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Bernd H. Klose (Ed.)

Asset Tracing & Recovery

The FraudNet World Compendium

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ERICH SCHMIDT VERLAG

Asset Tracing & Recovery

The FraudNet World Compendium

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Foreword

In my many years of investigating serious fraud as a journalist, a recurring theme is how little in the form of criminal proceeds are recovered from perpetrators for distribution to their victims. Even when fraudsters are actually criminally prosecuted and convicted, which is rare in itself, it is rarer still for there to be any meaningful recovery of their assets.

There are several reasons for this. A lack of money on the part of victims to fund a recovery effort is the most common one. Another is that, even when substantial funds are made available to try to locate, seize and freeze the assets of fraudsters, victims often hire attorneys who lack the necessary expertise, knowledge and experience to successfully unravel and pierce the complicated legal structures in multiple jurisdictions that fraudsters typically set up to protect their assets. In some cases, the mistakes are innocent and, in others, they are not, with investment frauds often followed by asset recovery scams. If victims are not careful, they can end up spending millions of dollars (on top of what they have already lost in the fraud) going nowhere slowly.

It does not have to be this way, however, and I am confident that you will find FraudNet's World Compendium "Asset Tracing & Recovery" a useful tool in educating you how to do things the right way so that you may meaningfully contribute to the ongoing fight by honest and hard-working people around the world to redress the enormous imbalance that currently exists between what is stolen and what is recovered.

In asset recovery, where fraudsters are prone to move their money out of concealed accounts in the most legally inhospitable of jurisdictions at the first hint of trouble and where being a day late is likely to cause an asset-tracer to be considerably more than a dollar short, it is imperative for victims and their advisors to act quickly and decisively. To do that, they must hire attorneys and investigators who know what they are doing.

Three of the contributing authors to this book are known to me personally and fall into this category, namely Martin Kenney, Ed Davis, and Bernd Klose. They, along with a fourth contributor, Christopher Redmond, have all spoken at an annual conference that I organize in Miami, Florida to educate attorneys, investigators, law enforcement, regulators, bankers, financial services providers and others about fraud detection and asset recovery. The OffshoreAlert Financial Due Diligence Conference attracts hundreds of high-level attendees from around the world who come to be educated by industry leaders such as Martin, Ed, and Bernd. Martin and Ed, in particular, have been instrumental in designing and developing the asset recovery agenda of the event. Martin has been involved since the conference's inception in 2002 and, the first time I heard him speak, it was obvious to me that he is unusually knowledgeable and passionate about asset recovery. He is the personification of the word "expert" and he has developed a formidable international reputation among his peers and enemies alike. Ed, meanwhile, joined the conference in 2003 and, along with Martin, he is the person I rely on most to ensure that our asset recovery agenda stays up-to-date with the latest laws, techniques and case studies on an international basis. Ed is regularly rated as one of our best speakers by attendees for the articulate, enthusiastic and tenacious manner in which he imparts his vast knowledge.

The most sincere compliment I can pay Martin, Ed and Bernd collectively is that, in the highly unlikely event that I decide to convert from an investigator of fraud to a perpetrator of it, they are among the last people on earth I would want poking into my financial affairs. It would possibly worry me more than a criminal investigation, which I suspect might be easier to deal with.

On a more sombre note, as an investigative journalist, I witness the effects of serious fraud on a continual basis. I see the emotional devastation and misery that often accompanies a financial loss. It is not a pretty sight. None of us are immune from becoming a victim, including me. It is with some embarrassment that I confess that, even with my extensive experience of investigating dishonesty, I too have suffered a financial loss by placing my trust in people who were not deserving of it.

Given the pervasiveness of dishonesty in our society, books like FraudNet's World Compendium "Asset Tracing and Recovery" have a special importance. It will assist readers in hitting fraudsters where it hurts them the most, i. e. their pockets.

David E. Marchant, Publisher, OffshoreAlert

Editor's Foreword

The French writer Joseph Joubert (1754–1824) is attributed with the statement that "Justice is the right of the weaker". And nowhere does justice seem to be in greater jeopardy than in cases of fraud. This is where criminals devise meticulously thought-out plans and apply unscrupulous tactics to surreptitiously obtain trust and exploit their victims.

In the age of globalisation, these criminals conceal themselves behind a conglomerate of self-erected companies, seemingly legal undertakings whose single purpose is to enable them not only to commit crimes, but also ensure them the long-term benefits. Criminals set up their companies with all of the financial finesses in order to pry the booty from the victim via internet at the speed of light. Erecting a façade of legitimacy, the criminal takes advantage of the rights he is conceded in a whole series of states all over the world while perverting them by his very actions. He not only perverts the law; he also jeopardises the fate of many a state in the world that did not pass generous trade and corporations laws to profit from fraud, but because they lack the natural resources and infrastructure that allow them to legitimately develop their countries.

Whoever is involved in making sure that the victim is given back the assets he has been deprived of will quickly discover that criminals are apparently at an advantage. They do not require much effort at all to overcome borders between states and legal systems while the victim only has limited resources for recouping assets. The reason is the fact that the victim has to rely on national law that is hardly designed to overcome the borders to other countries and legal systems with the same speed criminals can move at. That said, if we take a closer look at the statutory regulations forming the linchpins of global asset tracing and recovery, we quickly discover that a lot of different tactics are being pursued to give the victim assistance to make sure that crime is not a profitable business. We are following different tacks to reach the same goal, and that is depriving criminals of ill-gained assets and returning them to the rightful owner.

It might seem impossible to a lawyer on the continent of Europe that confidentiality in banking could be suspended by court order in some offshore location for making all of the bank documents of the alleged criminal or his companies available to the victim, even without giving him a hearing. It might seem even more incomprehensible to a lawyer living under common law that the state criminal prosecution authorities not only go into action for the victim in civil law systems, but that he also can take advantage of all of the investigations of the state prosecutor's office.

We have FraudNet, the association set up in Paris by the International Chamber of Industry and Commerce in 2004, to thank for getting experienced attorneys from 43 countries all over the world to meet under its auspices and regularly learn from one another. They not only specialise in the legal systems of their own home countries. They also have a rudimentary comprehension of the statutory regulations in other countries to help victims – those "weaker" persons. They not only do this to guarantee that crime doesn't pay, but because justice is indeed the right of the weaker.

It is a special honour for me that my colleagues who were organised in FraudNet in 2008 have taken up my idea of an international manual on asset tracing and recovery and worked with so much enthusiasm and enormous effort so that this book could be published just one year later. This is bound up with the hope that the knowledge it contains might help these victims enforce their rights over all borders against criminals anywhere in the world.

Bernd Klose
Friedrichsdorf/Taunus, October 2009

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Serious Fraud

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1 What Constitutes Serious Fraud?

There is no statutory definition of "serious fraud" although it is generally accepted involving the following elements: deliberate deception, trickery or cheating, intended to gain an advantage.

Simply put, fraud is a deliberate deception for unlawful gain. Often the term "white-collar crime" is used to describe fraud crimes committed by individuals, businesses and government professionals.

The phrase "white-collar crime" was coined in 1939 during a speech given by Edwin Sutherland to the American Sociological Society. Sutherland defined the term as "crime committed by a person of respectability and high social status in the course of his occupation". Although there is some disagreement as to what constitutes white-collar crime, the term may be said broadly to encompass a variety of non-violent crimes committed for the most part in commercial situations for financial gain. Many white-collar crimes are especially difficult to prosecute because the perpetrators use sophisticated means to conceal their activities through a series of complex transactions. The most common white-collar offenses include: antitrust violations, computer and internet fraud, credit card fraud, phone and telemarketing fraud, bankruptcy fraud, healthcare fraud, environmental law violations, insurance fraud, mail fraud, government fraud, tax evasion, financial fraud, securities fraud, insider trading, bribery, kickbacks, counterfeiting, public corruption, money laundering, embezzlement, economic espionage and trade secret theft.

Most of the above involve an element of fraud on the behalf of the offender. Put simply the offence of fraud would be committed where a person(s) or company dishonestly, to make a gain or to cause loss, make(s) a false representation, wrongfully fails to disclose information, or secretly abuses a position of trust. This also covers the offence of obtaining services dishonestly, where a person by any dishonest act, obtains services in respect of which payment is required, with intent to avoid payment.

The offences very often involve an allegation of conspiracy. This involves an agreement between two or more people to commit an offence.

While there is no comprehensive definition of serious fraud, for present purposes it covers activity the actual, likely or intended result of which is either a substantial financial gain to some person or serious prejudice to another. An act which would not by itself constitute serious fraud may nevertheless be so regarded if it forms part of a course of conduct the end result of which is substantial financial gain to some person or serious prejudice to another.

2 How Serious Is the Problem?

Serious! What is more, the impact of the current economic conditions is likely to lead to a sharp rise in not just the discovery of cases of fraud and white-collar crime but also the perpetration of it.

In the year 2008 fraud in the UK reached GBP 1.1 billion across 239 cases, according to the KPMG Forensic Fraud Barometer. This constitutes the second highest value and number of cases since the research – which monitors large cases coming before UK courts and involving fraud-related offences – started in 1987. Fraud by professional gangs remained at the extremely high levels seen in previous years (GBP 800 million in 2008), but there was a marked increase in fraud by individuals. Taken together, company managers, employees and customers were tried for some GBP 300 million of fraud last year, three times the value seen in 2007.

KPMG reported that the bulk of the fraud committed since the credit crunch began in August 2007 will most likely not yet have come into the public courts. The Fraud Barometer's records show that in the last recession of the early nineties the full peak of fraud in the courts was not reached until 1995.

There are three major factors in fraud, opportunity, motive and rationalisation. Opportunity can be presented by weaknesses in an organisation which allow fraud to happen and create an atmosphere where fraudsters believe they can operate with impunity. Motive ranges from simple financial pressure, whether personal or corporate: the need or desire to maintain a lifestyle, or pressure from managers to meet targets, to plain greed. Rationalisation is where the fraudster justifies actions which are otherwise unjustifiable.

An economic downturn can contribute to the first and second factors, and therefore can lead to increasing incidences, but also discovery, of fraud in these periods. Clearly there is more financial pressure in such a context, personal spending power is curtailed or reduced and companies find it more difficult to reach financial targets. As a result processes and controls are subject to increased scrutiny, under-performance leads to thorough reassessment of figures and priorities, thus increasing the likelihood of detection of irregularities. In addition, reduced employee work-load allows the possibility of time diversion to house keeping as opposed to profit generation. In simple terms, the results are more motivation to commit fraud and more discovery of it.

3 Serious Fraud – A Sampling of What Is Involved

The varieties of fraud are infinite. Here is just a sampling of the forms it takes.

3.1 Corporate Fraud

Corporate fraud is simply fraud on the company, predominantly perpetrated by employees or service providers. It can include falsification of financial information, including

- false accounting entries;
- bogus trades designed to inflate profit or hide losses; and
- false transactions designed to evade regulatory oversight.

It can also encompass

- self-dealing by corporate insiders, including insider trading;
- kickbacks;

- backdating of executive stock options;
- misuse of corporate property for personal gain; and
- individual tax violations related to self-dealing.

3.2 Market Manipulation

There is no generally accepted definition of the term market manipulation. Although manipulation is prohibited under a number of statutes in various jurisdictions, it tends not to be defined precisely. "Manipulation is difficult to define, but manipulative practices and schemes are usually readily identifiable."[1]

Market manipulation generally involves an attempt to interfere with the operation of the market. Various commentators have described it as "conduct intended to induce people to trade a security or force its price to an artificial level" or "deliberate interference with the free play of supply and demand in the securities markets". In essence Market manipulation involves the intentional interference with the forces of supply and demand in the market for securities – it is an act of dealing in shares to raise, lower or maintain their price in order to entice others to purchase these shares. The adverse effects of such activities are manifested in the misleading appearance of the volume of trade or disruption of price for a particular counter, created with the intention of deceiving genuine investors into entering the market place on a perceived uptrend. Market manipulators, thus, exploit the situation by offloading shareholdings at inflated prices. The ensuing crash, as the market adjusts itself to the genuine price of the share to which the manipulation was perpetrated, leaves existing investors holding shares worth less than the amount at which they were purchased.

One of the most prevalent forms of market manipulation is what is commonly referred to as "pump and dump". These schemes are effected by creating artificial buying pressure for a targeted security, generally a low-trading volume issuer in the over-the-counter securities market, that is largely controlled by the fraud perpetrators. This artificially increased trading volume has the effect of artificially increasing the price of the targeted security ("pumping"), which is rapidly sold off into the inflated market for the security by the fraud perpetrators ("dumping"), resulting in improper gains to the perpetrators and losses to innocent third party investors. Typically, the increased trading volume is generated by inducing unwitting investors to purchase shares of the targeted security through false or deceptive sales practices and/or public information releases.

A modern variation on these schemes involves largely foreign-based computer criminals gaining unauthorized access and intruding into the online brokerage accounts of unsuspecting victims in the other jurisdictions. These intruded victim accounts are then utilized to engage in coordinated online purchases of the targeted security to effect the pump portion of a manipulation, while the fraud perpetrators sell their pre-existing holdings in the targeted security into the inflated market to complete the dump.

[1] Vivien Goldwasser, Stock Market Manipulation and Short Selling. (Centre for Corporate Law and Securities Regulation, 1999), 154.

3.3 High Yield Investment Fraud

High yield investment fraud schemes may take a variety of forms but are all characterized by offers of low or no risk investments that guarantee unusually high rates of return. Most common among this type of fraud are the following schemes.

3.3.1 The Ponzi Scheme

Named after its early 20^{th} century creator, Charles Ponzi, these schemes use money collected from new "investors" (i. e., victims), rather than profits from the purported underlying business venture, to pay the high rates of return promised to earlier victims. This arrangement gives victims the impression that there is a legitimate, money-making enterprise behind the perpetrator's story when, in reality, victim monies are the only source of funding.

3.3.2 The Pyramid Scheme

As in Ponzi schemes, the money collected from newer victims of the fraud is paid to earlier victims to provide a veneer of legitimacy. In pyramid schemes, however, the victims themselves are induced to recruit further victims through the payment of recruitment commissions.

3.3.3 Prime Bank Scheme

Victims are induced to invest in financial instruments, allegedly issued by well-known institutions, which offer risk-free opportunities for high rates of return; the benefits are allegedly the result of the perpetrator's access to a secret worldwide exchange ordinarily open only to the world's largest financial institutions.

3.4 Advance Fee Fraud

This category of fraud encompasses a broad variety of schemes that are designed to induce their victims into remitting up-front payments in exchange for the promise of goods, services, and/or prizes. In the securities and commodities fraud context, victims are informed that in order to participate in a promising investment opportunity, they must first pay various taxes and/or fees.

3.5 Hedge Fund Fraud

Hedge Funds are private investment partnerships that have historically accepted only high-net worth clients willing to meet significant minimum investment thresholds. The industry as a whole has been largely unregulated but has become increasingly relevant to middle class investors through their exposure to hedge fund activities via ancillary investments (e. g., pension funds). The relative lack of regulatory scrutiny has made the industry vulnerable to fraud by fund managers, to include: overstatement/misappropriation of fund assets; overcharging for fund management fees; insider trading; market timing; and late trading.

3.6 Commodities Fraud

These schemes typically involve the deceptive or fraudulent sale of commodities investments. In such instances, false or deceptive sales practices are used to solicit victim funds for commodities transactions that either never occur or are inconsistent with the original sales pitches. Alternatively, commodities market participants may attempt to illegally manipulate the market for a commodity by fraudulently reporting price information or cornering the market to artificially increase the price of the targeted commodity.

3.7 Foreign Exchange Fraud

These schemes are characterized by the use of false or deceptive sales practices, alleging high rates of return for minimal risk to induce victims to invest in the foreign currency exchange market. In such instances, the touted transactions either never occur, are inconsistent with the original sales pitches, or are executed for the sole purpose of generating excessive trading commissions in breach of fiduciary responsibilities to the victim client. Alternatively, individual corrupt currency traders employed by large financial institutions may attempt to manipulate foreign currency exchange prices in an effort to generate illicit trading profits for their own enrichment.

3.8 Broker Embezzlement

These schemes involve illicit and unauthorized actions by brokers to steal directly from their clients. Such schemes may be facilitated by the forging of client documents, by the doctoring of account statements, or by unauthorized trading/funds transfer activities or other conduct in breach of the broker's fiduciary responsibilities to the victim client.

3.9 Late-Day Trading

These schemes involve the illicit purchase and sale of securities after regular market hours. Such trading is restricted in order to prevent individuals from profiting on market moving information which is released after the close of regular trading. Unscrupulous traders attempt to illegally exploit such opportunities by buying or selling securities at the market close price, secure in the knowledge that the market moving information will generate illicit profits at the opening of trading on the following day.

3.10 Mortgage Fraud

This encompasses any type of fraud on Mortgage based Lenders, sometimes second and even third mortgages can be taken out on one property with the result that somewhere in the chain a Lender is left exposed. Such frauds include the following.

3.10.1 Property Flipping

In these frauds property is purchased, falsely appraised at a higher value, and then quickly sold. The schemes typically involve one or more of the following: fraudulent appraisals, doctored loan documentation, inflating buyer income, etc. Kickbacks to buyers, investors, property/loan brokers, appraisers, and title company employees are common in this scheme.

3.10.2 Silent Second

In this scenario the buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.

3.10.3 Nominee Loans/Straw Buyers

The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

3.10.4 Fictitious/Stolen Identity

A fictitious/stolen identity may be used on the loan application. The applicant may be involved in an identity theft scheme: the applicant's name, personal identifying information, and credit history are used without the true person's knowledge.

3.10.5 Foreclosure Schemes

The perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Perpetrators mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator profits from these schemes by remortgaging the property or pocketing fees paid by the homeowner.

3.10.6 Equity Skimming

An investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.

3.10.7 Air Loans

This is a non-existent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows.

3.11 Mass Marketing Fraud

Mass marketing fraud is a general term for frauds that exploit mass-communication media, such as telemarketing, mass mailings, and the Internet. Since the 1930s, mass marketing has been a widely accepted and exercised practice. Advances in telecommunications and financial services technologies have further served to spur growth in mass marketing, both for legitimate business purposes, as well as for the perpetration of consumer frauds.

3.12 Advance Fee Fraud

This category of fraud encompasses a broad variety of schemes that are designed to induce their victims into remitting up-front payments in exchange for the promise of goods, services, and/or prizes. Some of the most prevalent schemes being encountered are the following.

3.13 Nigerian Letter Fraud

Victims are contacted regarding substantial sums of money held in foreign accounts and are requested to pay various fees to secure their transfer to the victim's home jurisdiction in exchange for a portion of the total proceeds. Alternatively, victims are asked to act as an agent in securing the release of such funds and are provided with counterfeit instruments that are to be cashed in order to pay any required fees, only to discover they must reimburse their financial institution for cashing a counterfeit instrument.

3.14 Foreign Lottery/Sweepstakes Fraud

Victims are informed they have won a substantial prize in a foreign drawing, but must remit payment for various taxes/fees to receive their winnings. Alternatively, victims are provided with counterfeit instruments, representing a portion of the winnings, which are to be cashed in order to pay the required fees, only to discover they must reimburse their financial institution for cashing a counterfeit instrument.

3.15 Overpayment Fraud

Victims who have advertised some item for sale are contacted by buyers who remit counterfeit instruments, in excess of the purchase price, for payment. The victims are told to cash the payments, deduct any expenses, and return or forward the excess funds to an individual identified by the buyer, only to discover they must reimburse their financial institution for cashing a counterfeit instrument.

The predominantly transnational nature of the mass marketing fraud crime problem presents significant impediments to effective investigation by any single agency or national jurisdiction. Typically, victims will reside in one or more countries, perpetrators will operate from another and the financial/money services infrastructure of numerous additional countries utilized for the rapid movement and laundering of funds.

4 What Is a Serious Fraudsman?

The Serious Fraudsman is someone who operates well outside of the bounds of what is normal behaviour. Free from the shackles of conscience, the most successful sharp dealers travel with little restraint.

Deceit is part of the human condition. Successful deceit, by its nature, requires the ability to persuade or convince others that all is as it should be. Such powers of persuasion are not borne of an ability to act but a supreme sense of self belief and often of arrogance. The dishonest obligor believes that he is entitled to what he takes and hides by virtue of the fact that he is who he is. Those whom he harms are viewed with contempt. Fydor Dostoevsky's insight into this world was aptly captured at the end of his novel, The Brothers Kharlamov, with two words – "Senseless, he."

The relationship between the widely accepted symptoms of antisocial personality disorders and the markings of leading economic criminals is remarkable. In 1993, one of the authors of this paper was advised by a psychiatrist in New York to read the grounding literature from his field of learning to obtain a better understanding of many of the people who were the subjects of his investigations. One of the seminal works in the study of psychiatry in respect of the most serious disorder of the criminal mind – authored by the husband and wife team of McCord and McCord in 1964 and called "The Psychopath"[2], reveals much about the people who count themselves among the world's leading economic criminals. The same is true of Cleckley's, The Mask of Sanity (Fourth Edition, 1964), which was the first work to draw "attention to the lack of success psychiatrists had in their efforts to treat the typical psychopath and to how the essential elements of the disorder made it a particularly unapproachable and difficult condition to manage".[3]

Cleckley suggested that the disorder was "masked by a well functioning, expressive and receptive process, whereby the psychopath can express himself vividly and eloquently, often conning others with his superficial charm".[4] In a lecture by psychiatrist Abigail Z. C. Mallillin, the following quotation was offered from a person with the disorder:

"*He will choose you, disarm you with his words, and control you with his presence. He will delight you with his wit and his plans. He will show you a good time, but you will always*

[2] McCord, W. & McCord, J., The Psychopath, Princeton: Van Nostrand, 1964.

[3] Lee, J. H., The Treatment of Psychopathic and Antisocial Personality Disorders: A Review, Clinical Decision Making Support Unit, Broadmoor Hospital (U. K.). ["Lee, J. H."].

