a regional Center for Excellence on AML/CFT and Anti-Corruption to provide responsive analysis conducted by independent experts, conduct training for the public and private sector on AML/CFT and anticorruption issues, and convene seminars and conferences. This center should work with all concerned subregional organizations and countries, but not be owned by any one of them. Instead, it could be established within a trusted academic institution or think tank, perhaps with support and guidance from subregional organizations and the IFIs. Its stakeholders should be seen not only as foreign donors interested in AML/CFT issues, but also local consumers: local governments, local subregional organizations, and crucially the private sector in the subregion, especially the financial sector. For that reason, although it might be set up through seed grants from government donors and major private foundations such as the Gates Foundation, which has recently started funding work in this area, it should aim to become financially self-sufficient over time, using training offerings for the private sector to raise sufficient revenue to be able to conduct independent research and analysis and provide bespoke assistance to interested governments.



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Money laundering and terrorist financing are major, interconnected problems for East Africa and the Horn. They pose threats to both security and development. States in the Intergovernmental Authority on Development (IGAD) subregion stand to benefit in multiple ways from stronger anti-money laundering (AML) and countering the financing of terrorism (CFT) efforts. Yet their efforts are hampered by limitations of data and knowledge about the subregion's AML/CFT vulnerabilities, risks, and capacities.

In this Baseline Study, in response to repeated requests from governmental, intergovernmental, private sector, and civil society partners, the IGAD Security Sector Programme (ISSP) and the Center on Global Counterterrorism Cooperation (CGCC) set out to fill that gap. The Study provides baseline data on perceptions of AML/CFT risks and capacities in the subregion, and identifies entrypoints for strengthened partnerships.