[4] Id. at p. 5.

get the bill. He will smile and deceive you, and he will scare you with his eyes. And when he is through with you, and he will be through with you, he will desert you and take with him your innocence and your pride. You will be left a lot sadder, but not a lot wiser, and for a long time you will wonder what happened and what you did wrong. And if another of his kind comes knocking on your door, you will open it. From an essay signed, 'A psychopath in prison'."[5]

5 How Do You Recognise His Trappings and Understand His Behavior?

The following points attempt to capture the essential trappings of a serious fraudsman. They are based upon observations of the writers and include quotations from judgments of well-known English jurists on the topic.

- He evinces no intention to be bound by public or private obligations. Law, contract, and obligation mean nothing. He will keep this fact hidden.
- He is often of casual or multiple residence.
- He knows no barriers. International boundaries are crossed with impunity.
- He will ordinarily hide his wealth behind a labyrinth of secret offshore companies, trusts, and other apparently legitimate devices and instruments. The liquid assets of his puppets are run through banks, whose client confidences are usually subject to the protection of criminal secrecy legislation. As Lord Cumming-Bruce of the English Court of Appeal said in Re: A Company [1985] BCLR 333, "… *he* [hides] *his wealth behind a … web of puppet companies, with puppet directors dancing to his* [the fraudsman's] *every tune*". One of the leading jurists of 20^{th} Century in Great Britain, Lord Justice Denning, Master of the Rolls, had this to say of the fraudster, Dr. Wallersteiner, in a seminal decision: "*He* [brings] … *into his service to further his unworthy ends … puppet concerns of his own making … puppet trusts in Liechtenstein … a puppet finance company in the Bahamas …* [and] *a puppet banking company in the City of London …*"[6]
- Another English Court offered the following: "*He uses a company as a … device and a sham, a mask which he* [holds] *before his face in an attempt to avoid recognition by the eye of equity.*"[7]
- He manifests an element of arrogance. There is an analogy from history, Julius Caesar. Caesar, the vituperative dictator, yearned for legitimacy. This is the constant. That *yearning*. So too, is it an absolute with sharp dealers that they feel the need to continue to represent to diverse parties that they are clever, shrewd and one step ahead of the game.
- He is cunning. He studies his victims before he strikes.

Many economic criminals bear these markings unobtrusively, sometimes in apparent obeisance. They come to banks, lawyers, accountants and other professionals, clothed

[5] As quoted in Lee, J. H. at p. 6.
[6] Denning MR, in the English Court of Appeal decision in *Wallersteiner v. Moir* [1974] 3 All ER 217, 223.
[7] *Jones v. Lipman* [1962] 1 WLR 832.

with the letters and trappings of legitimacy. The sharp dealer is well used to the successful juggle between appearance (or what he represents to the world at large) and reality (representing the dishonest self).

The literature of psychiatry provides key indicators of the presence of psychopathic disorders. These indicators are substantially similar to, and in some instances identical with, the seven points set-out above describing the signs of a serious economic criminal:

"– *callous unconcern for the feelings of others;*
– *gross and persistent attitude of irresponsibility and disregard for social norms, rules and obligations;*
– *incapacity to maintain enduring relationships, though having no difficulty in establishing them;*
– *very low tolerance to frustration and a low threshold for discharge of aggression, including violence;*
– *incapacity to experience guilt and to profit from experience, particularly punishment; and*
– *marked proneness to blame others, or to offer plausible rationalizations, for the behavior that has brought the patient into conflict with society.*" (International Classification of Diseases and Related Health Problems, Section F60, World Health Organization, 1992, as set-out in Lee, J. H., supra, at p. 4.)

In 1994, the American Psychiatric Association said that an anti-social personality disorder is present in persons over fifteen years of age who display three or more of the following seven characteristics – indicating a "pervasive pattern of disregard for and violation of the rights of others":

"– *failure to conform to social norms with respect to lawful behaviors as indicated by repeatedly performing acts that are grounds for arrest.*
– *deceitfulness, as indicated by repeated lying, use of aliases, or conning others for personal profit or pleasure.*
– *impulsivity or failure to plan ahead.*
– *irritability and aggressiveness, as indicated by repeated physical fights or assaults.*
– *reckless disregard for safety of self and others.*
– *consistent irresponsibility, as indicated by repeated failure to sustain consistent work behavior or honor financial obligations.*
– *lack of remorse, as indicated by being indifferent to, or rationalizing having hurt, mistreated, or stolen from another.*"[8] (Diagnostic and Statistical Manual of Mental Disorders, American Psychiatric Association, Lee, J. H., supra, at pp. 4–5.)

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[8] Hare's Psychopathy Checklist (1985) was based on a list of sixteen characteristics considered to be typical of psychopaths. He applied them to a series of prisoners. After further study, he expanded the list to a twenty-item version. Ratings of 0–2 apply to each item, which can give a maximum score of 40. At a cut-off score of 30 or above, a subject is designated a psychopath. This is Hare's list of characteristics: (1) glibness/superficial charm; (2) grandiose sense of self-worth; (3) need for stimulation/proneness to boredom; (4) pathological lying; (5) cunning/manipulative; (6) lack of remorse or guilt; (7) shallow affect; (8) callous/lack of empathy; (9) parasitic lifestyle; (10) poor behavioral controls; (11) promiscuous sexual behavior; (12) early behavioral problems; (13) lack of realistic, long-term goals; (14) impulsivity; (15) irresponsibility; (16) failure to accept responsibility for own actions; (17) many short-term marital relationships; (18) juvenile delinquency; (19) revocation of conditional release; and (20) criminal versatility.

In a 2007 Study by KPMG entitled Profile of a Fraudster Survey, based on a review of 360 actual fraud cases investigated in Europe, the Middle East and Africa, the typical fraudster

- was Male in 85 % of the cases,
- between the age of 36 and 55 years in 70 % of the cases,
- acted alone in 68 % of the cases.

6 How Does He Operate?

The activities specific to each dishonest obligor can vary according to where and from whom he learnt the trade and the opportunities that present themselves. There are however common themes and methods that continue to be used due to their reliability, and also because they mirror ordinary commercial transactions and are thus relatively safe ways of taking value by deception without stimulating suspicion at the early stages of a fraud.

Fraud has been with us for a long time. The English poet and novelist, Daniel Defoe, described, in rhyme, the phenomenon and mad hysteria that arose from the perpetration of a broad series of major frauds on the British capital market in 1720 known as the "South Sea Bubble":

"*Some in clandestine companies combine; Erect new stocks to trade beyond the line; With air and empty names beguile the town; And raise new credits first, then cry 'em down'; Divide the empty nothing into shares; And set the crowd together by the ears.*" Defoe (1660–1731)

In a world where boundaries diminish by the day, the opportunities to misappropriate wealth are endless and mutate dynamically. The proliferation of goods and services available for purchase over the Internet expands the facility of fraudsters to set up seemingly legitimate businesses anonymously, attract clients and their money and close their "operation" before law enforcement officials have a chance to investigate complaints which often take months to filter through.

Despite the varied methods available to "take" wealth, once a fraudster has chosen a method or created a ruse to trap money illegitimately, he will often stick with that method, preferring to hone it rather than change a routine or formula that has proven successful in the past. Thus, where a dubious enterprise has been shut down by law enforcement, it will frequently raise its ugly head in another part of the world, or indeed simply under another name and with a different appearance.

7 Who Are His Co-Conspirators and Facilitators?

His co-conspirators are knowing accomplices. However, there are also those who may assist in the primary acts of taking by deception unwittingly. These are often employees, following orders, and unaware that they are party to a dishonest design. Once the wealth has been successfully taken, it then must be hidden to obscure its provenance.

He cannot hide his *fructus sceleris* (the fruits of fraud) on his own. He needs the assistance of others – bankers, advisors, trustees, nominees and lawyers. Those advisors may fall into one or more of three categories:

1. the unwitting, innocent;
2. the reckless, indifferent, or perhaps wilfully blind counsellor; and
3. the witting co-conspirator.

It is these parties who facilitate. One of the keys to gaining an understanding of how to successfully address a wrongdoer is recognising that he needs the professional assistance of these people, and how they can be of use to him.

8 Serious Fraud Requires Serious Concealment

What we have outlined above can be termed the *first tier* fraudulent conduct; however the fruits of the fraud must be somehow concealed.

What we term the *second tier* fraudulent conduct is expressed by the sequestration of the *fructus sceleris* behind a veil of nominees, companies, trusts and other special purpose vehicles.

We revert to the protagonist. It is this master manipulator who controls both sets of activities, both tiers of the miscreant factual complex. To borrow from a recurring theme found in Shakespeare's tragedies, we dwell in two worlds – the world of appearance, and the world of reality. The reality is the protagonist who uses deceit to manipulate fact. If he is taken to task within the comfortable confines of conventional legal process, he will, in part, claim to be penurious, an asset-less hull. He points to his penury. He lies.

He uses deceit to steal and hide the money, and to keep it. To continue with Shakespeare's appearance and reality theme, there is this. Dancing about the self-described penurious protagonist are companies formed in the Turks and Caicos Islands, Panama, Luxembourg and the Bahamas. Tiers of trusts, bank accounts and companies reposed with wealth abound. Finding the hidden wealth is of no practical value unless it is attended with detailed, documented evidence attributing its beneficial ownership to *him*. Ordinarily, such evidence must also be procured under the protection of utmost secrecy so that it can be meaningfully used to pre-emptively freeze or preserve the assets thus located. Proof of the protagonist's suffocating dominance over his wealthy puppets often stands on the other side of what appears to be a legal analytical abyss.

His perceived strength is thus the fortressing of value beyond layers of asset hiding and purification devices. His fortress seems impenetrable.

One method used to launder the proceeds of bad dealing is known in the laundering trade as a *starburst*. This term is used to describe multiple, concurrent conveyances of fragments of money stolen through deceit. The *star* (of stolen monies) bursts, most usually a *scintilla* after the moment in time when the fraudster secures control over the object of his scheme – the money.

In a *starburst*, there are many co-participants acting in concert with the protagonist. At the instance of the fraudster, monies are disbursed to diverse locations (or, more accurately, to *people co-ordinates*) at once. A *starburst* has a point of inevitable, predictable collapse. The starburst implodes when the *people co-ordinates* at the outer reaches of it cause the funds to be moved onward. The *starburst* collapses at the point at which the protagonist retakes control of the preponderance of the monies which he caused to be disbursed in the first place. The monies do not typically return to their place of original jurisdiction. These funds are often reposed in a place of end deposit onshore, held by an offshore company – which is owned in turn by an offshore trust.

Each of the *people co-ordinates* in a starburst can earn a fee of between 2 % and 5 % of the value of the funds moved through their hands.

The use of puppet companies and trusts as repositories of the title to value held in bank accounts in the classic bank secrecy locales, makes an intimidating statement to the victim. This, combined with instances where a *starburst* (or other similar method) is used to deny the victim a clear trail to the point of end deposit, has the effect of compounding the forcefulness of the fraudster's statement.

The problem presented by asset concealment has serious repercussions not simply for the victims of primary fraud, but for confidence in the capital markets and the wellbeing of the world's economy. Assets concealed are assets upon which taxes are only rarely paid. Wealth concealed is effectively out of legitimate circulation. The presence of vast amounts of "concealed" wealth in the global monetary system distorts economic reality.

The offshore world consists of approximately 70 tax havens, the majority of which attract capital principally by maintaining bank and fiduciary relation secrecy legislation and by employing a policy of low taxation on foreign deposits and business enterprises.[9] Secrecy legislation purports to criminalize the dissemination of information concerning the ownership of wealth imparted to offshore banks, trust companies, lawyers or other confidants. These locales represent either a haven for, or an important element used to conceal, dubious wealth. It has been estimated that trillions of dollars of value passes through or is held in offshore accounts each year.

Although estimates of the size of the problem of international money laundering vary, the body that sets the global standard in helping countries to combat money laundering, the Financial Action Task Force on Money Laundering ("FATF"),[10] has said the following:

"*By its very nature, money laundering occurs outside of the normal range of economic statistics. Nevertheless, as with other aspects of underground economic activity, rough estimates have been put forward to give some sense of scale of the problem.*

The International Monetary Fund, for example, has stated that the aggregate size of money laundering in the world could be somewhere between two and five percent of the world's gross domestic product.

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9 Tax Havens of the World, Diamond, Walter

10 There are currently 34 members of the FATF; 32 jurisdictions and 2 regional organisations (the Gulf Cooperation Council and the European Commission). These 34 Members are at the core of global efforts to combat money laundering and terrorist financing. There are also 27 international and regional organisations which are Associate Members or Observers of the FATF and participate in its work.

Using 1996 statistics, these percentages would indicate that money laundering ranged between USD 590 billion and USD 1.5 trillion. The lower figure is roughly equivalent to the value of the total [annual] *output of an economy the size of Spain.*

Back in 1998, it was estimated that there were some 4,000 offshore banks licensed in almost 60 offshore jurisdictions and which controlled as much as USD 5 trillion in assets. About 44 % of the banks were located in the Caribbean and Latin America."[11]

Money laundering around the globe has increased dramatically over the past few decades. There is no single estimate of the actual dollar amount involved. However, the US Department of the Treasury has estimated that "*$ 600 billion represents a conservative estimate of the amount of money laundered each year*".[12] According to KPMG's 2007 Money Laundering survey estimated money laundering flows are reported to be in excess of USD 1 trillion being laundered every year by drug dealers, arms traffickers and other criminals.

In the most recent survey of money laundering cases in the US – although now admittedly somewhat dated – it was reported that in 2001, US District Courts completed 1,420 money laundering cases and convicted 1,243 individuals, or more than 87 % of the defendants were prosecuted. Some of these cases involved more than USD 100 million in laundered funds, and one-fifth of the cases involved more than USD 1 million. Of the Money Laundering Control Act charges made in 2001, 63 % involved fraud, bank embezzlement, the transportation of stolen property, and counterfeiting, and 16 % involved drug trafficking. Almost half (44 %) of the money laundering cases referred to US Attorneys in 2001 occurred in the six geographic areas designated by the US Departments of Justice and the Treasury as areas of high risk for financial crimes and money laundering activity (High Intensity Financial Crime Areas or HIFCAs).[13]

9 How Does Serious Fraud Happen? The Fraudster's Strength

What then is *his* true strength? It is *we* and our domain – the domain of banks, insurance companies and other repositories of legitimate wealth. To a fraudster, such institutions are predictable and unimaginative.

Victims can also be drawn from the unthinking masses. In 1852, Charles Mackay catalogued some of the most incredible examples of human folly in the second edition of his classic – "*Extraordinary Popular Delusions and the Madness of Crowds*". Mackay's work is a salutary reminder that the follies of man are not unique to Enron, WorldCom, Global Crossing, Adelphia Communications, Bre-X Minerals, mass telemarketing fraud, or the dot-com bubble. Mackay records the story of John Law and his Mississippi Company – which effectively bankrupted the people and nation of France in 1720 through frenzied speculation in shares of one company, merely because it had been granted the exclusive right to trade between France and the East Indies, China and the South Seas.[14] He also

11 See, www.oecd.org/fatf/NCCT/_en.htm.

12 See, www.treas.gov/offices/enforcement/publications/ml2002.pdf.

13 Bureau of Justice Statistics (17 July 2003). [Press release – "Over 18,000 charged with Federal money laundering from 1994–2001."]. US Department of Justice. www.ojp.usdoj.gov/bjs/pub/press/mlo01pr.htm.

14 Mackay, C., "Extraordinary Popular Delusions and the Madness of Crowds" (2^{nd} Ed.) (1852), page 14.

reveals the folly of the South Sea Bubble – which nearly did the same to Great Britain at the same time – and where "knavery gathered a rich harvest from cupidity",[15] and "visions of ingots danced before their eyes".[16] "Tulipomania" of 1636 Holland showed how an entire nation was brought to its knees by the mass lunacy that was speculation in tulips. Alchemy drew people over many centuries to lose fortunes by believing that some men could turn stone into gold. These and other grand events of mass madness and fraud are well-documented and should not be forgotten. Drawn from these examples, we can see how a sophisticated fraudsman might look upon his human prey as vulnerable and easily consumed.

Social psychologists use their cognitive dissonance theory to explain the ease by which mass frauds occur, by reference to the states of mind of victims:

"*The best explanation for anomalous behavior turns out to be cognitive dissonance theory, which says that when there is a conflict between your beliefs and your actions it is easier to change your beliefs than your actions. We frequently see cognitive dissonance theory at work when dealing with spousal abuse. It is psychologically easier for the abused spouse to say the abuse is okay because they love the abuser … than it is for them to admit that they might be victims, and make the appropriate changes to their behavior. In the case of missing investment money, it is psychologically easier for the investors to say the manager conducting the investigation is okay because they trust the manager … than it is for them to admit that they might be victims, and make the appropriate changes to their behavior.*"[17]

Predictable. Unimaginative. Shackled by analytical orthodoxy. Cognitive dissonance. His strengths.

However, where there are strengths there are also areas of vulnerability. The more extensive and complex the sharp dealer's empire becomes – the more elements become involved, and the more difficult it is to supervise each element effectively. The more paper used to record the relevant transactions, the longer the trail.

By volume of dealing, the most ubiquitous career economic criminals are those who have demonstrated a facility for taking in excess of USD 20 million in a single scheme. They are normally clothed with the trappings of legitimacy. It is this appearance which allows them to operate easily within the milieu of name financial institutions, affording them the opportunity to steal and hide significant tranches of wealth. They have mastered the art of transferring risk and exposure to the victim.

Of a lesser size, in terms of magnitude of dealing, are the occasional economic criminals and *male fide* (bad faith) transactors. This group is marked by the taking of wealth at the rate of USD 1 million to USD 20 million per transaction. These individuals may borrow money legitimately, but when it comes time to repay, they hide the money that they owe.

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[15] Mackay, C., "Extraordinary Popular Delusions and the Madness of Crowds" (2nd Ed.) (1852), page 88.

[16] Id, at page 53. Mackay also recorded that: "*The inordinate thirst of gain that had afflicted all ranks of society was not to be slacked even in the South Sea. Other schemes, of the most extravagant kind were started. The share-lists were speedily filled up, and an enormous traffic carried on in shares, while, of course, every means were resorted to to raise them to an artificial value in the market.*" Id, at pages 52–53.

[17] Page 3, The Business and Security e-Journal, The Lubrinco Group (New York) *www.lubrinco.com*, Volume 6 No. 10, October 2003.

In most large-scale money laundering cases, the primary protagonist has

- unlawfully obtained very substantial wealth,
- sought professional advice on how, when and where to hide that wealth, and
- taken steps to implement such advice by obscuring the ownership of the assets thus taken.

Such a person will wish to use the proceeds at some time in the future and, importantly, represents a person who possesses normal human vulnerabilities. To continue to carry out their unworthy ends, the violators of law who hold wealth illegally need to envelope themselves in

- proper legal systems,
- (purportedly) properly constituted juridical persons (such as companies), and
- gilt-edged financial institutions

in order that they might enjoy the fruits of their conduct.

10 How to Combat Serious Fraud – The Fraudster's Weaknesses

As indicated above, a dishonest obligor's key strengths are also his Achilles heel. His arrogance and contempt conspire against him. As he becomes more successful at making an ass of the law, so his sense of infallibility expands. He reaches a stage where he believes that he is untouchable. He has seen how ineffectual traditional methods of asset recovery are. A sense of security prevails. He relaxes.

He does not expect his adversaries to uncover the critical information required to show his asset fortifications for what they are – tissue-thin veils. Legal orthodoxy is assumed by him. A company is what it says it is. Imprudently, he relies on that. Frequently, victims and their advisors also incorrectly assume that the lifting of the veil[18] of a company is a legal rarity. His reliance on the separate juridical nature of his puppets is an expression of weakness. To exploit this, claimants ought to deploy the very element he flaunts, against him. His web. His fortifications. He, in effect, brings about his own downfall. The victim facilitates.

The recognition of common traits, and the identification and understanding of *modus operandi*, are crucial elements in the fight against economic crime. The internationalization of fraudulent operations has made more difficult the preparation of effective strategies to combat this form of wrongdoing. We must therefore learn to treat like with like, recognising that these actors exploit for their own advantages the divergence of legal systems among different countries. So we too must react with an internationalization of fighting strategies which have the effect of inverting the perceived strength of the professional money launderer.

[18] Or, to use the US lawyers' term, the "piercing of the corporate veil".

What can be done to turn the tables? Take the following illustration. A USD 720 million circular cheque and margin account kiting scheme is run from the Bahamas against a Canadian securities dealer. The fraudster, believing the person with whom he is engaged in conversation to be similarly predisposed to sail close to the wind, offers the following comment. While chuckling, he says " … *banks are dumb and laughable …;* [the victim, whom he refers to by name] *is laughable …. They* [the victim, whom he again names] *were an easy take … here's how I did them, and here's how I hid the money*". Unwittingly, he condemns himself. The counterparty to the conversation is not another miscreant. He is a professional investigator who acts for the victim.[19]

11 Serious Fraud Requires Serious Action

The nature of serious fraud is such that its discovery and the recovery of the misappropriated property requires serious investment, not just financial, but human and psychological. The conduct of a recovery exercise requires the input of serious professionals with in-depth experience and know-how, such experience is not borne overnight, years of study of the patterns of Fraudster's and their very particular psyche is a an invaluable foundation for any serious asset recovery professional faced with serious fraud. Trends evolve on a daily basis so real time intelligence is also crucial.

Any effective civil recovery model involving a dishonest obligor and substantial value requires the employment of a serious, professional recovery team which is comprised of an appropriate blend of forensic accountants, investigators, multi-jurisdictional pre-emptive remedy lawyers, information technology experts and fraud experts. These people must have an in-depth understanding of the experienced fraudster, her traits, her *modus operandi* and, ideally, her weaknesses.

The recovery of concealed assets involves the need to manage risk. The process requires the investment of substantial financial and human capital. The risk is a function of the degree of complexity of concealment and how many layers of legal relationships and jurisdictions are interposed between the *corpus* of value taken and the *corpus* concealed. The cost of recovery is not a function of the measure of the value of the obligation sought to be enforced. The cost of pursuing a USD 10 million claim can be the same as a USD 100 million one. In general, as more capital is spent on the process, the risk associated with a complete failure to recover declines. Thus, with each step, there is greater access to objective fact with which to justify the cost of moving forward to the next step. The process of mitigating the risk of a total failure to recover is thus incremental.

The five cornerstones to a well-constructed asset protection fortress include the following components:

- Trust,
- Company,
- Structuring,

[19] This is not a fictitious scenario. It represents facts drawn from a case with which one of the authors was charged.

– Multi-jurisdictional nature,
– Protection of “Confidential” Information.

These are all legal concepts. Many jurisdictions seek to superimpose seemingly insurmountable walls around bank, trust and company secrets – despite the fact that such barriers to information are used to flout law enforcement or to defraud creditors or victims. Abstract legal concepts and relations such as “company”, “contract” and “trust” are relied upon and used by law abiding citizens and fraudsters alike – a fact which makes it all the more difficult to discern which is which and what is what. The problem is compounded exponentially by the fragmentation of events and facts across national boundaries. The limited territoriality and local nature of law is a principal strength to nomadic rogues – who are delighted by the prospect of leaving an analytically chaotic path in their wake.

Legal mechanisms used in the secretion of wealth, howsoever derived, abound. The wealth so secreted is seemingly beyond reach. While legal means may be used to protect wealth – where the motive for protection or the means of acquisition of value is illegal or *male fide*, that bounty is fair game.

“*A wrong does not cease to be a wrong because it is cloaked in the form of law. The test of legality, then, is whether the result is lawful and the means used to achieve that result are lawful.*” *Newman v. Dore* 9 NE 2d 966, at 971; 275 NY 371, at 377 (NY S. Ct., 1937).

Concealed asset recovery will invariably involve an attack on at least one of these cornerstones. A careful deconstruction of the fortress may require a showing of a link between the assets hidden and the underlying wrong. The identification or discovery of concealed assets represents fertile ground for unrestrained and varied perspectives. When, in the middle of a major inquiry, information and leads appear to have been exhausted, the use of lateral thinking to constantly provide alternatives and new perspectives cannot be underestimated. According to Professor Simon Majaro, Co-Director of the Centre for Creativity at the Cranfield School of Management, “Creative thinking is the raw material of innovation”.

From an asset recovery perspective, taking a lateral approach will invariably involve contemplating or imagining how assets might have been hidden, taking into account the means used to misappropriate them in the first place, as well as what is known about the protagonist and his advisors. Patterns can be detected from what would appear to be a chaotic or random construction of facts. Lateral thinking can help us to attempt to rebuild the hypothetical asset fortress, bearing in mind methods and techniques currently available, or available within a particular sphere or jurisdiction, and an analysis of how the asset secretor has acted in the past. There can be no substitute for the experience that comes from many years of observing the personalities involved with fraud, their core traits and tendencies, and the means they commonly employ.

Chapter II

Remedies Available Internationally

International Anti-Money Laundering Instruments

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1 Introduction

Money laundering is usually defined in a host of different ways. Simply put, money laundering refers to the process or processes through which the proceeds of certain crimes are first disguised and then legitimized so as they can be enjoyed without risking discovery and prosecution.

Historically, it is possible to trace some initial domestic efforts at developing a legal regime to combat money laundering even if, originally, the goal pursued by these efforts was limited to the reduction of tax evasion. In the 1970s, for example, the United States Bank Secrecy Act established limitations to bank secrecy and placed upon financial institutions the obligation to report transactions that were suspected of involving funds that had not been declared for tax purposes. Likewise, the Swiss Banking industry respond to capital flight scandals in the mid-seventies, lead to the development of prudential rules in the banking area including notions of client identification and due diligence with respect to certain categories of customers. Both efforts constitutes the first instance of the kind of regulations that would eventually become mainstay features of anti-money laundering regimes.

Despite its domestic origins, when the control of money laundering became an important component of the war on drugs it soon became evident that the effectiveness of the system would heavily depend on how homogeneously it was applied across borders.

Empirical evidence shows that money laundering operations typically include an international dimension of one sort or another (Stessens, 2000; Beare and Schneider 1990). The explanation lies in the fact that trafficking offenses usually involve sellers and buyers that are not located within the same borders and, more generally, in the fact that the transnational character of crime is nothing more than an indirect effect of the increasingly transnational and globalized character of the legal economy.

Should the anti-money laundering legal regime be limited to some countries or not enforced homogeneously, those seeking to launder the proceeds of their crimes would do so in the jurisdictions where their conduct would not be subject to stringent controls. The only effect of exclusively domestic anti-money laundering measures would thus be a change in the geographical distribution of the phenomenon.

In this way, the reasonable conclusion is that any effective anti-money laundering regime must be premised on the harmonization and homogenization of local legislation, in order to facilitate cooperation between affected countries, to avoid distortions in the competence within the sectors affected by anti-money laundering regulation and to ensure that money launderers do not turn their operations to jurisdictions not as strongly committed to its control.

The strategies implemented by the United States during the 1980s to combat illicit drug trafficking, which included measures against money laundering as a centerpiece, were soon internationalized – the United Nations Convention Against Illicit in Narcotic Drugs and Psychotropic Substances (hereinafter, Vienna Convention) was adopted in 1988 – in what proved to be the starting point for the subsequent development of international anti-money laundering standards.

The reach of these standards has broadened significantly during the past two decades. In particular, the number and type of predicate offenses of money laundering grew larger and now includes almost every serious crime, the extent and nature of the prevention and detection activities increased significantly and the reach of the anti-money laundering regulation went from covering exclusively banks to other financial institutions and finally to those professions that are susceptible of providing financial services and those industries more prone to be used to launder ill-gotten gains.

While the first initiatives to internationalize an anti-money laundering regime were developed in the context of the United Nations, the topic eventually gave way to the creation of a specific international organization, the Financial Action Task Force (FATF), that would take the lead in the development of the regime and of regional bodies modeled after it that were created with the announced intention of helping to adequate the standards to the peculiar characteristics of each region. In addition, anti-money laundering regulation was also tackled by both the successive United Nations crime-based conventions on organized crime and corruption and by the institutions of the European Union, which have developed a number of different legal norms and recommendations to be adopted by member states in connection with money laundering.

International anti-money laundering regulations cover a broad and extensive range of topics. Nonetheless, many of these issues are not strictly or closely connected to the efforts to recover the proceeds of crime or other related assets, which is the main purpose of this book. In this vein, this chapter explores the development of international anti-money laundering standards and presents their main features in those specific areas that are most relevant to the question of international asset tracing and asset recovery, namely, the standards to prevent and detect transfers of proceeds of crime; the standards related to the adoption of provisional measures to prevent such transfers or the disposal of assets under investigation and the standards of confiscation of proceeds of crime domestically and in cross border proceedings.

The chapter focuses on the international instruments that exercise and have exercised the greatest influence in the development and implementation of anti-money laundering standards around the globe, while referencing other instruments when appropriate. The instruments analyzed at length are the FATF's 40 Recommendations, Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the United Nations Conventions against Transnational Organized Crime (hereinafter UNTOC) and Corruption (hereinafter UNCAC).

The chapter is organized as follows: section 2 discusses the main features and structure of the international anti-money laundering regime as well as the spread of international anti-money laundering standards; section 3 discusses the standards developed by different international organisms and regimes aimed at the prevention of money laundering; section 4 is dedicated to the study of international regulations with regard to the detection of money laundering; section 5 discusses the provisional measures, typically freezing and seizure of assets, that are dictated by international standards for the purposes of securing and preventing the disposal of assets that are suspect of being laundered and related to predicate offenses; and, finally, section 6 introduces the reader to the international standards with regard to confiscation and repatriation of assets connected with money laundering and predicate offenses.

2 The Development of International Anti-Money Laundering Standards

2.1 The Structure of the International Anti-Money Laundering Regime

Regardless of the initial domestic experiments that provided some sort of foundation, since the 1990s the legal regime to control money laundering is basically a system designed within international organizations with the intention of being applied globally through national governmental institutions with a degree of homogeneity that would enable strong and frequent cooperation amongst them.

This legal regime can be understood as a system that is structured around three central objectives. The first deals with issues of prevention and detection of money laundering and is regulatory in nature. The second is concerned with the criminal investigation and prosecution of money laundering and with the confiscation of the assets in question. The third interacts between the other two, has an hybrid nature and is mostly dedicated to a combination of financial investigation, collaboration with the criminal justice system and, sometimes, supervising compliance by non-financial businesses.

Most organized crime activities – trafficking in drugs, weapons, human organs and migrants or the sexual exploitation of individuals – involve the production of goods and services that are outside of the legal economy. The structure of the transactions that involve these goods and services is typically consensual – exchanges between producers, transporters, sellers and final consumers – and, therefore, they do not result in specific victims. The absence of victims implies that, unlike what occurs with other crimes, none of the persons involved in the activity report it to the authorities. Thus, one of the main goals of the preventative axis is precisely to supplant the role played by the victim so that the authorities are able to detect the criminal activities by themselves and to initiate criminal investigations into them.

The core aspect of this axis is the requirement that banks, other financial intermediaries and some professions and industries that may occasionally provide financial services, organize themselves as to prevent criminally obtained money to enter into their organizations, detect such transactions that are suspected of involving illicit funds and report these suspicious operations to the authorities charged with investigating them further. The rationale behind the system is that all of these different subjects will fulfill their obligations in order to preserver their reputations and to minimize the legal risks that result from their being associated with this type of transactions.

Under its original inception, the system was limited to the detection of transactions involving funds that had originated in drug trafficking offenses but has since then evolve to include "the widest range of predicate offenses" (FATF 2003, § 1).

With regard to banks and other involved subjects, it is expected that they shall, at least, get to "know their customers", exercise continuous due diligence over those customers that present specific risks, keep records of their transactions during a period of time that allows for them to be used as evidence in the context of criminal investigations and to develop internal procedures that ensure that the organization can comply with the former obligations.

Suspicious transactions have to be reported by these institutions and professionals to a centralized agency usually named Financial Intelligence Unit (hereinafter, FIU). FIUs process the information produced by those actors and mediates the interaction between the first axis and the one dealing with criminal investigation and prosecution. In some countries, FIUs are also responsible for supervising compliance by financial institutions and other professionals of their anti-money laundering obligations, while in others, that function is not centralized but rather lies with each different and already existing authority for each category of subjects (banking, insurances and stock market supervising authorities among others) while the FIU only performs that role with regard to the subjects of anti-money laundering regulations that do not have an independent supervisory body – as it is generally the case with gambling, antiques and works of arts trading and some liberal professions.

The main function of FIUs is to analyze the suspicious transactions reported by financial institutions and other relevant subjects. In order to perform this function, FIUs have almost unrestricted access to all the information available in the local financial system and, with certain restrictions, to information concerning foreign financial systems. FIUs access information available in foreign financial systems through their counterpart in each different country. This system of administrative cooperation is coordinated by an informal network of FIUs, the Egmont Group, which currently comprises the FIUs of 108 countries. The Egmont Group was created with the goal of overcoming the obstacles to cooperation that resulted from differences in banking confidentiality regulations in each country and in the institutional characteristics of FIUs around the world (administrative, judicial or law enforcement types).

In the event that the analysis conducted by a FIU augments the suspicious over the illicit origin of the assets involved, the case is forwarded to the criminal law enforcement authorities (public prosecutors, police department or judges depending on the specific characteristics of the criminal procedure of the country in question), which give form to the criminal axis of the anti-money laundering regime. In order to process this new type of cases, the criminal justice system was also adapted accordingly and new crimes, new methods of confiscation and new powers of investigation were approved and implemented. While these new features of the criminal justice system recognize some domestic precedents, they soon became internationalized through their incorporation in the Vienna Convention. The convention mandated the establishment as a criminal offense of laundering of property derived from drug trafficking (Vienna, Article 3), incorporated the notion of seizure and confiscation of the proceeds of drug trafficking related offenses (Vienna, Article 5) and developed more streamlined procedures for Mutual Legal Assistance and Extradition (Vienna, Articles 6 and 7), which still constitutes the core criminal aspects of money laundering law, though they have been enlarged to most profit driven crimes.

The regime, as well as the relationship among its different components both at the domestic and international level, is represented in the following graph.

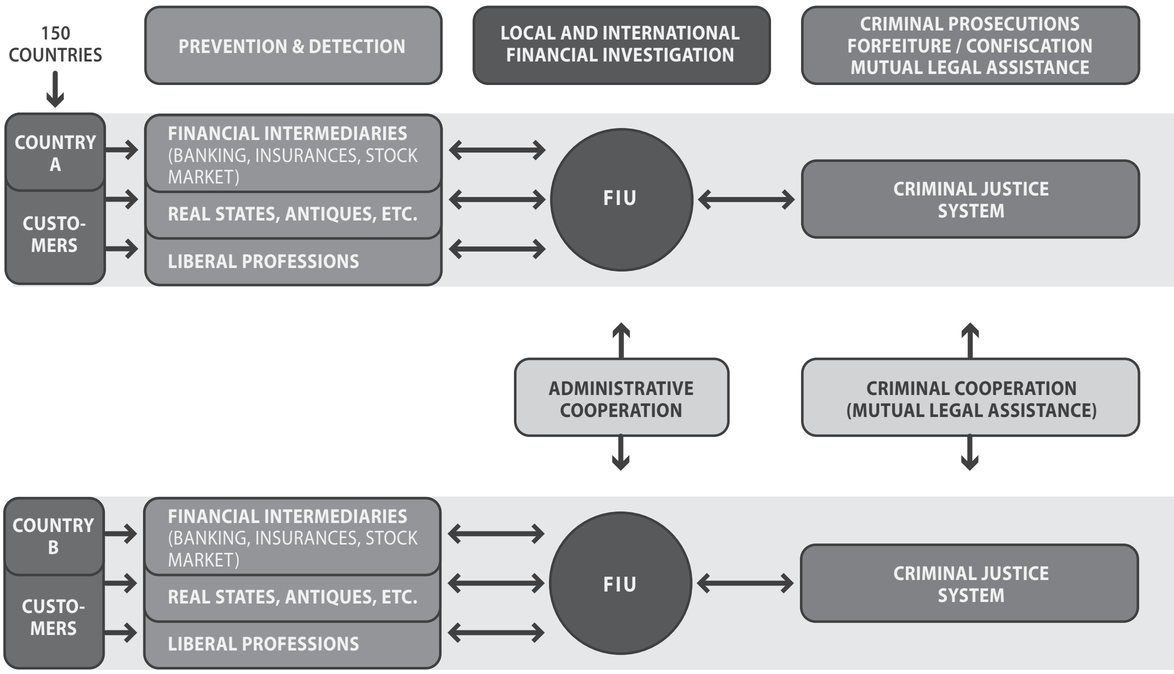

Figure 2.1: The International Anti-Money Laundering Regime

2.2 The Development of the International Anti-Money Laundering Regime: The Role of the Financial Action Task Force

The internationalization and remarkably fast expansion of anti-money laundering standards is closely connected to the creation, in 1990, of the Financial Action Task Force (FATF). The initiative to create this intergovernmental group was mostly the product the United States, the United Kingdom and France in the context of their interactions as G7 member states. While France originally sought merely to control capital flight and tax evasion it soon had to abandon these objectives as the inclusion in the initiative of financial centers, such as Switzerland and Luxembourg, was deemed fundamental in the pursue of the United States' main objective, the disruption of drug trafficking finances.

FATF is currently composed of 32 member states, which include the OECD countries and some developing countries deemed able to play a leading role in their specific regions. The group is informally constituted and governed by consensus.

The dominant role of FATF as the forum where international anti-money laundering public policy is developed starts to take shape in 1990 when the group produced an action plan that included 40 Recommendations. This document, subsequently revised in 1996 and 2003, soon became the global standard in the prevention and sanction of money laundering.

The original version of the 40 Recommendations was substantially modified in the 1996 and 2003 revisions. These revisions expanded the reach of the 40 Recommendations with regard, among other areas, to the nature and number of money laundering predicate offenses, the type of institutions and professions that should be subjected to due diligence and reporting obligations and the nature of the due diligence to be exercised by them in the performance of these obligations.

In 1990 money laundering predicate offenses were limited to drug trafficking and related crimes, mirroring the provisions of the Vienna Convention. However, in 1993, the Council of Europe Convention on Laundering (ETS,141) already defined *predicate offenses* as "any criminal offense", while leaving the door open for States to restrict the scope of predicate offenses if they consider it appropriate (Pieth, 2004). In this vein, the 1996 version of the 40 Recommendations also indicates that all "serious offenses" (FATF 1996, § 4) should constitute money laundering predicate offenses, a criterion that, while certainly broader and more stringent, still left room for each state to make the relevant determination of what constitutes a "serious offense" on its own. In 2003, however, the FATF decided to recommend that "countries should apply the crime of money laundering to all serious offenses, with a view to including the widest range of predicate offenses" and included the recommendation that states should, at a minimum, include offenses within "each of the designated categories of offenses" (FATF 2003, § 1).[1]

The successive revisions of the 40 Recommendations have also brought with them an expansion of the institutions that should comply with customer due diligence and reporting obligations. Under the original anti-money laundering regime only banks and non-bank financial institutions (NBFIs) were supposed to comply with customer identification, record keeping and due-diligence obligations.

However, it soon became evident that, should anti-money laundering policies implemented only by financial institutions, money laundering would be displaced and conducted through other sectors of the legal economy. Thus, the 1996 version of FATF extended the application of the recommendations to non-supervised NBFIs and suggested that national authorities should consider applying the anti-money laundering recommendations to "the conduct of financial activities as a commercial undertaking by businesses and professions that are not financial institutions". The latter recommendation was afterwards made more stringent in the 2003 version of the 40 Recommendations going further than a recommendation and directly indicating that "customer due diligence and record-keeping requirements … apply to designated non-financial businesses and professions" (FATF 2003, § 12). It lists casinos, real estate dealers, precious metals and stone dealers, lawyers, notaries and other independent legal professionals and accountants as well as trust and company service providers as "designated non-financial businesses and professions" subject to the aforementioned obligations. It should be noted that, once again, the direct imposition of these obligations to non-financial business and professions was undertaken by the European Council before the adoption of the 2003 version of the 40 Recommendations (Directive 2001/97/EC).

Finally, there are significant differences between current and previous versions of the 40 Recommendations as to the extent of the customer identification, due diligence and

[1] The Glossary to the 2003 40 Recommendations defines "designated categories of offenses" as including: participation in an organized criminal group and racketeering; terrorism, including terrorism financing; trafficking in human beings and migrant smuggling; sexual exploitation, including sexual exploitation of children; illicit trafficking in narcotic drugs and psychotropic substances; illicit arms trafficking; illicit trafficking in stolen and other goods; corruption and bribery; fraud; counterfeiting currency; counterfeiting and piracy of products; environmental crime; murder, grievous bodily injury; kidnapping, illegal restraint and hostage-taking; robbery theft; smuggling; extortion; forgery; piracy; and, insider trading and market manipulation.

reporting obligations to which financial and non-financial institutions are subjected. In the 1990 version, banks and non-bank financial institutions were only required to identify the "immediate client", to increase their diligence in connection with "complex, unusual large transactions, and all unusual patterns of transaction, which have no apparent economic or visible lawful purpose" and to maintain records on transactions for at least five years to be able to comply with information requests from the competent authorities. Furthermore, the recommendations indicated that financial institutions, in dealing with transactions that are suspect of involving funds that stem from criminal activities, "should be permitted or required to report promptly their suspicions to the competent authorities".

The 1990 version of the 40 Recommendations can be said to have incorporated what is usually termed the "rule-based" approach to prevention (Pieth, 2004). Under this model, "know your customer" procedures were alike for all clients and transaction involving funds over a certain threshold were reported without much investigation. This model involves the generation of a huge number of folders within financial intermediaries and as well as a huge number of reports, which are difficult to process by the FIU (Stessens, 2000; Pieth, 2004). Further, the cost of implementation for banks and financial institutions is very high and, as it is applied to all customers, not necessarily proportional to the risks posed by the vast majority of transactions.

These arguments led to the transition, completed by the 2003 version of the 40 Recommendations to a "risk based approach". This second model allows financial intermediaries to adjust "know your customer" procedures to the risk posed by each client and requires the reporting of transactions that are suspected of being linked to money laundering operations as assessed by banks and other institutions. The model is logically more cost-efficient and presents the additional benefit, from the perspective of financial institutions, of implying less disclosure of information about customers to law enforcement authorities.

The "risk based approach" allows financial and non-financial institutions and professionals that are subject to anti-money laundering regulations to establish, following guidance from local FIUs and other regulatory authorities, different risk categories and to reduce their diligence over the certain transactions when customers are deemed to be low risk, as it is the case of publicly traded companies that are, by definition, subjected to monitoring by other economic actors and institutions. The system also mandates an increased diligence when the customer in question presents specific risk factors, as it is the case, for example, of "politically exposed persons". This increased diligence requirements demand that institutions and professionals be sufficiently familiar with the "customer's business profile" to be able to compare a suspicious transaction with the customer's usual pattern. In assessing a suspicious transaction, information should be gathered with regard to the origin of the assets in question and their destination as well as to the economic reasons that justify the transaction.

Not only has there been a shift from a rule-based to a risk-based approach in the 40 Recommendations but the reporting requirements have also shifted from optional to mandatory: the 1996 FATF Recommendations already state that financial institutions should be required to report their suspicions promptly, a standard that remains in force in the current version of the recommendations.

2.3 The Development of International Anti-Money Laundering Standards: Beyond the FATF

While the successive iterations of the FATF standards represent the farthest-reaching and more comprehensive set of international anti-money laundering regulations, the issue has been prominently incorporated into the agenda of other international and supranational organizations, both public and private.

In particular, within the United Nations framework, the topic of the prevention of money laundering was first included in the Vienna Convention – which limited itself to the criminalization of money laundering when the predicate offense was an illicit drug trafficking activity. The UNTOC (2000) and the UNCAC (2003) went further and detailed a number of obligations for states parties in relation to the implementation of measures to combat money-laundering. Moreover, the United Nations Office on Drugs and Crime coordinates the Global Program against Money Laundering, Proceeds of Crime and Terrorist Financing (GPML), which has been instrumental in the diffusion and enforcement of international anti-money laundering standards. However, the greatest contribution of these instruments – as it shall be discussed in Sections 4 and 5 of this chapter – are not the standards with regard to the prevention and detection of money laundering, which only set out the general features that domestic anti-money laundering systems should present, but rather the incorporation of obligations regarding the adoption of provisional measures, such as freezing and seizure, in connection with laundered assets and their confiscation and repatriation.

As previously mentioned, the European Community first and the European Union later have also contributed to the development and enforcement of international anti-money laundering standards, both in relation to prevention and detection of money laundering and to the freezing, seizing and confiscation of laundered assets. In this vein, "Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing", as its various predecessors, sets out the regulations to be adopted by European Union member states with regard to the prevention and detection of money laundering, building on and replacing existing legislation and incorporating in EU law the 2003 revision of the FATF Recommendations (Levi & Reuter, 2006). Further, "Council Framework Decision 2005/212/JHA on Confiscation of Crime-Related Proceeds, Instrumentalities and Property" complements the anti-money laundering regime with the inclusion of obligations for member states with regard to confiscation of the proceeds of crime. Finally, the 2005 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, hereinafter Warsaw Convention, updates the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crimes. The new convention incorporates the FATF standards, and is fully consistent with current European Union legislation. While the convention does not include such detailed regulations as other European Union legislation (for example with regard to customer identification and due diligence), it remains the most comprehensive instrument to tackle the question of money laundering and includes provisions with regard to prevention, detection and criminal prosecution of money laundering as well as other dealing with freezing, seizure and confiscation of laundered assets and international cooperation in criminal matters related to money laundering.

2.4 The Legal Nature of International Anti-Money Laundering Standards

Before turning to the substantive standards, it is necessary to briefly highlight the differences in nature between the international legal instruments from which these standards emanate and, in particular, their binding or non-binding character.

FATF Recommendations constitute the universally recognized standard in anti-money laundering and are deemed to constitute the threshold to be applied by all countries. However, as a result of both the nature of FATF as an informal intergovernmental group without legal capacity to issue binding regulations and the decision not to draft the recommendations as an international convention, those recommendations are not binding either for FATF member states or for other countries. The fact that countries choose to comply with these recommendations despite their non-binding character can be explained by the effectiveness of the monitoring system developed by FATF – and later followed by other regional groups modeled after the FATF – which comprises both a self-evaluation that every member must undertake in writing every year and a mutual-evaluation consisting of in depth interviews of relevant actors in each member state that are carried out by specialists in financial regulation, criminal law and international cooperation representing other member states. The reports are published and considered by the FATF in the formulation of additional recommendations. Furthermore, the FATF developed a procedure aimed at identifying Non Cooperative Countries and Territories in order to signal which states were non-compliant some specific criteria. By relying almost exclusively on peer pressure and naming and shaming techniques and the reputational concerns of its members, FATF has been effective in achieving a reasonable degree of compliance with its anti-money laundering recommendations and of homogenization between domestic regulations in all countries (Jorge, 2009).

Unlike FATF Recommendations, the United Nations conventions that have helped to develop anti-money laundering standards, as well as European Union conventions and legislation, all have a binding character and state parties to them, or member states in the case of European Union legislation, must comply with the obligations set forth in each of the instruments. While this does not guarantee full compliance, it does open the door to different avenues for enforcement of these obligations and for redress in the event of a violation.

3 Prevention and Detection of Money Laundering

As discussed, the first axis of the international anti-money laundering regime is concerned with the prevention and detection of money laundering. These goals are pursued by imposing on financial institutions and non-financial institutions that may occasionally provide financial services, a number of obligations that they have to fulfill in their daily operations and in relation with their customers.

These obligations include the proper identification of customers (what is usually known under the “know your customer” notion) and the exercised of continued due diligence over their transactions in order to identify those that are suspicious of involving funds that originate from predicate offenses and that may constitute money laundering and the obligation to report these suspicious transactions to the proper competent authorities for further investigation.

While prevention and detection standards and obligations are incorporated in all of the international instruments dealing directly or indirectly with the question of money laundering, the analysis in the present and following section shall be concentrated mostly on the FATF Recommendations and on the EU Directive 2005/60/EC, which spell out in much more detail what states should require of financial and non-financial institutions operating in their legal economy. Reference shall be made as well to the much more general obligations with regard to prevention and detection of money laundering that are present in the UNTOC and UNCAC and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism.

3.1 Legal and Natural Persons Subject to Anti-Money Laundering Obligations

The evolution of the international anti-money laundering regime has resulted in a significant expansion of the range of institutions and professions that should be subjected to prevention and detection obligations with regard to money laundering.

The current version of the FATF Recommendations provides that costumer due diligence and record-keeping requirements should apply not only to financial institutions but also to certain non-financial businesses and professions under certain circumstances, including casinos, real estate agents; dealers in precious metals and dealers in precious stones; lawyers, notaries, other independent legal professionals and accountants; and trust and company service providers (FATF 2003, § 12).

Unlike FATF, the whole EU Directive applies to credit institutions; financial institutions; and to certain legal or natural persons acting in the exercise of their professional activities if certain requirements are met, including: auditors, external accountants and tax advisors; notaries and other independent legal professionals; trust company service providers; real estate agents; casinos; and natural and legal persons trading in goods when payments are made in cash in an amount of EUR 15.000 or more. The Directive allows the Member States to exclude a legal or natural person from the application of the Directive when this person engage in a financial activity on an occasional or very limited basis and where there is little risk of money laundering or terrorist financing.

The extension of anti-money laundering obligations from banks to non-banks financial institutions and other non financial institutions and professions is also established in the Warsaw Convention (Article 13.2.a), the UNTOC Convention (Article 7.a) and the UN Convention against Corruption (Article 14.1.a).

3.2 Customer Identification and Due Diligence

Under the FATF recommendations, financial institutions should not keep anonymous accounts (FATF 2003, § 5). This requirement is extended to credit institution under the EU Directive (EU Directive, 2005, Article 6).

The institutions and persons covered by the EU Directive and the FATF Recommendations should undertake Customer Due Diligence (CDD) measures over all new costumers and also, at appropriate times, to existing customers on a risk-sensitive basis (FATF 2003, § 5; EU Directive, 2005, Article 9.6).

As mentioned, new standards have shifted from only requiring documentation to demand verification of the information provided (Pieth, 2004). Indeed, in conducting CDD, both under the FATF recommendations and under the EU directive, the obliged person or institution should identify the customer and verify her identity using reliable, independent sources, data or information. They should also identify the beneficial owner, taking reasonable measures to verify her identity such that the regulated entity is satisfied that it knows who the beneficial owner is (FATF 2003, § 5; EU Directive, 2005, Article 8). More specifically, if the beneficial owner is a legal person or arrangement, the institution should take reasonable measures to understand the ownership and control structure of the customer (FATF 2003, § 5; EU Directive, 2005, Article 8).[2] The rationale of this requirement is that this kind of structures may be used as a "front" for others and, thus, measures to identify the actual persons operating are necessary (Pieth, 2004).

The regulated entity is also required to obtain information on the purpose and intended nature of the business relationship, conducting ongoing monitoring of this relationship and scrutiny of the transactions undertaken throughout its course to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, business and risk profile, including where necessary, the source of funds (FATF 2003, § 5).

Both the FATF and the EU directive allow the regulated entity to determine the extent of the aforementioned measures on a risk sensitive basis depending on the type of customer, business relationship or transaction (FATF 2003, § 5; EU Directive, 2005, Article 8.2), the result of the transition from a "rule-based approach" to a "risk-based approach" that was discussed in the previous section. However, the EU Directive specifically establishes that the institution should be able to demonstrate to the competent authorities that the extent of the measures is appropriate in the view of the risk of money laundering and terrorist financing (EU Directive, 2005, Article 8.2).

The UNTOC, the UNCAC and the Warsaw Convention all require, in much more general terms, that customer and beneficial owner identification be an integral component of the anti-money laundering regime that each State Party is required to adopt domestically (UNTOC, Article 7(a); UNCAC, Article 14(a); Warsaw Convention, Article 13(2)(a)(i)). However, none of them sets out specific indications as to how should the identification be conducted.

[2] Article 8 of the EU Directive specifically include Trusts among the legal arrangements covered by this provision.

According to FATF Recommendations, regulated entities should verify the identity of the customer and of the beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers (FATF 2003, § 5). However, countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the business relationship, where money laundering risks are effectively managed and where it is essential not to interrupt the normal conduct of business (FATF 2003, § 5).

The EU Directive is stricter in this regard. It provides that the verifications should always take place before the establishment of the business relationship or the carrying-out of the transaction (EU Directive, 2005, Article 9.1). Nevertheless, by way of derogation, member states may allow the verification to be completed during the establishment of a business relationship if this is necessary not to interrupt the normal conduct of business and where there is little risk of money laundering or terrorist financing occurring (EU Directive, 2005, Article 9.2). In these cases, the procedures should be completed as soon as practicable after the initial contact (EU Directive, 2005, Article 9.2).

Under the EU Directive, Member States may establish certain exceptions by means of derogation of the directive's provisions. In relation with life insurance, member states may allow the verification of the identity of the beneficiary at or before the time of payout or at or before the time the beneficiary intends to exercise rights vested under the policy (EU Directive, 2005, Article 9.3). Regarding the opening of a bank account, Member States may allow such operation provided that there are adequate safeguards in place to ensure that transactions are not carried out until full compliance is obtained (EU Directive, 2005, Article 9.4).

Both the FATF Recommendations and the EU Directive establish that if the financial institution is unable to identify the customer and the beneficial owner and obtain information on the purpose and intended nature of the business relationship in accordance with the aforementioned provisions, it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship and should consider making a suspicious transaction report (FATF 2003, § 5; EU Directive, 2005, Article 9.5). However, under the EU Directive, Member States are not obliged to apply these measures in situations when notaries, independent legal professionals, auditors, external accountants and tax advisors are in the course of ascertaining the legal position for their client or performing their task in defending or representing that client in, or concerning judicial proceedings, including advice on instituting or avoiding proceedings.

3.3 Customer Due Diligence Standards under the "Risk-Based Approach"

International anti-money laundering instruments usually distinguish between three types of standards in client acceptance procedures: ordinary, simplified and increased (Pieth, 2004). Again, this is the result of the transition from a "rule-based" to a "risk-based" approach that makes those institutions and persons subject to anti-money laundering regulations responsible for the identification of the level of money laundering risk involved in every operation and permits them to adjust the level of diligence required accordingly.

Indeed, according to FATF recommendations, regulated persons and institutions may determine the scope of the measures adopted on a risk sensitive basis, depending on the type of customer, business relationship or transaction (FATF 2003, § 5). For higher risk categories, financial institutions should perform enhanced due diligence and, under certain circumstances, where there are low risks, countries may decide that the financial institutions can apply reduced or simplified measures (FATF 2003, § 5). On the same line, the EU Directive provides for a simplified and an enhanced costumer due diligence procedure (EU Directive, 2005, Articles 11–13).

An enhanced customer due diligence procedure applies, in addition to the general measures describe above, in situations which by their nature can present a higher risk of money laundering or terrorist financing. Specifically, both the EU directive and the FATF recommendations provide for this kind of procedure in cross-border correspondent banking and in transactions with politically exposed persons residing in another country.

In cases of cross-border[3] correspondent banking relationships, the credit institutions should: (a) gather sufficient information about the respondent institution to fully understand the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision; (b) assess the respondent institution's anti-money laundering and anti-terrorist financing controls; (c) obtain approval from senior management before establishing new correspondent banking relationships; (d) document the respective responsibilities of each institution; and (e) regarding payable-through accounts, be satisfied that the respondent credit institution has verified the identity of and performed ongoing due diligence on the customers having direct access to accounts of the correspondent and that it is able to provide relevant customer due diligence data to the correspondent institution, upon request (FATF 2003, § 7; EU Directive, 2005, Article 13.3).

Politically Exposed Persons (PEP) are natural persons who are or have been entrusted with prominent functions – such as Heads of State or of government, senior politicians, senior government, judicial, or military officials, senior executives of state owned corporations, and important political party officials – their immediate family members or persons known to be close associates of such persons (EU Directive, 2005, Article 3.8; FATF Glossary). In transactions or business relationships with PEPs residing in other countries, institutions should: (a) have appropriate risk-based procedures to determine whether the customer is a politically exposed person; (b) have senior management approval for establishing business relationship with such customers; (c) take adequate measures to establish the source of wealth and source of funds; (d) conduct enhanced ongoing monitoring of the business relationship (EU Directive, 2005, Article 13.4; FATF 2003, § 6). The UNCAC, Article 52.a, includes a general obligation to enhance due diligence over PEPs.

The EU Directive also requires this kind of enhanced due diligence when the customer has not been physically present for identification purposes and when the situation meet the technical criteria established by the European Union Council (EU Directive, 2005, Article 13.1).

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[3] The EU directive is only applicable to cross-frontier correspondent banking relationships with respondent institutions from third countries.

In cases where the customer has not been physically present for identification purposes, the regulated person or entity should take specific and adequate measures to compensate for the higher risk. For instance, they may ensure that the costumer's identity is established by additional documents, data or information; they may adopt supplementary measures to very or certify the documents supplied, or require confirmatory certification by a credit or financial institution covered by the directive; or they may ensure that the first payment of the operations is carried out through an account opened in the customer's name with a credit institution (EU Directive, 2005, Article 13.2).

Besides this enhanced procedure, the EU Directive provides for a simplified procedure under which CDD measures will not apply unless there is a suspicion of money laundering or terrorist financing; and it will not be necessary to identify the customer and the beneficial owner beforehand (EU Directive, 2005, Article 11.1).

The simplified procedure applies when the customer is a credit or financial institution covered by the directive, or situated in a country that imposes requirements equivalent to those established by the directive and supervised for compliance with those requirements (EU Directive, 2005, Article 11.1).

Further, EU member states may allow institutions and persons covered by the directive not to apply CDD procedures to: (a) listed companies whose securities are admitted to trading on a regulate market in one or more Member State;[4] (b) beneficial owners of pooled accounts held by notaries and other independent legal professionals;[5] (c) domestic public authorities; or (d) any other customer representing a low risk of money laundering or terrorist financing which meets the technical criteria established by the Commission (EU Directive, 2005, Article 11.2).

EU member states may also allow institutions and persons not to apply customer due diligence procedure in respect of: (a) life insurance policies where the annual premium is no more than EUR 1000 or the single premium is no more than EUR 2500; (b) insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral; (c) a pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member's interest under the scheme; or (d) electronic money[6] where the amounts are under certain thresholds (EU Directive, 2005, Article 11.5).

Nevertheless, these exceptions do not apply to credit and financial institutions or listed companies from countries that do not meet certain conditions (EU Directive, 2005, Article 12).

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[4] This exception is also applicable to listed companies from third countries which are subject to disclosure requirements consistent with those of community legislation.

[5] This exception is also applicable to professionals from third countries provided that they are subject to requirements to combat money laundering or terrorist financing consistent with international standards and are supervised for compliance with those requirements and provided that the information on the identity of the beneficial owner is available, upon request, to the institutions that act as depository for the pooled accounts.

[6] Electronic money is defined, for the purposes of the European Union, by Article 1(3)(b) of Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions.

3.4 Record-Keeping

According to FATF recommendations, regulated persons and entities should maintain, at least for 5 years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requested by competent authorities. Such records, should be sufficient to permit reconstruction of individual transactions (including the amount and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity (FATF 2003, § 10).

The EU directive contains similar requirements regarding business relationships and transactions. According to Article 30 institutions and persons covered by the directive should keep the supporting evidence and records, consisting of the original documents or copies admissible in court proceedings under the applicable national legislation for a period of at least five years following the carrying-out of the transactions or the end of the business relationship.

FATF also requires financial institution to keep records on the identification data obtained through the customer due diligence process (e. g. copies of records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the business is ended (FATF 2003, § 10). Similarly, the EU directive request institutions and persons covered to keep a copy or the references of the evidence required for the customer due diligence for the same period than the FATF recommendations (EU Directive, 2005, Article 30.a).

The obligation that domestic anti-money laundering regimes incorporate record-keeping obligations for the relevant legal and physical persons is also included in UNCAC (Article 14(1)(a)), the Warsaw Convention (Article 13(2)(a)(iii)) and the UNTOC (Article 7(1)(a)). In all of these cases, the conventions limit themselves to the indication that domestic legal systems should include record-keeping obligation but do not spell out the specific record-keeping requirements.

3.5 Suspicious Transactions Reports

The main component of the detection of money laundering strategy is constituted by the obligation, bearing upon financial and non-financial institutions and professions, to report to competent authorities any transaction that the institution, according to internal procedures, suspects that may involve funds from illicit origins and that it may constitute money laundering.

Unlike previous iterations of the anti-money laundering regime, in which all transactions had to be reported to FIUs or other competent authorities, the transition to a "risk-based" approach has brought with it a shift that emphasizes the responsibility of institutions covered by anti-money laundering regulations in the determination of the suspicious character of transactions. Rather than relying exclusively on the objective standard for reporting transactions exceeding a certain threshold, countries have incorporated – to different degrees – elements of subjective reporting that reduce the reporting burden by requiring that financial and non-financial institutions reports only those transactions that they deem to be suspicious. While the criminal justice policy objectives pursued by some countries with the implementation of anti-money laundering regulations – such as the dismantling of retail drug distribution networks in the United States – continue to require the report of transactions that meet a certain objective threshold, a tendency towards a more subjective approach to the reporting of transactions can simultaneously be detected, both in the countries that continue to have objective standards for reporting as in those that have shifted most dramatically to self-assessment of the transactions on the part of financial and non-financial institutions (Levi and Reuter 2006; Pieth 2004).

In this vein, the EU Directive establishes that member states should require the regulated institutions and persons to pay special attention to any activity which they regard as particularly likely, by its nature, to be related to money laundering or terrorist financing and in particular complex or unusually large transactions and all unusual patterns of transactions which have no apparent economic or visible lawful purpose (EU Directive, 2005, Article 20).

The FATF contains a similar provision. It also requires financial institutions to pay special attention to complex, unusual large transactions, and all unusual patterns transactions, which have no apparent economic or visible lawful purpose. However, unlike the EU Directive, it requires that the background purpose of such transactions, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors (FATF 2003, § 11).

The EU Directive provides that each Member State should establish a FIU in order to combat money laundering and terrorist financing (EU Directive, 2005, Article 21.1). The FIU should be established as a central national unit and should be responsible for receiving (and, to the extent permitted, requesting), analyzing and disseminating to the competent authorities disclosures of information which concerns potential money laundering, potential terrorist finance or are required by national legislation or regulation (EU Directive, 2005, Article 21.2).

According to the FATF Recommendations, if a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity or are related to terrorist financing, it should be required to report promptly its suspicions to the Financial Intelligence Unit (FATF 2003, § 13).

Similarly, in the European Union, the institutions and persons covered by the Directive, and where applicable their directors and employees, should fully cooperate by promptly informing the FIU, on their own initiative, where either of them knows, suspects, or has reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted (EU Directive, 2005, Article 22.1.a). The EU directive also establishes that Member States should require the regulated institutions and persons to refrain from carrying out transactions, which they know or suspect to be related to money laundering or terrorist financing until they have informed the FIU (EU Directive, 2005, Article 24.1). However, where such action is suspected of giving rise to money laundering or terrorist financing and where to refrain in such manner is impossible or is likely to frustrate efforts to pursue the beneficiaries of a suspected money laundering or terrorist financing operation, the institutions and persons concerned should inform the FIU immediately afterwards (EU Directive, 2005, Article 24.2).

These reporting obligations are also included, in a fashion similar to the one discussed in connection with customer identification and record-keeping, in the UNTOC (Article 7(1)(a)), the UNCAC (Article 14(1)(a)) and the Warsaw Convention (Article 13(2)(a)(ii)).

4 Freezing Assets and other Provisional Measures

The origins of the anti-money laundering regime were, as discussed in section 2, closely connected with the development of a new strategy in the efforts to reduce illicit drug trafficking.

This strategy was not limited to the prevention and detection of money laundering but rather included a new mindset for law enforcement activities that would not longer be exclusively centered around the prosecution and conviction of individual persons within but rather around the tracing, identification and confiscation of the proceeds of the criminal activities and other assets that may have resulted from it.

In this context, a necessary requirement in any law enforcement strategy so designed is the availability of “provisional measures”, that is, measures aimed at enabling the preservation of the proceeds of crime or other assets for the purposes of being afterwards able to execute a confiscation order with respect to them (Stessens, 2000; Schmid, 2008). This type of provisional measures typically includes the seizure or freezing of the property in question.

In this vein, international anti-money laundering standards incorporate a set of recommendations or obligations that States take the necessary measures to be able to carry out such seizures or freezing of property that is being investigated as it may be necessary to ensure that it may not be dealt, transferred or disposed of in an attempt to prevent its confiscation.

The question of provisional measures is included in Recommendation 3 of the FATF’s 40 Recommendations. Recommendation 3 indicates that “Countries should adopt measures similar to those set forth in the Vienna and UNTOC, including legislative measures, to enable their competent authorities to confiscate property laundered, proceeds from money laundering or predicate offences, instrumentalities used in or intended for use in the commission of these offences, or property of corresponding value” including the authority to “carry out provisional measures, such as freezing and seizing, to prevent any dealing, transfer or disposal of such property”.

The Vienna Convention incorporates the states parties’ obligation to adopt the necessary measures to enable their authorities to freeze or seize property in connection with the Convention (Vienna, Article 5(2)) and the UNTOC includes a similar obligation with regard to assets and for the purposes of eventual confiscation (UNTOC, Article 12(2)).

Within the European Union framework, the question of provisional measures in the context of money laundering and asset recovery is dealt with by the Warsaw Convention which mandates the adoption of legislative measures necessary for states to be able to “freeze or seize rapidly property which is liable to confiscation” in accordance with the Convention (Warsaw Convention, Articles 4, 5, 6).

Finally, UNCAC also includes specific provisions with regard to provisional measures. Article 31(2) provides that "each State Party shall take such measures as may be necessary to enable the identification, tracing, freezing or seizure" of "proceeds of crimes derived from offences established in accordance with the Convention or property the value of which corresponds to that of such proceeds" and of "property, equipment or other instrumentalities used in or destined for use in offences established in accordance with" the Convention. The identification, tracing, freezing or seizure should be conducted "for the purpose of eventual confiscation".

While the scope of application of provisional measures in accordance with some of these instruments is limited to the offenses set forth by them, their domestic inclusion usually extends its application to the assets related to all money laundering predicate offenses in each state, thus broadening their reach.

The type of provisional measures that each international instrument mandates be available in domestic legal systems is almost absolutely identical. The Warsaw Convention, the Vienna Convention, the UNTOC, and the UNCAC all require that state parties adopt the necessary legislative measures to ensure that the competent authorities may freeze or seize the assets in question. All of these instruments define "freezing" or "seizure" respectively as "temporarily prohibiting the transfer, conversion, disposition or movement of property" or "temporarily assuming custody or control of property" when these measures are adopted "on the basis of an order issued by a court or other competent authority"(UNCAC, Article 2(f); Vienna, Article 1(1); UNTOC, Article 2(f); Warsaw Convention, Article 1(g)). The only departure from these definitions is present in the Warsaw Convention where "freezing" includes the prohibition of the destruction of the property instead of the prohibition of the conversion of the property.

With regard to the assets that may be subjected to "freezing" and "seizure", these international legal instruments generally include a very broad definition, typically including, *mutatis mutandi*, the proceeds of crime derived from the offenses covered by each specific instrument, or property the value of which corresponds to that of such proceeds, as well as property, equipment or other instrumentalities used in or destined for use in offenses covered by each instrument (UNTOC, Article 12(1); Vienna, Article 5(1), UNCAC, Article 31(1), Warsaw Convention, Article 3). Furthermore, property is broadly defined as "property of any description, whether corporeal or incorporeal, movable or immovable, and legal documents or instruments evidencing title or interest in such property" (Warsaw Convention, Article 1(b)).

The fundamental criteria to be applied for provisional measures is that, as the sole purpose of its adoption is to "freeze a situation in order not to jeopardize or void the execution of a later decision", provisional measures of this type can only be ordered in relation with "assets that are likely to be confiscated at the end of a formal court procedure" (Schmid, 2008).

The most delicate and controversial aspect of this issue is that proceeds of crimes tend to be difficult to identify and seize once they have been incorporated into the legal economy (Schmid, 2008), and thus, these instruments incorporate the possibility that States parties introduce, if such a requirement is consistent with their domestic legislation, a reversal of the burden of proof whereby the persons indicted need to demonstrate the lawful origins of the alleged proceeds of crimes (Warsaw Convention, Article 3(4); Vienna, Article 5(7); UNCAC, Article 31(8); UNTOC, Article 12(7)).

The problems raised by this last possibility are particularly acute when the State seeks confiscation of the assets in accordance with international anti-money laundering standards. The final section of this chapter deals with these standards and explorer the question further.

Before going there, it should be noted that articles 54 and 55 of UNCAC represent a step forward in the recovery of illicit assets to the extent that they devise a system of mutual legal assistance for the execution of provisional measures, as well as of confiscation orders, which overcomes the weaknesses of previous iterations of international cooperation in criminal matters. Whereas the Vienna Convention (Article 5.4.a) and the UNTOC Convention (Article 13.1) required State Parties either to enforce a foreign judgment or to open their own case for confiscation, UNCAC requires that State Parties have adequate legal authority to undertake both types of action and that they enact legislation to enable them to enforce foreign restraining orders, or to initiate restraint actions in conjunction with independent confiscation action (Claman, 2008). While the application of UNCAC is limited to the mandatory offences established by the convention, it should be expected that, in adapting domestic legislation to their international obligations, States enact mutual legal assistance statutes that are consistent with UNCAC but also generally applicable to other crimes.

Further, in the European Union context, the Council Framework Decision on the execution in the European Union of orders freezing property or evidence,[7] sets out a regime for regional cooperation with regard to freezing of property or evidence and requires recognition and immediate execution of freezing orders issued in accordance with the Decision.

5 International Standards with Regard to Confiscation and Repatriation of Proceeds and Instruments of Crimes

This final section deals with the question of confiscation of repatriation of proceeds of crimes, instrumentalities and property. The development of international standards with regard to confiscation and repatriation in the context of anti-money laundering initiatives is, as already mentioned, the result of the original use of anti-money laundering tools as part of a larger strategy in the war on drugs. This strategy included confiscation of proceeds of drug trafficking offenses and other assets as one of its most fundamental aspects and was later extended to other money laundering predicate offenses.

5.1 International Standards with Regard to Confiscation

International standards with regard to confiscation are included in the FATF Recommendations, the Vienna and UNTOC Conventions, the Convention on Money Laundering and the United Nations Convention Against Corruption (UNTOC, Article 12(1);

[7] European Union Council Framework Decision 2003/577/JHA of 22 July 2003.

Vienna, Article 5(1); UNCAC, Article 31(1); Warsaw Convention, Article 3). Further, European Union legislation also deals with the issue in "Council Framework Decision 2005/212/JHA on Confiscation of Crime-Related Proceeds, Instrumentalities and Property".[8]

As these instruments deal simultaneously with the question of provisional measures and that of confiscation, for the sake of brevity reference is made to section 5 in relation to the property that may be subjected to confiscation.

The Vienna, UNTOC and UNCAC (as well as the FATF Recommendations by reference to the latter) define confiscation as the "permanent deprivation of property by order of a court or other competent authority" (Vienna, Article 1(f) ; UNTOC, Article 2(g); UNCAC, Article 2(g)). Confiscation is defined by the Warsaw Convention, in Article 1(d), and by "Council Framework Decision 2005/212/JHA", in Article 1, as "a penalty or a measure, ordered by a court following proceedings in relation to a criminal offence or criminal offences resulting in the final deprivation of property". It is thus clear that, while global standards seem to admit the possibility of a confiscation not being ordered exclusively by a court after judicial proceedings, that alternative does not seem to be available within the European Union.

The implementation of a criminal justice system centered on confiscation of assets has been traditionally faced with several issues that severely affect its effectiveness. First, on many occasions, confiscation is limited to the unlawful goods being dealt – before any proceed actually results from their sell – or, at the most, to the proceeds strictly connected to the specific instance of the crime being investigated, rather than involving all of the illicit assets owned by the person being prosecuted. Second, it is extremely difficult for prosecutors to establish the "illicit origin" of the assets beyond any reasonable doubt. And finally, the legal tools available to execute confiscation over assets owned by, or in possession of, third parties.

It should be noted, however that, in the European Union context, "Council Framework Decision 2005/212/JHA" represents a breakthrough with regard to previous international standards and a possible path of solution for these issues. Indeed, while Article 2 of the Framework Decision incorporates the traditional notion of confiscation, Article 3 mandates that member states adopt the necessary measures to enable it to exercise the so-called "extended powers of confiscation". These extended powers of confiscation, whose application is limited to proceedings in connection with the offences listed in the Framework Decision,[9] include the possibility of confiscating: (a) property that "has

[8] Framework Decisions were incorporated into the Treaty of the European Union by the Treaty of Amsterdam (Article 11). These decisions can be adopted by the European Union Council "for the purpose of approximation of the laws and regulations of the Member States" and are "binding upon the Member States as to the result to be achieved but shall leave to the national authorities the choice of form and methods". Framework Decisions are foreseen explicitly for police and judicial cooperation in criminal matters.

[9] The Framework Decision lists a series of offences covered by previous Framework Decisions that are subject to the extended power of confiscation when committed within the framework of a criminal organization (counterfeiting of currency, money laundering, trafficking in human beings, facilitation of unauthorized entry, transit and residence, sexual exploitation of children and child pornography and illicit drug trafficking) as well as others covered by Framework Decision 2002/475/JHA on combating terrorism.

been derived from criminal activities of the convicted person during a period of time prior to conviction for the offence … which is deemed reasonable by the court in the circumstances of the particular case"; (b) alternatively, property that "has been derived from similar criminal activities of the convicted person during a period prior to conviction for the offence … which is deemed reasonable by the court in the circumstances of the particular case"; or, alternatively, (c) "where it is established that the value of the property is disproportionate to the lawful income of the convinced person and a national court based on specific facts is fully convinced that the property in question has been derived from the criminal activity of that convicted person". Furthermore, the Framework Decision leaves member states the alternative to include as well the necessary measures to "enable it to confiscate … either in whole or in part, property acquired by the closest relations of the person concerned and property transferred to a legal person in respect of which the person concerned – acting either alone or in conjunction with his closes relations – has a controlling influence".

In general, the European Court of Human Rights has admitted the compatibility of the "extended confiscation" with the presumption of innocence (ECHR 2001; ECHR 2005). Recently, however, the ECHR condemned The Netherlands for the violation of the presumption of innocence in a case in which the Supreme Court of The Netherlands had ordered, apart from the confiscation of the criminal goods for which the person charged has been punished, the confiscation of goods presumably obtained by means of crimes of which the accused had been acquitted. The confiscation amount derived from a police report which projected the prices of stolen products, but it had not been proved that the goods had been in possession of the accused.

The ECHR stated that the decision violated the the presumption of innocence for two reasons. First, the Court considered that "confiscation following on from a conviction … is a measure (maatregel) inappropriate to assets which are not known to have been in the possession of the person affected, the more so if the measure concerned relates to a criminal act of which the person affected has not actually been found guilty. If is not found beyond a reasonable doubt that the person affected has actually committed the crime, and if it cannot be established as fact that any advantage, illegal or otherwise, was actually obtained, such a measure can only be based on a presumption of guilt … Secondly … the impugned order related to the very crimes of which the applicant had in fact been acquitted" thus resulting a violation of the general rule that "following a final acquittal, even the voicing of suspicion regarding an accused's innocence is no longer admissible".[10]

The limit imposed by the ECHR can be taken as the conceptual balance of the extended confiscation notion in Europe: it does not necessarily constitute a criminal sanction, thus allowing the introduction of a range of preventive civil proceedings, in which the burden of the proof is shared and the examination of the assets beyond the proceeds of crime under reasonable criteria.

As a parallel development, a number of countries belonging to different legal traditions – the United States, Ireland, the United Kingdom, Italy, Australia, Colombia, South Africa,

[10] TEDH, Geerings v. The Netherlands, Case 30810/03, Sentence dated 1 March 2007, par. 47–49.

Antigua y Barbuda, some Canadian provinces including Ontario, Alberta, Manitoba, Saskatchewan and British Columbia and, more recently, the city of Mexico – have established civil confiscation proceedings through which the State questions the ownership of an asset based upon the fact it having been acquired with money of illicit origin. The burden of proof in these proceedings is reversed and the individual alleging to be the legitimate owner of the assets is charged with conclusively establishing that allegation.

These procedures has been successfully used when the defendant has died, when the wrongdoer is unknown, when the property belongs to a third party which connection with the crime is hard to trace, when the defendant is a fugitive, when the defendant is under prosecution in a different country from the one where the assets are (Cassella, 2008). However, they must be carefully drafted to avoid constitutional and international human rights violations.

5.2 International Standards with Regard to Repatriation of Confiscated Property

As discussed in the previous section, international cooperation with the purpose of confiscation of laundered assets is central to the anti-money laundering regime.

With the purpose of aligning incentives for cooperation, the traditional notion according to which assets belongs to the State enforcing the confiscation order (*locus regit actum*) has in the last two decades been replaced by the practice of sharing the assets among the countries that cooperated in the investigation and the legal proceedings. This is the rule under the Vienna and UNTOC.

States Parties can even agree on sharing schemes (usually where there is no identifiable victim, as in drugs cases), although asset sharing is not a principle under the Convention. Sharing schemes may vary, as countries may establish that they would share the recovered assets on an equal basis, or they can establish other distributive calculations depending on each State Party's contribution and effort in the recovery.

States Parties may establish in their domestic legislation, where necessary, provisions enabling them to conclude such agreements. Assisting States Parties and international organizations that enjoy full trust by all parties may help to negotiate or even be included in such agreements. They may, inter alia, help the affected States Parties to enter into negotiations or to establish transparency and monitoring arrangements about the way in which the funds recovered would be spent if and when recovered and returned. High priority must be given to the general principle that all such agreements are voluntary and must be mutually acceptable to both sides.

Nonetheless, as corruption offences are different in nature, UNCAC introduces a major breakthrough to this principle. Under Article 57 of UNCAC, State Parties assume, as a general principle, the obligation to return the confiscated property to the requesting State Party. The obligation to return the property is absolute when the confiscation relates to cases of embezzlement of public funds and or laundering of embezzled public funds. In the case of proceeds of any other offence covered by UNCAC, the obligation to return the confiscated property to the requesting State Party is limited to those cases in which it "reasonably establishes its prior ownership of such confiscated property" or when there is recognition of damage to the requesting State Party. In all other cases, there is no obligation *per se* to return the confiscated property but States should give priority consideration to returning confiscated property to the victim country. The latter situation is similar in nature to the principle of Article 14(1) of the UNTOC Convention.

Given the fact that sometimes evidentiary problems and other practical or legal issues may arise, Article 57(5) allows States Parties to enter into voluntary agreements or mutually accepted arrangements on a case-by-case basis, for the final disposal of the confiscated asset. This possibility does not depart from the principle of unconditional return of assets in earlier sections of the Article. It allows, in specific circumstances, a level of flexibility in what is the most effective means of recovery and which may better reflect concerns or issues either or both States Parties may have where direct restitution may not always be feasible or appropriate. In such particular cases, agreement provisions may include establishing special funds under the administration of an international organization or the requested State Party for a specific use of the asset, such as law enforcement projects, or for social purposes, such as education on issues related to the prevention and fight against corruption, humanitarian assistance and the like. The agreement reached by Kazakhstan, the United States and Switzerland in a case concerning the return of frozen assets that originated from transactions involving American businessman and Kazakh officials is one such example of the repatriated assets being channeled through a foundation that will use them for agreed purposes. (Veglio & Siegenthaler, 2008).

6 Conclusions

The efforts to create, from international organizations, relatively homogeneous national regimes to prevent and reduce money laundering, have been quite successful. This success is particularly striking because, apart from multiple institutional, legal and political agreements, the money laundering control system requires the consolidation of a cooperative model between the financial sector and the State on an extremely sensitive issue: the reduction of crime. The nature and operation of the anti-money laundering regimen thus established require a number of concluding remarks.

The anti-money laundering regime is a dynamic body of binding rules and non-binding standards, which are nonetheless mostly treated as binding, emanating from a number of different regional and international organizations or inter-governmental bodies and incorporated into domestic legal regimes. Close monitoring of international developments is, thus, essential in establishing the legal framework applicable to anti-money laundering as well as laundered assets confiscation and repatriation.

While international standards are not, by themselves, directly binding either on States or on domestic natural or legal persons, they have been – and continue to be – treated as such. The regime of mutual evaluations set up by the FATF and its regional counterparts has greatly contributed to that result inasmuch as it provides incentives for States to adjust their domestic legislation to these standards. Further, inasmuch as these standards can be said to expand and inform the more basic anti-money laundering obligations contained in binding conventions, it would be possible to argue that they are binding "by proxy".

Further, while the most restrictive standards and obligations are typically contained in crime-based conventions and, thus, only applicable to the offences defined therein, the process of domestic legal reform undertaken to comply with these conventions usually goes beyond them and extends the new legal tools and institutes to all offences, dramatically expanding the reach of this regime.

On a more general level, despite the difficulties inherent to establishing a cooperative relation between the public and the private sectors, it can be affirmed that the 80s' dichotomy between cooperating with the State in crime reduction and being a successful financial center based on the culture of secrecy to attract capitals of doubtful origin has yielded in favor of the first part of the equation. In other words, the bank secrecy of offshore centers that a decade ago constituted the greater obstacle to serious crimes investigation has yielded to the needs of cooperation for financial information exchange. Bank secrecy continues in operation in relation to tax affairs, although recent pressures have also started to erode it in this area.

Even though the accelerated rhythm with which the project was started was not, and is not, free from coercive diplomacy instances, and double standards, in some cases, on the part of the countries exerting it, it can be affirmed that nowadays all actors discuss about more efficient ways to improve the system from the inside.

In this process, the system – currently accepted as the key rule of the game- created to evaluate compliance with the standards must be highlighted. The system of mutual evaluations has gained consensus and reputation, even beyond the money laundering sphere, as the more efficient and accepted alternative to monitor compliance with international rules.

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Basics of International Insolvency Law

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1 International Bankruptcy Law Reform: The International Insolvency Standard Established by UNCITRAL's Legislative Guide on Insolvency and The World Bank Principles

1.1 The Work of UNCITRAL in Developing an International Insolvency Standard

One of the greatest tasks a State can undertake is to reform its laws. Such a process can take a significant number of years and substantial political and cultural turmoil can occur in the process. Envision if that concept is taken one step further with an organization given the task of reforming not one State's laws, but all of the States of the world in order to provide one uniform law. UNCITRAL was given such a mandate by the United Nations.

On 17 December 1966, by Resolution 2205, the United Nations established the United Nations Commission on International Trade Law ("UNCITRAL") with a mandate to harmonize and unify the law of international trade, bearing in mind the interest of all people and in particular those in developing countries, in the continuing development of international trade and commerce.

UNCITRAL since its establishment has met and exceeded the expectations of the international community by providing a number of excellent products for the international trade community. Such products have included the establishment of model laws, protocols, conventions and other works on arbitration, ecommerce, accounts receivable and letters of credit, among others. After several years of concerted effort by the Insolvency Working Group in the development of a uniform procedure to address cross-border insolvency proceedings, a Model Law was developed to address such issues. On 15 December 1997, by Resolution 52/158, the General Assembly of the United Nations adopted the Model Law on Cross-Border Insolvency.

After achieving a consensus on the development of the Model Law on Cross-Border Insolvency, Australia in 1999 proposed to UNCITRAL to undertake a project to develop a legislative guide on insolvency law. The proposal was made as most States are limited to liquidation proceedings and a need was perceived for the establishment of a Legislative Guide detailing the key objectives and criteria as a basis for the establishment of reorganization insolvency proceedings. The proposal was vetted and in July, 2000 at the UNCITRAL Commission Meeting in New York, the Commission directed that a colloquium be established to determine whether there was sufficient interest to undertake such a project.

In December of 2000, at UNCITRAL's headquarters in Vienna, Austria, a Colloquium was held under the joint sponsorship of the International Bar Association and INSOL. UNCITRAL invited to the Colloquium a wide range of insolvency experts from the academic community, private practice, the judiciary, numerous governments and governmental organizations.

Over 150 people attended the Colloquium and at the end of the three-day period, a consensus had been arrived at that not only was the project appropriate but the primary elements of an effective insolvency system had been identified with a recommendation to the UNCITRAL Commission that the project should move forward.

In July, 2001, in Vienna, Austria, the UNCITRAL. Commission received a report from the Colloquium and concurred with the recommendation and directed Working Group V (the Insolvency Working Group) to prepare a Legislative Guide on Insolvency Law.

At this juncture, the structure of Working Group V becomes more formal. Two week Working Group sessions, alternating between the United Nations facilities in New York and Vienna are convened yearly. The Working Group sessions, conducted in the six official languages of the United Nations, consist of the 36 member States of UNCITRAL, along with observer States, those being any country member of the United Nations. In addition, governmental organizations such as the World Bank, The International Monetary Fund (IMF), The Asian Development Bank (ADB) and similar entities are encouraged to participate. In addition, non-governmental organizations (NGOs) actively participate in the Working Group sessions. NGOs include The American Bar Association, The European Union, The International Bar Association, The International Chamber of Commerce, INSOL, The International Insolvency Institute, and other organizations recognized by UNCITRAL as having an international focus and who can provide expertise and assist the overall Working Group in the area of insolvency and in the development of an insolvency guide.

The entire process is organized and coordinated by the UNCITRAL Secretariat. The Secretariat chairs each of the Working Group sessions and prepares the materials for review and discussion by the Working Group members. Jernej Sekolec was the Secretary of UNCITRAL who oversaw the development of the Legislative Guide on Insolvency Law. Jenny Clift, a legal officer at UNCITRAL, was assigned the task of drafting and revising the materials based upon the decisions and determinations of the Working Group. Delegates from member States, along with representatives of governmental organizations and NGOs actively participated in the interchange of ideas and concepts to effectuate the development of the legislative guide.

The process that Working Group V adopted in the development of the Legislative Guide was to take each of the areas which were determined to be an essential element of an effective insolvency system and then, based upon the Working Group's experience and actions, to expand each of the areas to include background information, commentary and recommendations. The background information consisted of how various states address specific areas of insolvency. The commentary would then further address the relative pros and cons and the effect upon international trade and commerce as to various proposed treatments of the insolvency law. Finally, a recommendation consisted of recommendations that enacting States should consider adopting in the development of an effective insolvency system. Thus, as the project developed, the Working Group set forth the key objections of the insolvency system and further determined the scope and extent of the core features of that system in order to implement and to implement the key objectives.

The Working Group commenced Working Group sessions in July, 2001 and completed their seventh session in March, 2004. A further Working Group session was held at the UNCITRAL Commission meeting in New York in June, 2004 and the Legislative

Guide on Insolvency Law was adopted by consensus on 25 June 2004 by the UNCITRAL Commission.

Thereafter, the General Assembly by Resolution 59/40 on 2 December 2004 adopted the Legislative Guide on Insolvency Law.

Throughout the process the Secretariat and especially its Legal Officer Jenny Clift, worked extensively on drafting and redrafting of the Legislative Guide on Insolvency Law based on continuing input from the Working Group. In addition, representatives of The Hague Conference met with a group of experts designated by UNCITRAL to develop choice of law rules. The choice of law rules developed at that conference and thereafter were then proposed to the Working Group for its consideration and were ultimately adopted by the Legislative Guide.

The key element of the entire process was the continued interaction and cooperation between countries, governmental and non-governmental organizations, along with the Secretariat in which a consensus was ultimately reached in developing the Legislative Guide on Insolvency Law. The process resulted in a balanced approach to the interest of debtors, creditors and equity holders for the recommendation to restructure existing businesses and not just to effectuate a liquidation or termination of those businesses. The resultant product promotes transparency and predictability. In addition, the Legislative Guide on Insolvency Law is the product of both civil and common law jurisdictions, vast cultural and political differences, many languages and traditions. The Legislative Guide on Insolvency Law is truly a global product developed through a transparent and cooperative process and in which the final result was achieved by consensus.

1.2 Key Objectives and Features of the Legislative Guide on Insolvency

Considering insolvency law reform, key objectives must first be determined. In addressing law reform basic considerations must first be determined before the law can be further developed.

The participants at the INSOL-IBA Colloquium first identified the key objectives in the insolvency system and thereafter, the UNCITRAL Insolvency Working Group, through its first Working Group sessions, further clarified and identified key considerations under effective insolvency law. UNCITRAL first through the Colloquium and the initial Working Group sessions set forth the general features of insolvency law.

After substantial discussion, Recommendation 7 was adopted by the Insolvency Working Group to establish the common features that should be considered in the design of an effective and efficient insolvency law. Paragraph 22 through 27, inclusive, of Part I provide background commentary in regard to Recommendation 7.

Recommendation 7 states as follows:

In order to design an effective and efficient insolvency law, the following common features should be considered:

a) Identifying the debtors that may be subject to insolvency proceedings, including those debtors that may require a special insolvency regime;
b) Determining when insolvency proceedings may be commenced and the type of proceeding that may be commenced, the party that may request commencement and whether the commencement criteria should differ depending upon the party requesting commencement;
c) The extent to which the debtor should be allowed to retain control of the business once insolvency proceedings commence, or be displaced and an independent party (in the *Guide* referred to as the insolvency representative) appointed to supervise and manage the debtor, and the distinction to be made between liquidation and reorganization in that regard;
d) Identification of the assets of the debtor that will be subject to the insolvency proceedings and constitute the insolvency estate;
e) Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative, and where the protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings;
f) The manner in which the insolvency representative may deal with contract entered into by the debtor before the commencement of proceedings and in respect of which both the debtor and its counterparty have not fully performed their respective obligations;
g) The extent to which set-off or netting rights can be enforced or will be protected, notwithstanding the commencement of insolvency proceedings;
h) The manner in which the insolvency representative may use or dispose of assets of the insolvency estate;
i) The extent to which the insolvency representative can avoid certain types of transactions that result in the interests of creditors being prejudiced;
j) In the case of reorganization, preparation of the reorganization plan and the limitations, if any, that will be imposed on the content of the plan, the preparer of the plan and the conditions required for its approval and implementation;
k) Rights and obligations of the debtor;
l) Duties and functions of the insolvency representative;
m) Functions of the creditors and creditor committee;
n) The treatment of claims and their ranking for the purposes of distributing the proceeds of liquidation;
o) Distribution of the proceeds of liquidation;
p) Costs and expenses relating to the insolvency proceedings;
q) Discharge or dissolution of the debtor; and
r) Conclusion of the proceedings.

The next step in the process was to develop core provisions for an effective and efficient insolvency law. Part II of the Legislative Guide on Insolvency Law sets forth recommendations to establish the core provisions.

Recommendations 8 to 13 address eligibility and jurisdiction. The provisions on eligibility and jurisdiction are as follows:

1.2.1 Contents of Legislative Provisions

Eligibility (Paras. 1–11)

(8) The insolvency law should govern insolvency proceedings against all debtors that engage in economic activities, whether natural or legal persons, including State-owned enterprises,[1] and whether or not those economic activities are conducted for profit.

(9) Exclusions from the application of the insolvency law should be limited and clearly identified in the insolvency law.[2]

Jurisdiction (Paras. 12–18)

(10) The insolvency law should specify which debtors have sufficient connection to a State to be subject to its application. Different approaches may be taken to identifying appropriate connecting factors, but the grounds upon which a debtor can be subject to the insolvency law should include:[3]

(a) That the debtor has its centre of main interests in the State; or
(b) That the debtor has an establishment in the State.

(11) The insolvency law should establish a presumption that, in the absence of proof to the contrary, a legal person's centre of main interests is in the State in which it has its registered office, and a natural person's centre of main interests is in the State in which that person has their habitual residence.

(12) The insolvency law should define "establishment" to mean "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services".[4]

Competent Courts (Para. 19)

(13) The insolvency law should clearly indicate (or include a reference to the relevant law which establishes) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings.

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1 It is not intended that the *Guide* would apply to the insolvency of States, sub-national governments, municipalities and other similar types of organization, except to the extent that they are a "state-owned enterprise".

2 Highly regulated organizations such as banks and insurance companies may require specialized treatment that can appropriately be provided in a separate insolvency regime or through special provisions in the general insolvency law. Some SOEs, such as those involved in sensitive sectors of the economy might also be excluded.

3 This recommendation is intended to indicate minimum and non-exclusive grounds for commencing insolvency proceedings. Other grounds, such as presence of assets, are used in some jurisdictions, but are not recommended: see the discussion in part two, chapter I, paras. 17–18 above and paras. 184–187 of the Guide to Enactment of the UNCITRAL Model Law.

4 UNCITRAL Model Law, art. 2(f).

Recommendations 14 to 29 address application and commencement procedures. The provisions on application and commencement are as follows:

1.2.2 Commencement Standard

Persons Permitted to Apply (Paras. 33–53)

(14) The insolvency law should specify the parties permitted to make an application for commencement of insolvency proceedings which should include the debtor and any of its creditors.[5]

Debtor Application (Paras. 33–36 for Liquidation and 45–47 for Reorganization)

(15) The insolvency law should specify that insolvency proceedings can be commenced on the application of a debtor if the debtor can show either that:

(a) It is or will be generally unable to pay its debts as they mature; or
(b) Its liabilities exceed the value of its assets.[6]

Creditor Applications (Paras. 37–41 for Liquidation and 48–53 for Reorganization)

(16) The insolvency law should specify that insolvency proceedings can be commenced on the application of a creditor if it can be shown that either:

(a) The debtor is generally unable to pay its debts as they mature; or
(b) The debtor's liabilities exceed the value of its assets.

Presumption that the Debtor is Unable to Pay (Para. 37)

(17) The insolvency law may establish a presumption that, if the debtor fails to pay one or more of its mature debts, and the whole of the debt is not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt claimed, the debtor is generally unable to pay its debts.[7]

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5 This would include a government authority that is a creditor of the debtor.

6 The intention of this recommendation and the recommendation on creditor applications is to allow legislators flexibility in developing commencement standards, based on a single or dual test approach. Where the insolvency law adopts a single test, it should be based on the debtor's inability to pay debts as they mature (cessation of payments test) and not on the balance sheet test. Where the insolvency law contains both tests (cessation of payments and balance sheet tests) proceedings can be commenced if one of the tests can be satisfied.

7 Where the debtor has not paid a mature debt and the creditor has obtained a judgement against the debtor in respect of that debt, there would be no need for a presumption to establish that the debtor was unable to pay its debts. The debtor could rebut the presumption by showing, for example, that it was able to pay its debts; that the debt was subject to a legitimate dispute or offset; or that the debt was not mature. The recommendations on notice of commencement provide protection for the debtor by requiring notice of the application for commencement of proceedings to be given to the debtor and providing the debtor with an opportunity to rebut the presumption.

Commencement on Debtor Application (Para. 65)

(18) The insolvency law should specify that where the application for commencement is made by the debtor:

(a) The application for commencement will automatically commence the insolvency proceedings; or
(b) The court will promptly determine its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.

Commencement on Creditor Application (Paras. 57 and 67)

(19) The law generally should specify that, where a creditor makes the application for commencement:

(a) Notice of the application promptly is given to the debtor;[8]
(b) The debtor be given the opportunity to respond to the application, by contesting the application, consenting to the application or, where the application seeks liquidation, requesting the commencement of reorganization proceedings; and
(c) The court promptly determines its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.[9]

Denial of an Application to Commence Proceedings (Paras. 61–62)

(20) The insolvency law should specify that, where the decision to commence proceedings is to be made by the court, the court may deny the application to commence and, where appropriate, impose costs or sanctions against the applicant, if it determines:

(a) That it does not have jurisdiction, the debtor is ineligible or does not meet the commencement standard; or
(b) That the application is an improper use of the law.

(21) Where the application was made by a creditor, the insolvency law should specify that the debtor promptly be given notice of the decision to deny.

Notice of Commencement of Proceedings

(22) The insolvency law should establish procedures for giving notice of the commencement of insolvency proceedings.

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8 Where the debtor's whereabouts is unknown and it cannot be contacted, the general law may provide relevant rules concerning the giving of notice in such circumstances.

9 A determination that the commencement standard has been met may involve consideration of whether the debt is subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt (see also chapter I, paras. 61–63).

General Notice

(23) The insolvency law should specify that the means of giving notice of the commencement of insolvency proceedings must be appropriate[10] to ensure that the information is likely to come to the attention of interested parties.[11] The insolvency law should specify the party responsible for giving that notice.

Notice to Creditors (Paras. 65–66)

(24) The insolvency law should specify that notice of the commencement of proceedings be given to creditors individually, unless the court considers that, under the circumstances, some other form of notice would be more appropriate.[12]

Content of Notice (Para. 71)

(25) The insolvency law should specify that the notice of commencement of insolvency proceedings include:

(a) Information concerning submission of claims, including the time and place for submission;
(b) The procedure and form requirements for the submission of claims;
(c) The consequences of failure to submit a claim in accordance with paragraphs (a) and (b); and
(d) Information concerning verification of claims, application of the stay and its effects, and meetings of creditors.

Debtor with Insufficient Assets (Paras. 72–75)

(26) The insolvency law should specify the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceedings. Different approaches may be taken including:

(a) Denial of the application, except where the debtor is an individual who would be entitled to a discharge; or
(b) Commencement of the proceedings, where different mechanisms for appointment and remuneration of the insolvency representative may be available.[13]

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10 The question of what is appropriate in a particular case will also involve considerations of cost effectiveness and the insolvency law should not require, for example, expensive publication in a national newspaper, when publication in a local paper will suffice.

11 General notice would generally be provided by way of making the information available in a publication such as an official government gazette, a widely circulated national, regional or local newspaper, through electronic means, or through relevant public registries.

12 The obligation to prepare the list of creditors to be given notice is dealt with under obligations of the insolvency representative and the debtor (see chapter III, paras. 23–27 and 49–51).

13 See chapter III, paras. 44–47.

Dismissal of Insolvency Proceedings (Para. 79)

(27) The insolvency law should permit the court to dismiss proceedings if, after commencement, the court determines, for example, that:

(a) The proceedings constitute an improper use of the insolvency law; or
(b) The debtor was ineligible or did not meet the commencement standard at the time of commencement.

(28) The insolvency law should specify that where proceedings are dismissed, the court may impose costs or sanctions, where appropriate, against the applicant for commencement of the proceedings.

(29) The insolvency law should require notice of a decision to dismiss proceedings to be given.

Recommendations 30 to 34 address applicable law provisions. The provisions on applicable law are as follows:

Law Applicable to Validity and Effectiveness of Rights and Claims (Paras. 81 and 82)

(30) The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

Law Applicable in Insolvency Proceeding: Lex Fori Concursus (Paras. 83–84)

(31) The insolvency law of the State in which insolvency proceedings are commenced (lex fori concursus) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

(a) Identification of the debtors that may be subject to insolvency proceedings;
(b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement;
(c) Constitution and scope of the insolvency estate;
(d) Protection and preservation of the insolvency estate;
(e) Use or disposal of assets;
(f) Proposal, approval, confirmation and implementation of a plan of reorganization;
(g) Avoidance of certain transactions that could be prejudicial to certain parties;
(h) Treatment of contracts;
(i) Set-off;
(j) Treatment of secured creditors;

(k) Rights and obligations of the debtor;
(l) Duties and functions of the insolvency representative;
(m) Functions of the creditors and creditor committee;
(n) Treatment of claims;
(o) Ranking of claims;
(p) Costs and expenses relating to the insolvency proceedings;
(q) Distribution of proceeds;
(r) Conclusion of the proceedings; and
(s) Discharge.

Exceptions to the Application of the Law of the Insolvency Proceedings (Paras. 85–90, Specifically Paras. 86 and 87)

(32) Notwithstanding recommendation 31, the effects of insolvency proceedings on the rights and obligations of the participants in a payment or settlement system or in a regulated financial market shall be governed solely by the law applicable to that system or market.

(33) Notwithstanding recommendation 31, the effects of insolvency proceedings on rejection, continuation and modification of labour contracts may be governed by the law applicable to the contract.

(34) Any exceptions additional to recommendations 32 and 33 should be limited in number and be clearly set forth or noted in the insolvency law.

Recommendations 35 through 38 address assets constituting the insolvency estate and the day upon which the estate is constituted. The provisions on assets and date of constitution are as follows:

Assets Constituting the Estate (Paras. 1–16)

(35) The insolvency law should specify that the estate should include:

(a) Assets of the debtor[14] including the debtor's interest in encumbered assets and in third party-owned assets;
(b) Assets acquired after commencement of the insolvency proceedings; and
(c) Assets recovered through avoidance and other actions.

(36) In the case of insolvency proceedings commenced where the debtor has its centre of main interests, the insolvency law should specify that the estate include all assets of the debtor wherever located.[15]

[14] Ownership of assets would be determined by reference to the relevant applicable law, where the term "assets" is defined broadly to include property, rights and interest of the debtor, including the debtor's rights and interests in third-party owned assets.

[15] Where the insolvency law adopts a universal approach as recommended here, the law should also address the issue of recognition of foreign proceedings, see UNCITRAL Model Law on Cross-Border Insolvency (annex III).

Time of Constitution of the Insolvency Estate (Paras. 22–24)

(37) The insolvency law should specify the date from which the estate is to be constituted, being either the date of application for commencement or the effective date of commencement of insolvency proceedings.

Assets Excluded from the Insolvency Estate where the Debtor Is a Natural Person[16] (Paras. 18–21)

(38) The insolvency law should specify the assets, if any, that are excluded from the estate where the debtor is a natural person.

Recommendations 39 to 51 address preservation of the value of the estate and the preservation of those assets. The provisions on preservation and value of the estate are as follows:

Provisional Measures[17] (Paras. 47–53)

(39) The insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor[18] or the interests of creditors, between the making of an application to commence insolvency proceedings and commencement of the proceedings,[19] including:

(a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;
(b) Entrusting the administration or supervision of the debtor's business, which may include the power to use and dispose of assets in the ordinary course of business, to an insolvency representative or other person[20] designated by the court;
(c) Entrusting the realization of all or part of the assets of the debtor to an insolvency representative or other person designated by the court, in order to protect and preserve the value of assets of the debtor that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and
(d) Any other relief of the type applicable or available on commencement of proceedings under recommendations 46 and 48.

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16 Exclusions generally are not provided for legal person debtors. On the types of assets that may be excluded in respect of natural persons; see above, paras. 18–21.

17 These articles follow the corresponding articles of the UNCITRAL Model Law on Cross-Border Insolvency, see Art. 19.

18 The reference to assets in paragraphs (a) to (c) is intended to be limited to assets that would be part of the insolvency estate once proceedings commence.

19 The insolvency law should indicate the time of effect of an order for provisional measures e. g. at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time (see above, para. 44).

20 The term "other person" in recommendation 39 (b) and (c) is not intended to include the debtor.

Indemnification in Connection with Provisional Measures (Para. 51)

(40) The insolvency law may provide the court with the power to:

(a) Require the applicant for provisional measures to provide indemnification and, where appropriate, to pay costs or fees; or
(b) Impose sanctions in connection with an application for provisional measures.

Balance of Rights between Debtor and Insolvency Representative (Paras. 50 and 70–73)

(41) The insolvency law should clearly specify the balance of the rights and obligations between the debtor and any insolvency representative appointed as a provisional measure. Between the time of an application for commencement of insolvency proceedings and commencement of those proceedings, the debtor is entitled to continue to operate its business and to use and dispose of assets in the ordinary course of business, except to the extent restricted by the court.

Notice (Para. 52)

(42) The insolvency law should specify that, unless the court limits or dispenses with the need to provide notice, appropriate notice be given to those parties in interest affected by:

(a) An application or court order for provisional measures (including an application for review and modification or termination); and
(b) A court order for additional measures applicable on commencement, unless the court limits or dispenses with the need to provide notice.

Ex Parte Provisional Measures (Para. 52)

(43) The insolvency law should specify that where the debtor or other party in interest affected by a provisional measure is not given notice of the application for that provisional measure, the debtor or other party in interest affected by the provisional measures has the right upon urgent application to be heard promptly[21] on whether the relief should be continued.

Modification or Termination of Provisional Measures (Para. 53)

(44) The insolvency law should specify that the court, at its own motion or at the request of the insolvency representative, the debtor, a creditor or any other person affected by the provisional measures, may review and modify or terminate those measures.

[21] Any time limit included in the insolvency law should be short in order to prevent the loss of value of the debtor's business.

Termination of Provisional Measures (Para. 53 and Chap. I, Para. 63)

(45) The insolvency law should specify that provisional measures terminate when

(a) An application for commencement is dismissed;
(b) An order for provisional measures is successfully challenged under recommendation 43; and
(c) The measures applicable on commencement take effect, unless the court continues the effect of the provisional measures.

Measures Applicable on Commencement (Paras. 30–34)

(46) The insolvency law should specify that, on commencement of insolvency proceedings:[22]

(a) Commencement or continuation of individual actions or proceedings[23] concerning the assets of the debtor, and the rights, obligations or liabilities of the debtor are stayed;
(b) Actions to make security interests effective against third parties and to enforce security interests are stayed;[24]
(c) Execution or other enforcement against the assets of the estate is stayed;
(d) The right of a counterparty to terminate any contract with the debtor is suspended;[25] and
(e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.[26]

Exceptions to the Application of the Stay (Para. 35)

(47) The insolvency law may permit exceptions to the application of the stay or suspension under recommendation 46 and where it does so, those exceptions should be clearly stated. Paragraph (a) of recommendation 46 should not affect the right to commence

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22 These measures would generally be effective as at the time of the making of the order for commencement.

23 See Art. 20 UNCITRAL Model Law on Cross-Border Insolvency. It is intended that the individual actions referred to in paragraph (a) of recommendation (46) would also cover actions before an arbitral tribunal. It may not always be possible, however, to implement the automatic stay of arbitral proceedings, such as where the arbitration does not take place in the State but in a foreign location.

24 If law other than the insolvency law permits those security interests to be made effective within certain specified time periods, it is desirable that the insolvency law recognize those periods and permit the interest to be made effective where the commencement of insolvency proceedings occurs before expiry of the specified time period. Where law other than the insolvency law does not include such time periods, the stay applicable on commencement would operate to prevent the security interest being made effective (for further discussion see above, para. 32 and the UNCITRAL Legislative Guide to Secured Transactions).

25 See chapter II, paras. 114–119. This recommendation is not intended to preclude the termination of a contract if the contract provides for a termination date that happens to fall after the commencement of insolvency proceedings.

26 The limitation on the right to transfer, encumber or otherwise dispose of assets of the estate may be subject to an exception in those cases where the continued operation of the business by the debtor is authorised and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

individual actions or proceedings to the extent necessary to preserve a claim against the debtor.[27]

Additional Measures Available on Commencement (Para. 34)

(48) The insolvency law should specify that the court may grant relief additional to the measures applicable on commencement.[28]

Duration of Measures Automatically Applicable on Commencement (Paras. 54–58)

(49) The insolvency law should specify that the measures applicable on commencement of insolvency proceedings remain effective throughout the insolvency proceedings until:

(a) The court grants relief from the measures;[29]
(b) In reorganization proceedings, a reorganization plan becomes effective;[30]
(c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires,[31] unless it is extended by the court for a further period on a showing that (i) an extension is necessary to maximize the value of assets for the benefit of creditors; and (ii) the secured creditor will be protected against the diminution of the value of the encumbered asset.

Protection from Diminution of the Value of Encumbered Assets (Paras. 63–69)

(50) The insolvency law should specify that upon application to the court, a secured creditor should be entitled to protection of the value of the assets in which it has a security interest. The court may grant appropriate measures of protection that may include:

(a) Cash payments by the estate;
(b) Provision of additional security interests; or
(c) Such other means as the court determines.

Relief from Measures Applicable on Commencement (Paras. 60–62)

(51) The insolvency law should specify that a secured creditor may request the court to grant relief from the type of measures applicable on commencement on grounds that may include that:

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27 See Art. 20(3), and paras. 151–152 of the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency. Where an issue arises as to quantification of a claim, the court may be requested to consider whether relief from the stay can be provided to enable an action or proceeding to be commenced for that purpose.

28 The additional relief that may be available will depend upon the types of measures available in a particular jurisdiction and what measures, in addition to the measures applicable on commencement, might be appropriate in a particular insolvency proceeding.

29 Relief should be granted on the grounds included in recommendation 51.

30 A plan may become effective upon approval by creditors or following confirmation by the court, depending upon the requirements of the insolvency law (see chapter IV, paras. 54 and following).

31 It is intended that the stay should apply to secured creditors only for a short period of time, such as between 30 and 60 days, and that the insolvency law should clearly state the period of application.

(a) The encumbered asset is not necessary to a prospective reorganization or sale of the debtor's business;
(b) The value of the encumbered asset is diminishing as a result of the commencement of insolvency proceedings and the secured creditor is not protected against that diminution of value; and
(c) In reorganization, a plan is not approved within any applicable time limits.

Recommendations 52 to 62 address the use and disposition of assets and procedures in regard to the same. The provisions on the use and disposition of assets are as follows:

Power to Use and Dispose of Assets of the Estate (Para. 74)

(52) The insolvency law should permit:

(a) the use and disposal of assets of the estate (including assets subject to security interests) in the ordinary course of business, except cash proceeds; and
(b) the use and disposal of assets of the estate (including assets subject to security interests) outside the ordinary course of business, subject to the requirements of recommendations 55 and 58.

Further Encumbrance of Encumbered Assets (Para. 84)

(53) The insolvency law should specify that assets subject to security interests may be further encumbered, subject to the requirements of recommendations 65, 66 and 67.

Use of Third Party Owned Assets (Paras. 90–91)

(54) The insolvency law should specify that the insolvency representative may use assets owned by third parties and in the possession of the debtor provided specified conditions are satisfied, including:

(a) The interests of the third party will be protected against diminution in the value of the assets; and
(b) The costs under the contract of continued performance of the contract and use of the assets will be paid as an administrative expense.

Procedure for Notification of Disposal (Para. 82)

(55) The insolvency law should specify that adequate notice of any disposal conducted outside the ordinary course of business be given to creditors[32] and that they have the opportunity to be heard by the court.

(56) The insolvency law should specify that notification of public auctions be provided in a manner that will ensure the information is likely to come to the attention of interested parties.

[32] When the assets are encumbered assets or subject to other interests, recommendation (58) also applies.

General Methods of Sale (Paras. 79–82)

(57) The insolvency law should specify methods of sale for sales conducted outside the ordinary course of business that will maximize the price obtained for assets being sold in insolvency proceedings, and permit both public auctions and private sales.

Ability to Sell Assets of the Estate Free and Clear of Encumbrances and other Interests (Paras. 85 and 86)

(58) The insolvency law should permit the insolvency representative to sell assets that are encumbered or subject to other interests free and clear of those encumbrances and other interests, outside the ordinary course of business, provided that:

(a) The insolvency representative gives notice of the proposed sale to the holders of encumbrances or other interests;
(b) The holders are given the opportunity to object to the proposed sale;
(c) Relief from the stay has not been granted; and
(d) The priority of interests in the proceeds of sale of the asset is preserved.

Use of Cash Proceeds (Paras. 92 and 93)

(59) The insolvency law should permit the insolvency representative to use and dispose of cash proceeds if:

(a) The secured creditor consents to such use or disposal; or
(b) The secured creditor was given notice of the proposed use or disposal and an opportunity to be heard by the court; and
(c) The interests of the secured creditor will be protected against diminution in the value of the cash proceeds.

Urgent Sales (Paras. 77 and 80)

(60) The insolvency law should permit urgent sales of assets to be conducted outside the ordinary course of business, where the assets by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy. The insolvency law may provide that prior approval of the court or of creditors is not required in such circumstances.

Disposal of Assets to Related Persons (Para. 81)

(61) The insolvency law should require any proposed disposal of assets to related persons to be carefully scrutinised before being allowed to proceed.

Burdensome Assets (Para. 88)

(62) The insolvency law should permit the insolvency representative to determine the treatment of any assets that are burdensome to the estate. In particular, the insolvency

law may permit the insolvency representative to relinquish burdensome assets following the provision of notice to creditors and the opportunity for creditors to object to the proposed action, except that where a secured claim exceeds the value of the encumbered asset, and the asset is not required for a reorganization or sale of the business as going concern, the insolvency law may permit the insolvency representative to relinquish the asset to the secured creditor without notice to other creditors.

Recommendations 63 to 68 address post-commencement finance. The provisions on post-commencement finance are as follows:

Attracting and Authorizing Post-commencement Finance (Paras. 94–100, 105 and 106)

(63) The insolvency law should facilitate and provide incentives for post- commencement finance to be obtained by the insolvency representative where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate. The insolvency law may require the court to authorize or creditors to consent to the provision of post-commencement finance.

Priority for Post-commencement Finance (Paras. 101 and 102)

(64) The insolvency law should establish the priority that may be accorded to post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of ordinary unsecured creditors including those unsecured creditors with administrative priority.

Security for Post-commencement Finance (Paras. 103 and 104)

(65) The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on unencumbered assets, including after-acquired assets, or a junior or lower priority security interest on already encumbered assets of the estate.

(66) The law[33] should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation 67.

(67) The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

33 This rule may be in a law other than the insolvency law, in which case the insolvency law should note the existence of the provision.

(a) The existing secured creditor was given the opportunity to be heard by the court;
(b) The debtor can prove that it cannot obtain the finance in any other way; and
(c) The interests of the existing secured creditor will be protected.[34]

Effect of Conversion on Post-commencement Finance (Para. 107)

(68) The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority provided to post-commencement finance in the reorganization should continue to be recognized in the liquidation.[35]

Recommendations 69 to 86 address the treatment of contracts and automatic termination and acceleration. The provisions on treatment of contracts and automatic termination and acceleration are as follows:

Treatment of Contracts not Fully Performed (Paras. 108–112)

(69) The insolvency law should specify the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations.

Automatic Termination and Acceleration Clauses (Paras. 114–119)

(70) The insolvency law should specify that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:

(a) An application for commencement, or commencement, of insolvency proceedings;
(b) The appointment of an insolvency representative.[36]

(71) The insolvency law should specify the contracts that are exempt from the operation of recommendation 70, such as financial contracts, or subject to special rules, such as labour contracts.

Continuation or Rejection (Paras. 120–122, 126 and 127)

(72) The insolvency law should specify that the insolvency representative may decide to continue the performance of a contract of which it is aware where continuation would be beneficial to the insolvency estate.[37] The insolvency law should specify that:

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[34] See above, paras. 63–69.

[35] The same order of priority may not necessarily be recognized. For example, post-commencement finance may rank in priority after administrative claims relating to the costs of the liquidation.

[36] This recommendation would apply only to those contracts where such clauses could be overridden (see commentary above at paras. 143–145 on exceptions) and is not intended to be exclusive, but to establish a minimum: the court should be able to examine other contractual clauses that would have the effect of terminating a contract on the occurrence of similar events.

[37] Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation, unless the contract has a termination date which happens to fall after the commencement of insolvency proceedings.

(a) the right to continue apply to the contract as a whole; and
(b) that the effect of continuation is that all terms of the contract are enforceable.

(73) The insolvency law may permit the insolvency representative to decide to reject a contract.[38] The insolvency law should specify that the right to reject apply to the contract as a whole.

Timing and Notice of Decision to Continue or Reject (Paras. 128–129)

(74) The insolvency law should specify a time period within which the insolvency representative is required to make a decision to continue or reject a contract, which time period may be extended by the court.

(75) The insolvency law should specify the time at which the rejection will be effective.

(76) The insolvency law should specify that where a contract is continued or rejected, the counterparty be given notice of the continuation or rejection, including its rights in respect to submitting a claim and the time in which the claim should be submitted, and permit the counterparty to be heard by the court.

Right of the Counterparty to Request a Decision (Para. 125)

(77) Notwithstanding recommendation 74, the insolvency law should permit a counterparty to request the insolvency representative (within any specified time limit) to make a prompt decision and, in the event that the insolvency representative fails to act, to request the court to direct the insolvency representative to make a decision to continue or reject a contract.

Consequences of Failure to Make a Decision (Paras. 123, 124 and 127)

(78) The insolvency law should specify the consequences of the failure of the insolvency representative to make a decision within the specified time period with respect to contracts of which it is aware. Failure by the insolvency representative to act within the specified time period should not operate to continue a contract of which the insolvency representative was not aware.[39]

Continuation of Contracts where the Debtor is in Breach (Para. 130)

(79) The insolvency law should specify that where the debtor is in breach under a contract the insolvency representative can continue the performance of that contract, provided the breach is cured, the non-breaching counterparty is substantially returned to the economic position it was in before the breach, and the estate is able to perform under the continued contract.

[38] An alternative to providing a power to reject contracts is the approach of those jurisdictions that provide that performance of a contract simply ceases unless the insolvency representative decides to continue its performance.

[39] See chapter III. A.4(b) which refers to the debtor's obligation to provide information, including a list of contracts not fully performed.

Performance Prior to Continuation or Rejection (Para. 131)

(80) The insolvency law should specify that the insolvency representative may accept [or require] performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted **[or required] by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:[40]

(a) If the counterparty has performed the contract the amount of the administrative expense should be the contractual price of the performance.
(b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with paragraph (a).

Damages for Subsequent Breach of a Continued Contract (Paras. 132 and 133)

(81) The insolvency law should specify that where a decision is made to continue performance of a contract, damages for the subsequent breach of that contract should be payable as an administrative expense.

Damages Arising from Rejection (Para. 134 and 135)

(82) The insolvency law should specify that any damage arising from the rejection of a pre-commencement contract would be determined in accordance with applicable law and should be treated as an ordinary unsecured claim. The insolvency law may limit claims relating to the rejection of a long-term contract.

Assignment of Contracts (Paras. 139–142)

(83) The insolvency law may specify that the insolvency representative can decide to assign a contract, notwithstanding restrictions in the contract, provided the assignment would be beneficial to the estate.

(84) Where the counterparty objects to assignment of a contract, the insolvency law may permit the court to nonetheless approve the assignment provided:

(a) The insolvency representative continues the contract;
(b) The assignee can perform the assigned contractual obligations;
(c) The counterparty is not substantially disadvantaged by the assignment; and
(d) The debtor's default under the contract is cured before assignment.

(85) The insolvency law may specify that where the contract is assigned, the assignee will be substituted for the debtor as the contracting party with effect from the date of the assignment and the estate will have no further liability under the contract.

[40] See chapter V. C.

Post-commencement Contracts (Para. 147)

(86) The insolvency law should specify that contracts entered into after the commencement of insolvency proceedings are post-commencement obligations of the estate. Claims arising from those contracts should be payable as an administrative expense.

Recommendations 87 to 99 avoidable transactions, either preferential transfers or fraudulent conveyances. The provisions on avoidable transactions are as follows:

Avoidable Transactions (Paras. 170–179)

(87) The insolvency law should include provisions which apply retroactively and are designed to overturn transactions,[41] involving the debtor or assets of the estate and which have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors. The insolvency law should specify the following types of transactions as avoidable:

(a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors;
(b) Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was a gift or was made in exchange for a nominal or less than equivalent value or for inadequate value which occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); and
(c) Transactions involving creditors where a creditor obtained, or received the benefit of, more than its pro rata share of the debtor's assets which occurred at a time when the debtor was insolvent (preferential transactions).

Security Interests (Para. 180)

(88) The insolvency law should specify that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of the law on the same grounds as other transactions.

Establishing the Suspect Period (Paras. 188–191)

(89) The insolvency law should specify that the transactions described in recommendation 87(a)–(c) may be avoided if they occurred within a specified period (the suspect period) calculated retroactively from a specified date, being either the application for or commencement of the insolvency proceedings. The insolvency law may specify different suspect periods for different types of transactions.

[41] The use of the word "transaction" in this section is intended to refer generally to the wide range of legal acts by which assets may be disposed of or obligations incurred including by way of a transfer, a payment, a security interest, a guarantee, a loan or a release or an action to make a security interest effective against third parties, and may include a composite series of transactions.

Transactions with Related Persons (Paras. 182–184)

(90) The insolvency law may specify that the suspect period for avoidable transactions involving related persons is longer than for transactions with unrelated persons.

(91) The insolvency law should specify the categories of persons with sufficient connection to the debtor to be treated as related persons.[42]

Transactions Exempt from Avoidance Actions (Para. 185)

(92) The insolvency law should specify the transactions that are exempt from avoidance, including financial contracts.

Conduct of Avoidance Proceedings (Paras. 192–195)

(93) The insolvency law should specify that the insolvency representative have the principal responsibility to commence avoidance proceedings.[43] The insolvency law may also permit any creditor to commence avoidance proceedings with the agreement of the insolvency representative and where the insolvency representative does not agree, the creditor may seek leave of the court to commence such proceedings.

Funding of Avoidance Proceedings (Para. 196)

(94) The insolvency law should specify that the costs of avoidance proceedings be paid as administrative expenses.

(95) The insolvency law may provide alternative approaches to address the pursuit and funding of avoidance proceedings.

Time Limits for Commencement of Avoidance Proceedings (Para. 197)

(96) The insolvency law or applicable procedural law should specify the time period within which an avoidance proceeding may be commenced. That time period should begin to run on the commencement of insolvency proceedings. In respect of transactions referred to in recommendation 87 which have been concealed and which the insolvency representative could not be expected to discover, the insolvency law may provide that the time period commences at the time of discovery.

Elements of Avoidance and Defences (Paras. 198–201)

(97) The insolvency law should specify the elements to be proved in order to avoid a particular transaction, the party responsible for proving those elements and specific defences to avoidance. Those defences may include that the transaction was entered into

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[42] "Related person" is defined in the Glossary.

[43] Issues relevant to avoidance may also arise in proceedings commenced by a person other than the insolvency representative, where the insolvency representative raises avoidance by way of defence against enforcement.

in the ordinary course of business prior to commencement of insolvency proceedings. The law may also establish presumptions and permit shifts in the burden of proof to facilitate the conduct of avoidance proceedings.

Liability of Counterparties to Avoided Transactions (Para. 202)

(98) The insolvency law should specify that a counterparty to a transaction that has been avoided must return to the estate the assets obtained or, if the court so orders, make a cash payment to the estate for the value of the transaction. The insolvency law should determine whether the counterparty to an avoided transaction would have an ordinary unsecured claim.

(99) The insolvency law may specify that where the counterparty does not comply with the court order avoiding the transaction, in addition to avoidance and any other remedy, a claim by the counterparty may be disallowed.

Recommendations 101 to 107 provide that financial contracts are important and essential elements of international capital markets and should not be modified by insolvency laws. The provisions on financial contracts are as follows:

(101) The insolvency law should recognize contractual termination rights associated with financial contracts that permit the termination of those contracts and the set-off and netting of outstanding obligations under those contracts promptly after the commencement of insolvency proceedings. Where the insolvency law stays the termination of contracts or limits the enforceability of automatic termination clauses on commencement of insolvency proceedings, financial contracts should be exempt from such limitations.[44]

(102) Once the financial contracts of the debtor have been terminated by a counterparty, the insolvency law should permit the counterparty to net or setoff obligations under those terminated financial contracts to establish a net exposure position relative to the debtor. This termination and set-off to establish a net exposure should be permitted regardless of whether the termination of the contracts occurs prior to or after the commencement of insolvency proceedings. Where the insolvency law limits or stays the exercise of set-off rights upon commencement of insolvency proceedings, set-off and netting of financial contracts should be exempt from such limitations.

(103) Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

[44] This will allow market participants to extend credit based on "net" positions and make it impossible for the debtor to "cherry pick" contracts by performing some and breaching others, which is especially important with regard to financial contracts because of systemic risk.

(104) The insolvency law should specify that routine pre-bankruptcy transfers consistent with market practice, such as the putting up of margin for financial contracts[45] and transfers to settle financial contract obligations[46] should be exempt from avoidance.

(105) The insolvency law should recognize and protect the finality of the netting, clearing and settlement of financial contracts through payment and settlement systems upon the insolvency of a participant in the system.

(106) Recommendations 101 to 105 should apply to all transactions that are considered to be "financial contracts," whether or not one of the counterparties is a financial institution.[47]

(107) Financial contracts should be defined broadly enough to encompass existing varieties of financial contracts and to accommodate new types of financial contracts as they appear.

Recommendations 108 to 114 address rights and obligation of the debtor. The provisions in regard to the debtor are as follows:

1.2.3 Rights

Right to Be Heard (Para. 21)

See Recommendation 137.

Right to Participate and Request Information (Para. 20)

(108) The insolvency law should specify that the debtor is entitled to participate in the insolvency proceedings, and to obtain information relating to the insolvency proceedings from the insolvency representative and the court.

Right to Retain Property to Preserve the Personal Rights of the Debtor (Para. 20)

(109) Where the debtor is a natural person, the insolvency law should specify that the debtor is entitled to retain those assets excluded from the estate by the law.[48]

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45 Margin is the process of posting additional cash or securities as a security for the transactions in accordance with a contractual formula that accounts for fluctuations in the market value of the contract and the existing security. For example, on a swap, a margin of 105 per cent might be required to maintain the termination value of the contract. If the security position falls to 100 per cent, an additional margin might be required to be posted.

46 In some circumstances, a settlement payment might be viewed as a preference. In the example of a swap, settlement payments are to be made monthly or upon termination of the contract based on the market value of the contract. These payments are not value for value transfers, but rather payment of an accrued debt obligation that has matured. In countries that have a fixed suspect period for all transactions occurring before commencement, such a payment might also be subject to avoidance.

47 Even if a given financial contract does not involve a financial institution, the impact of the insolvency of a counterparty could entail systemic risk.

48 See chapter II, paras. 17–21 and recommendation 38.

Obligations of the Debtor (Paras. 22–27, 29 and 30)

(110) The insolvency law should clearly specify the debtor's obligations in respect of insolvency proceedings. Those obligations should arise on the commencement of, and continue throughout, those proceedings. The obligations should include the obligations:

(a) To cooperate with and assist the insolvency representative to perform its duties;
(b) To provide accurate, reliable and complete information relating to its financial position and business affairs that might be requested by the court, the insolvency representative, creditors and/or the creditor committee, including lists of:[49] (i) transactions occurring prior to commencement that involved the debtor or the assets of the debtor; (ii) ongoing court, arbitration or administrative proceedings, including enforcement proceedings; (iii) assets, liabilities, income and disbursements; (iv) debtors and their obligations; (v) creditors and their claims prepared in cooperation with the insolvency representative and revised and amended by the debtor as claims are verified and admitted or denied;
(c) To cooperate with the insolvency representative to enable the insolvency representative to take effective control of the estate and to facilitate or cooperate in the recovery by the insolvency representative of the assets, or control of the assets of the estate, wherever located[50] and business records;
(d) Where the debtor is a natural person, to provide notice to the court if it proposes or is forced to leave its habitual place of residence and, where the debtor is a legal person, to obtain the consent of the court or the insolvency representative to the movement of the headquarters of the debtor.

Confidentiality (Paras. 28, 52 and 115)

(111) The insolvency law should specify protections for information provided by the debtor[51] or concerning the debtor that is commercially sensitive or confidential.

The Debtor's Role in Continuation of the Business (Paras. 2–18)

(112) The insolvency law should specify the role of the debtor in the continuing operation of the business during insolvency proceedings. Different approaches may be taken, including:

(a) Retention of full control of the business (debtor-in-possession), with appropriate protections including varying levels of control of the debtor and provision for displacement of the debtor in specified circumstances;[52]

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[49] Subject to allowing the debtor the time necessary to collect the relevant information.
[50] See the UNCITRAL Model Law on Cross-Border Insolvency, annex III.
[51] Information provided by the debtor may include information in control of the debtor, owned by the debtor or a third party.
[52] It should be noted that this option relies on a well-developed court structure and the application of protections that operate to displace the debtor in certain circumstances. For a more detailed explanation see chapter III, paras. 16–18.

(b) Limited displacement where the debtor may continue to operate the business on a day-to-day basis, subject to the supervision of an insolvency representative, in which event the division of responsibilities between the debtor and the insolvency representative should be specified in the law; or
(c) Total displacement of the debtor from any role in the business and the appointment of an insolvency representative.

(113) The insolvency law should specify, where the debtor is a debtor-in-possession, those functions of the insolvency representative that may be performed by the debtor-in-possession.

Sanctions for Failure to Comply (Paras. 32 and 33)

(114) The insolvency law should permit the imposition of sanctions for the failure of the debtor to comply with its obligations under the insolvency law.

Recommendations 115 to 125 address the selection and qualification of the insolvency representative along with the insolvency representative's powers, functions and related issues: The provisions on the insolvency representative are as follows:

Qualifications (Paras. 36–41)

(115) The insolvency law should specify the qualifications and qualities required for appointment as an insolvency representative, including integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters. The insolvency law should also specify the grounds upon which a proposed insolvency representative may be disqualified from appointment.

Conflict of Interest (Paras. 42 and 43)

(116) The insolvency law should require the disclosure of a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence by:

(a) A person proposed for appointment as an insolvency representative or a person appointed as an insolvency representative where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings;
(b) Persons proposed for employment by the insolvency representative or the estate including professionals or a person employed by the insolvency representative where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings.

(117) The insolvency law should specify that the obligation to disclose set forth in recommendation 116 should continue throughout the insolvency proceedings. The law should specify the consequences of a conflict of interest or lack of independence.

Appointment (Paras. 44–47)

(118) The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.

Remuneration (Paras. 53–59)

(119) The insolvency law should establish a mechanism for fixing the remuneration of the insolvency representative and establish priority for payment of that remuneration.

Duties and Functions of the Insolvency Representative (Para. 49)

(120) The insolvency law should specify that the insolvency representative have an obligation to protect and preserve the assets of the estate. The insolvency law should specify the insolvency representative's duties and functions with respect to the administration of the proceedings and preservation and protection of the estate, including continued operation of the debtor's business.

Right to Be Heard (Para. 116)

See recommendation 137.

Confidentiality (Paras. 28, 52 and 115)

See recommendation 111.

Liability (Paras. 60–65)

(121) The insolvency law should specify the consequences of the insolvency representative's failure to perform, or to properly perform, its duties and functions under the law and any related standard of liability imposed.

Removal and Replacement (Paras. 73 and 74)

(122) The insolvency law should establish the grounds and procedure for removal of the insolvency representative. The grounds may include:

(a) Incompetence, failure to perform or failure to exercise the proper degree of care in the performance of its powers and functions;
(b) Inability to perform;
(c) Lack of a particular or specialized qualification required by a specific case;
(d) Engaging in illegal acts or conduct;

(e) Conflict of interest or a lack of independence that would justify removal; or
(f) Where the function of the insolvency representative changes.[53]

(123) The insolvency law should establish a mechanism for removal of the insolvency representative that reflects the manner in which the insolvency representative was appointed and provides a right for the insolvency representative to be heard.

(124) In the event of the death, resignation, or removal of the insolvency representative, the insolvency law should establish a mechanism for appointment of a replacement and specify whether or not court approval of the replacement is necessary.

Estates with Insufficient Assets to Meet Costs of Administration (Para. 45 and Chapter I, Paras. 72–75)

(125) Where the insolvency law provides for appointment of an insolvency representative to administer an estate with insufficient assets to meet the costs of administering the insolvency proceedings, the insolvency law should also establish a mechanism for appointment and remuneration of that representative.

Recommendations 126 to 136 address the ability of creditors to participate in the insolvency proceedings and also provide for the formation of creditors' committees. The provisions on creditors and creditors' committees are as follows:

Right to Be Heard

See Recommendations 133 and 137.

Confidentiality

See recommendation 111.

Participation by Creditors (Paras. 75–87)

(126) The insolvency law should specify that creditors, both secured and unsecured, are entitled to participate in insolvency proceedings and identify what that participation may involve in terms of the functions that may be performed.

Voting by Creditors (Paras. 96–98)

(127) The insolvency law should specify the matters on which a vote of creditors is required and establish the relevant eligibility and voting requirements. In particular, the insolvency law should require the vote of creditors to approve or reject a reorganization plan.

53 Such as where the proceedings are converted from liquidation to reorganization.

Convening Meetings of Creditors (Paras. 91–94)

(128) The insolvency law may require a first meeting of creditors to be convened within a specified time period after commencement to discuss matters specified in the law. The insolvency law may also permit the court, the insolvency representative or creditors holding a specific percentage of the total value of unsecured claims to request the convening of any other meeting of creditors and specify the circumstances in which such a meeting may be convened. The insolvency law should specify the party responsible for giving notice to creditors of such a meeting.

Creditor Representation (Paras. 88–90)

(129) The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation.[54] The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.

(130) Where the insolvency law permits a creditor committee or representative to be appointed the relationship between the creditors and the creditor committee or representative should be clearly specified.[55] The insolvency law should specify how the costs of the creditor committee would be paid.

Creditors that May Be Appointed to a Creditor Committee (Paras. 101–106)

(131) The insolvency law should specify the creditors that are eligible to be appointed to a committee. The creditors who may not be appointed to the creditor committee would include related persons and others who for any reason might not be impartial. The insolvency law should specify whether or not a creditor's claim must be admitted before the creditor is entitled to be appointed to a committee.

Mechanism for Appointment to a Creditor Committee (Paras. 107–109)

(132) The insolvency law should establish a mechanism for appointment of a creditor committee. Different approaches may include selection of the creditor committee by creditors or appointment by the court or other administrative body.

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[54] See recommendation 112–113 and the continuing role of the debtor in reorganization. Where the debtor remains in possession of the business, a creditor committee or other creditor representative will have an important role to play in overseeing and, where necessary, reporting on the activities of the debtor.

[55] In particular, the insolvency law should specify: the distribution of functions and powers between the creditors and the creditor committee, and the mechanism for resolution of disputes between the creditors and the creditor committee.

Rights and Functions of a Creditor Committee (Paras. 110–112)

(133) The insolvency law should specify the rights and functions of the creditor committee in insolvency proceedings, which may include:

(a) Providing advice and assistance to the insolvency representative or the debtor-in-possession;
(b) Participating in development of the reorganization plan;
(c) Receiving notice of and being consulted on matters in which their class has an interest, including the sale of assets outside the ordinary course of business;
(d) The right to hear the insolvency representative at any time; and
(e) The right to be heard in the proceedings.

Employment and Remuneration of Professionals by a Creditor Committee (Para. 112)

(134) The insolvency law should permit a creditor committee, subject to approval by the court to select, employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions. The insolvency law should specify how the costs and remuneration of those professionals would be paid.

Liability of a Creditor Committee (Para. 113)

(135) The insolvency law should specify that members of a creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found to have acted fraudulently or to be guilty of wilful misconduct.

Removal and Replacement of Members of a Creditor Committee (Para. 114)

(136) The insolvency law should specify the grounds for removal of members of a creditor committee and provide for their replacement.[56]

Recommendations 137 and 138 provide address the right to appeal and the right to be heard. The provisions on the right to appeal and the right to be heard are as follows:

Right to Be Heard and to Request Review (Paras. 116–119)

(137) The insolvency law should specify that a party in interest have a right to be heard on any issue in the insolvency proceedings that affects its rights, obligations or interests. For example, a party in interest should be entitled to:

(a) Object to any act that requires court approval;
(b) Request review by the court of any act for which court approval was not required or not requested; and
(c) Request any relief available to it in insolvency proceedings.

[56] Exercise of the power to remove will depend on the method of appointment of the committee.

Right of Appeal[57] (Para. 120)

(138) The insolvency law should specify that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests.

Recommendations 139 to 159 address the development and processing of the plan of reorganization. The provisions on plans of reorganization are as follows:

Proposal of a Reorganization Plan (Paras. 6–16)

(139) The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings, or within a specified time period after commencement of the insolvency proceedings:

(a) The time period should be fixed by the insolvency law;
(b) The court should be authorized to extend the time period in appropriate circumstances;

(140) The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings or within a specified period of time after commencement of the insolvency proceedings: where liquidation proceedings are converted to reorganization proceedings, the insolvency law should also address the impact of conversion on time limits for proposal of a plan.

Preparation of a Disclosure Statement (Para. 23)

(141) The insolvency law should require a plan to be accompanied by a disclosure statement that will enable an informed decision about the plan to be made. The same party that prepares the plan should prepare the disclosure statement.

Submission of the Plan and Disclosure Statement (Para. 23)

(142) The insolvency law should provide a mechanism for submission of the plan and disclosure statement to creditors and equity holders.

Contents of a Disclosure Statement (Paras. 24 and 25)

(143) The insolvency law should specify that the disclosure statement include:[58]

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57 In accordance with the key objectives, the insolvency law should provide that appeals in insolvency proceedings should not have suspensive effect unless otherwise determined by the court, in order to ensure that insolvency can be addressed and resolved in an orderly, quick and efficient manner without undue disruption. Time limits for appeal should be in accordance with generally applicable law, but in insolvency need to be shorter than otherwise to avoid interrupting insolvency proceedings.

58 Where the insolvency representative does not prepare, or is not involved in the preparation of, the plan and the statement, the insolvency representative should be required to comment on both instruments. Information included in the disclosure statement should be subject to the obligations of confidentiality discussed in chapter III, paras. 28, 52 and 116 and recommendation 111.

(a) A summary of the plan;
(b) Information relating to the financial situation of the debtor including assets, liabilities and cash flow;
(c) Non-financial information that might have an impact on the future performance of the debtor;
(d) A comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;
(e) The basis upon which the business would be able to keep trading and could be successfully reorganized;
(f) Information showing that, having regard to the effect of the plan and that adequate provision has been made for satisfaction of all obligations provided for in the plan; and
(g) Information on the voting mechanisms applicable to approval of the plan.

Content of a Plan (Paras. 18–22)

(144) The insolvency law should specify the minimum contents of a plan. The plan should:

(a) Identify each class of creditors and the treatment provided for each class by the plan (e. g. how much they will receive and the timing of payment, if any);
(b) Detail the treatment of equity holders;
(c) Detail the terms and conditions of the plan;
(d) Identify the debtor's role in implementation of the plan;
(e) Identify those responsible for future management of the debtor and supervision of the implementation of the plan and indicate their affiliation with the debtor and their remuneration; and
(f) Indicate how the plan will be implemented.

Voting Mechanisms (Paras. 26–51)

(145) The insolvency law should establish a mechanism for voting on approval of the plan. The mechanism should address the creditors and equity holders who are entitled to vote on the plan; the manner in which the vote will be conducted, either at a meeting convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether or not creditors and equity holders should vote in classes according to their respective rights.

(146) The insolvency law should specify that a creditor or equity holder whose rights are modified or affected by the plan should not be bound to the terms of the plan unless that creditor or equity holder has been the given the opportunity to vote.

(147) The insolvency law should specify that where the plan provides that the rights of a creditor or equity holder or class of creditors or equity holders are not modified or affected by a plan, that creditor or equity holder or class of creditors or equity holders is not entitled to vote on approval of the plan.

(148) The insolvency law should specify that creditors entitled to vote on approval of the plan should be separately classified according to their respective rights and that each class should vote separately.

(149) The insolvency law should specify that all creditors and equity holders in a class should be offered the same treatment.

Approval by Classes (Paras. 49–51, 54 and 55)

(150) Where voting on approval of the plan is conducted by reference to classes, the insolvency law should specify how the vote achieved in each class would be treated for the purposes of approval of the plan. Different approaches may be taken, including requiring approval by all classes or approval by a specified majority of the classes, but at least one class of creditors whose rights are modified must approve the plan.

(151) Where the insolvency law does not require approval by all classes, the insolvency law should address the treatment of those classes that do not vote to support a plan that is otherwise approved by the requisite classes consistent with the grounds set forth in recommendation 152.

Confirmation of an Approved Plan (Paras. 56 and 60–63)

(152) Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to confirm the plan if the following conditions are satisfied:

(a) The requisite approvals have been obtained and the approval process was properly conducted;
(b) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;
(c) The plan does not contain provisions contrary to law;
(d) Administrative claims and expenses will be paid in full except to the extent that the holder of the claim or expense agrees to different treatment; and
(e) Except to the extent that affected classes of creditors have agreed otherwise, if a class of creditors has voted against the plan that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

Challenges to Approval (Where There is no Requirement for Confirmation) (Paras. 57–59)

(153) Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit interested parties, including the debtor, to challenge the approval of the plan. The insolvency law should specify criteria against which a challenge can be assessed which should include:

(a) Whether the grounds set forth in recommendation 152 are satisfied; and
(b) Fraud, in which case the requirements of recommendation 154 should apply.

Challenges to a Confirmed Plan (Para. 65)

(154) The insolvency law should permit a confirmed plan to be challenged on the basis of fraud. The insolvency law should specify:

(a) A time limit for bringing such a challenge by reference to the time of discovery of the fraud;
(b) The party that may bring such a challenge; and
(c) That the challenge should be heard by the court. Amendment of a plan (paras. 52 and 66)

(155) The insolvency law should permit amendment of a plan and specify the parties that may propose amendments and the time at which the plan may be amended including between submission and approval, approval and confirmation, after confirmation and during implementation, where the proceedings remain open.

Approval of Amendments (Paras. 67 and 68)

(156) The insolvency law should establish the mechanism for approval of amendments to the plan. That mechanism should require notice to be given to the creditors and other parties affected by the modification; specify the party required to give notice; require the approval of creditors and other parties affected by the modification; and satisfaction of the rules for confirmation (where confirmation is required). The insolvency law should also specify the consequences of failure to secure approval of proposed amendments.

Supervision of Implementation (Para. 69)

(157) The law may establish a mechanism for supervising implementation of the plan, which may include supervision by the court, by a court appointed supervisor, by the insolvency representative, or by a creditor-appointed supervisor.[59]

Conversion to Liquidation (Paras. 72–75)

(158) The insolvency law should provide that the court may convert reorganization proceedings to liquidation where:

(a) A plan is not proposed within any time limit specified by the law and the court does not grant an extension of time;
(b) A proposed plan is not approved;
(c) An approved plan is not confirmed (where the law requires confirmation);
(d) An approved or a confirmed plan is successfully challenged; or
(e) There is substantial breach by the debtor of the terms of the plan or an inability to implement the plan.[60]

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[59] Where the proceedings involve a debtor-in-possession, or where the proceedings conclude on approval of the plan, it may not be necessary to appoint a supervisor.

[60] This course of action is only available where the proceedings remain open during implementation – see chapter VI, paras. 16–17.

Failure of Implementation of a Plan (Paras. 70 and 71)

(159) The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

Recommendations 160 to 168 address expedited reorganization proceedings. The provisions on expedited reorganization proceedings are as follows:

Commencement of Expedited Reorganization Proceedings (Paras. 84 and 85 and Chapter I, Paras. 12–18 and Recommendations 10–12 on Jurisdiction)

(160) The insolvency law should specify that expedited proceedings can be commenced on the application of any debtor that:

(a) Is or is likely to be generally unable to pay its debts as they mature;
(b) Has negotiated a reorganization plan and had it accepted by each affected class of creditors; and
(c) Satisfies the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law.

(161) The insolvency law may additionally specify that an expedited proceeding can be commenced on the application of any debtor if:

(a) The debtor's liabilities exceed or are likely to exceed its assets; and
(b) The requirements of recommendation 159(b) and (c) are satisfied.

Application Requirements (Para. 89)

(162) The insolvency law should specify that the following additional materials should accompany an application for commencement of expedited reorganization proceedings:

(a) The reorganization plan and disclosure statement;
(b) A description of the voluntary restructuring negotiations that preceded the making of the application for commencement, including the information provided to affected creditors to enable them to make an informed decision about the plan;
(c) Certification that unaffected creditors are being paid in the ordinary course of business and that the plan does not modify or impair the rights or claims of unaffected creditors without their agreement;
(d) A report of the votes of affected classes of creditors demonstrating that those classes have accepted the plan by the majorities specified in the insolvency law;
(e) A financial analysis or other evidence which demonstrates that the plan satisfies all applicable requirements for reorganization; and
(f) A list of the members of any creditor committee formed during the course of the voluntary restructuring negotiations.

Commencement

(163) The insolvency law should specify that the application for commencement will automatically commence the proceedings or that the court will be required to promptly determine whether the debtor satisfies the requirements of recommendations 159 or 160 and if so, commence proceedings.

Effect of Commencement (Para. 90)

(164) The insolvency law should specify that:

(a) Provisions of the insolvency law that apply to full reorganization proceedings will also apply to expedited proceedings unless specified as modified or not applicable;[61]
(b) Unless otherwise determined by the court, the effects of commencement should be limited to the debtor, individual creditors and classes of creditors and equity holders whose rights are modified or affected by the plan;
(c) Any creditor committee formed during the course of the voluntary restructuring negotiations should be treated as a creditor committee appointed under the insolvency law; and
(d) A hearing on the confirmation of the plan by the court should be held as expeditiously as possible.

Notice of Commencement (Para. 87 and Chapter I, Paras. 64–71 and Recommendations 22–25)

(165) The insolvency law should specify that notice of the commencement of expedited proceedings be given to affected creditors and affected equity holders. The notice should specify:

(a) The amount of each affected creditor's claim according to the debtor;
(b) The time period for submitting a claim in a different amount if the affected creditor disagrees with the debtor's statement of the claim, and the place where the claim can be submitted;
(c) The time and procedure for challenging claims submitted by other parties;
(d) The time and place for the hearing on confirmation of the plan, and for the submission of any objection to confirmation; and
(e) The impact of the plan on equity holders.

[61] Provisions of the insolvency law that generally would not be applicable or that could be modified would include: full claim filing; notice and time periods for plan approval; the post-commencement mechanics of providing the plan and disclosure statement to creditors and other interested parties and for solicitation of votes and voting on the plan; appointment of an insolvency representative (who generally would not be appointed unless required by the plan); provisions on amendment of the plan after confirmation. An exception to the provisions of the insolvency law applicable to full reorganization proceedings would be that creditors not affected by the plan would be paid in the ordinary course of business during the implementation of the plan.

Confirmation of the Plan (Paras. 60–63 and 88 and Recommendation 152)

(166) The insolvency law should specify that the court will confirm the plan if:

(a) The plan satisfies the substantive requirements for confirmation of a plan in full reorganization proceedings, in so far as those requirements apply to affected creditors and affected equity holders;
(b) The notice given and the information provided to affected creditors and affected equity holders during the voluntary restructuring negotiations was sufficient to enable them to make an informed decision about the plan and any pre-commencement solicitation of acceptances to the plan complied with applicable law;
(c) Unaffected creditors are being paid in the ordinary course of business and the plan does not modify or affect the rights or claims of unaffected creditors without their agreement; and
(d) The financial analysis submitted with the application demonstrates that the plan satisfies all applicable requirements for reorganization.

Effect of a Confirmed Plan (Para. 64)

(167) The insolvency law should specify that the effect of a plan confirmed by the court should be limited to the debtor and those creditors and equity holders affected by the plan.

Failure of Implementation of a Confirmed Plan (Paras. 70, 71 and 91)

(168) The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

Recommendations 169 to 184 address the treatment of creditors' claims and the processing of the same. The provisions on creditors' claims are as follows:

Requirement to Submit (Paras. 1 and 13)

(169) The insolvency law should require creditors who wish to participate in the proceedings to submit their claims, and that the basis and amount of the claim be specified. The law should minimize the formalities associated with submission of claims. The insolvency law should permit claims to be submitted using different means, including mail and electronic means.

Undisputed Claims (Paras. 17–19, 35 and 36)

(170) The insolvency law may permit claims that are undisputed to be admitted by reference to the list of creditors and claims prepared by the debtor in cooperation with the insolvency representative[62] or the court or the insolvency representative may require a creditor to provide evidence of its claim. The law should not require that in all cases a creditor must appear in person to prove its claim.

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[62] See recommendation 110.

Claims that May Be Submitted (Para. 1)

(171) The insolvency law should specify that claims that may be submitted include all rights to payment which arise from acts or omissions of the debtor[63] prior to commencement of the insolvency proceedings, whether mature or not, whether liquidated or unliquidated, whether fixed or contingent. The law should identify claims that will not be affected by the insolvency proceedings.[64]

Secured Claims (Paras. 2–5)

(172) The insolvency law should specify whether secured creditors are required to submit claims.[65]

Equal Treatment of Similarly Ranked Creditors (Paras. 10 and 21)

(173) The insolvency law should specify that all similarly ranked creditors, regardless of whether they are domestic or foreign creditors, are to be treated equally with respect to the submission and processing of their claims.

Timing of Submission of Claims (Paras. 13–16)

(174) The insolvency law should specify the time period after commencement in which claims may be submitted, which time period should be adequate to allow creditors to submit their claims.[66]

Consequences of Failure to Submit a Claim (Paras. 24–27)

(175) The insolvency law should specify the consequences of failure to submit a claim within the time limit.

Foreign Currency Claims (Para. 22)

(176) Where claims are denoted in foreign currency, the insolvency law should specify the circumstances in which those claims must be converted and the reasons for conversion. Where conversion is required, the law should specify that the claim will be converted into local currency by reference to a specified date, such as the effective date of commencement of insolvency proceedings.

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[63] This would include claims by third parties or a guarantor for payment arising from acts or omission of the debtor.

[64] Some insolvency laws provide, for example, that claims such as [government] fines and penalties and taxes will not be affected by the insolvency proceedings. Where a claim was to be unaffected by the insolvency proceedings it would continue to exist and would not be included in any discharge.

[65] See UNCITRAL Model Law on Cross-Border Insolvency, art. 14 (3) and para. 111 of the Guide to Enactment, which notes that under some laws a secured creditor who files a claim is deemed to have waived the security interest or some of the privileges attached to the credit, while under other laws failure to submit a claim has that result.

[66] Where proceedings involve foreign creditors, longer time periods may be required to facilitate submission of claims. Also, it is desirable that claims be made at an early stage of the proceedings so that the insolvency representative will be aware of the claims involved, of the encumbered assets and of the value of those assets and claims.

Admission or Denial of Claims (Paras. 29–40)

(177) The insolvency law should permit the insolvency representative to admit or deny any claim, in full or in part.[67] Where the claim is to be denied or subjected to treatment under recommendation 183 as a claim by a related person, whether in full or in part, notice of the reasons for the decision should be given to the creditor.

Unliquidated Claims (Para. 38)

(178) The insolvency law should permit unliquidated claims to be admitted provisionally, pending determination of the amount of the claim by the insolvency representative.

Valuation of Secured Claims (Para. 38)

(179) The insolvency law should provide that the insolvency representative may determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset.

Disputing a Claim (Para. 41)

(180) The insolvency law should permit an interested party to dispute any submitted claim, either before or after admission, and request review of that claim by the court.

Review of Claims Denied or Subjected to Special Treatment (Paras. 32, 33 and 48)

(181) The insolvency law should permit creditors whose claims have been denied or subjected to treatment under recommendation 183 as a claim by a related person, whether in full or in part, to make a request, within a specified period of time after notification of the decision, to the court for review of their claim.

Provisional Admission of Disputed Claims (Para. 41)

(182) The insolvency law should specify that, claims disputed in the insolvency proceedings could be admitted provisionally by the insolvency representative pending resolution of the dispute by the court.

Effects of Admission (Para. 43)

(183) The insolvency law should specify the effects of admission, including provisional admission, of a claim. These effects may include:

(a) Entitling the creditor to participate in the proceedings and to be heard;
(b) Permitting the creditor to vote at a meeting of creditors, including on approval of a plan;

[67] In some jurisdictions, the court may be required to ratify the decision of the insolvency representative.

(c) Determining the priority to which the creditor's claim is entitled;
(d) Determining the amount for which the creditor is entitled to vote;
(e) Except in the case of provisional admission of a claim, permitting the creditor to participate in a distribution.[68]

Claims by Related Persons (Para. 48)

(184) The insolvency law should specify that claims by related persons should be subject to scrutiny and, where justified:[69]

(a) The voting rights of the related person may be restricted;
(b) The amount of the claim of the related person may be reduced; or
(c) The claim may be subordinated.[70]

Recommendations 185 to 193 address provisions of priority and distribution to creditors. The provisions on priority and distribution to creditors are as follows:

Classes and Treatment of Creditors Affected by Commencement of Insolvency Proceedings

(185) The insolvency law should specify the classes of creditors that will be affected by the commencement of insolvency proceedings and the treatment of those classes in terms of priority and distribution.

Establishing an Order for Satisfaction of Claims (Paras. 5 and 52)

(186) The insolvency law should establish the order in which claims are to be satisfied from the estate.

Priority Claims (Paras. 53 and 67–71)

(187) The insolvency law should minimize the priorities accorded to unsecured claims. The law should set out clearly the classes of claims, if any, that will be entitled to be satisfied in priority in insolvency proceedings.

Secured Claims (Paras. 62–65)

(188) The insolvency law should specify that secured claims should be satisfied from the encumbered asset in liquidation or pursuant to a reorganization plan, subject to claims that are superior in priority to the secured claim, if any. Claims superior in priority to secured claims should be minimized and clearly set forth in the insolvency law. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor.

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68 However, when making a distribution, the insolvency representative may be required to take account of claims that have been provisionally admitted, or submitted but not yet admitted.
69 Sufficient justification may involve situations where the debtor is undercapitalized or there has been self-dealing, as noted above, para. 48.
70 On subordination, see below, paras. 55–61.