



Promotion of international cooperation to  
combat illicit financial flows and strengthen  
good practices on assets return to foster  
sustainable development:

**Achievements, challenges and ways forward**

**Paper prepared by UNCTAD, in collaboration with UNODC, in compliance with A/RES/74/206**



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## Executive Summary

This paper has prepared by the secretariat of the United Nations Conference on Trade and Development, in collaboration with the United Nations Office on Drugs and Crime, in compliance with §29 of A/RES/74/206 on the “Promotion of international cooperation to combat illicit financial flows and strengthen good practices on asset return to foster sustainable development”.

Section 1 provides an introductory overview of the economic impact of illicit financial flows (IFFs) on sustainable development, in the context of concerns about the current financing gap to achieve the 2030 Agenda and of the Covid-19 pandemic.

Section 2 presents an abbreviated version of the UNCTAD-UNODC Conceptual Framework for the Measurement of Illicit Financial Flows, as published in UNCTAD’s Sustainable Development Goals Pulse Report 2020. This discusses the challenges posed by the statistical measurement of IFFs, summarizes core features of the conceptual framework developed for the statistical definition of IFFs for SDG Indicator 16.4.1, and discusses the reasons for the methodological choice of a “bottom-up” and direct approach to the statistical measurement of IFFs.

Section 3 of the paper turns to the policy challenges faced when combatting IFFs. Subsection 3.1 focuses on tax-motivated IFFs (base erosion and profit-shifting by multinational enterprises (MNEs)), as last discussed in more detail in a dedicated section of UNCTAD’s Trade and Development Report 2019. These include insufficient consideration of developing country concerns in recent progress made by the OECD/G20-led BEPS project towards a fractional apportionment scheme and the need for a more systematic consideration of the impact of the increasingly pervasive digitalization of the economy on cross-border taxation and, in particular, on developing country fiscal revenues. Subsection 3.2., prepared by UNODC, is dedicated to IFFs relating to organized crime and grand corruption. Although the international community already has a robust architecture to address these IFFs and to support the recovery and return of stolen assets, challenges to the effective implementation of existing legal and policy framework include international cooperation, interagency cooperation, financial transparency, accountability and integrity, as well as information-sharing on public-private partnerships.

Section 4 concludes and briefly discusses priorities for ways forward in combatting IFFs as these arise from the discussions in sections 2 and 3.

## Introduction

Illicit financial flows (IFFs) encompass a range of cross-border economic and financial activities, by private and official entities and individuals, that are either already illegal under given national and international regulations and laws, or considered illicit in the sense of constituting a systematic abuse of such regulations that would call for prompt adjustment of these by relevant authorities. A common identifier of IFFs is the persistent use of financial secrecy jurisdictions to hide origins and destinations of such financial flows from public scrutiny.<sup>1</sup>

IFFs, and the financial secrecy infrastructure underpinning them, affect citizens around the world through reduced tax revenues, worsening income and wealth inequalities<sup>2</sup> and through the erosion of the legitimacy of political, regulatory and judiciary systems, in a number of ways:

- a) Good governance: States that rely primarily on their taxpayers for their revenue are likely to develop and maintain transparent and democratic modes of representation and governance.<sup>3</sup> Where IFFs undermine state-building or existing social contracts through diminished tax revenue, by fueling destabilizing criminal activity and by undermining state legitimacy through grand corruption and weak regulatory overview over the cross-border operations of multinational enterprises (MNEs), the result can be a vicious cycle in which weakened governments find it difficult to prevent the growth of IFFs and are, in turn, further undermined by these.
- b) Sustainable and inclusive growth and development: IFFs, by undermining financial integrity pose a threat to global financial stability and therefore sustainable global growth and development. Moreover, the wider importance of fiscal revenues for domestic resource mobilization lies in their greater stability and predictability compared to many other sources of finance. Tax revenues and policies are also an essential mechanism to mitigate income inequalities and promote inclusive growth and development through redistributive tax designs and transfer programmes to the poorer sections of society. Last not least, tax revenues provide core funding for essential public services, such as health care – of particular relevance in the context of the Covid-19 pandemic - and education.
- c) Structural and environmental transformation: Effective tax systems are, furthermore, indispensable to re-orient production and consumption flows towards sustainable sectors and productive investment, through selective subsidies and, more generally, the re-pricing of economic activities in accordance with societal priorities, at national and international levels.

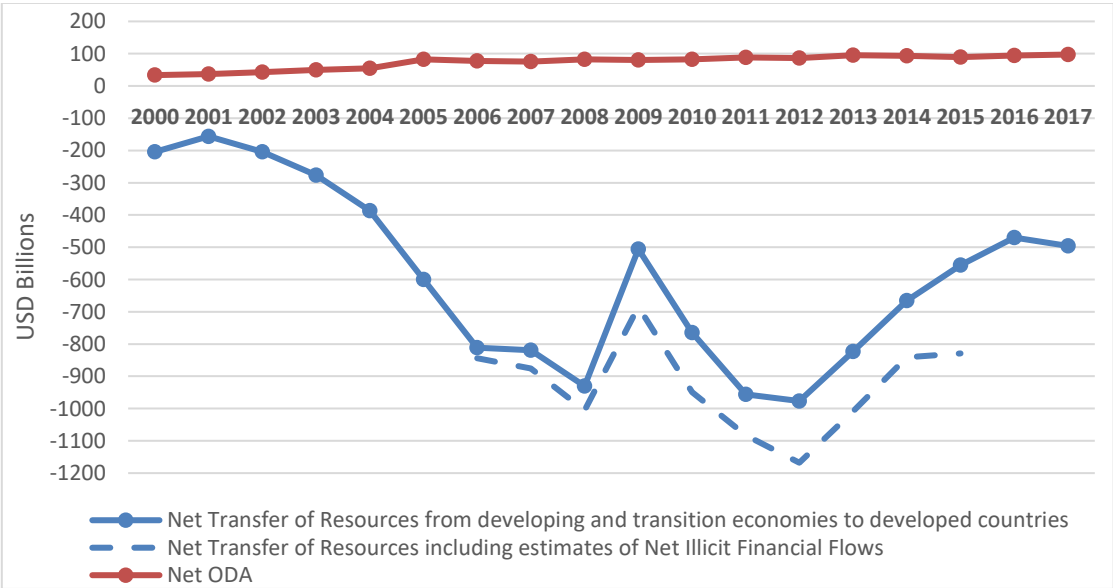
In recognition of the global threat posed by IFFs, the United Nations system has played a pivotal role in combatting IFFs, in particular through supporting the implementation of the United Nations Convention Against Corruption (UNCAC) and the United Nations Convention Against Transnational Organized Crime (UNTOC). More recently, it has also been on the forefront of promoting a multilateral agenda to address the corrosive impact of IFFs on economic development and development finance, specifically. Thus, the 2030 Agenda includes the reduction of IFFs as one of the targets of Sustainable Development Goal 16 on Peace, Justice and Strong Institutions (16.4.). Furthermore, the Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development states that “measures to combat corruption and curb illicit financial flows will be integral to our efforts” (§18), calls upon member States to “redouble efforts to substantially reduce illicit financial flows by 2030” (§23), and commits to “work to strengthen regulatory frameworks at all levels to further increase transparency and accountability of financial

institutions and the corporate sector, as well as public administrations.” (§25). Similarly, the United Nations Secretary-General’s Road Map for Financing the 2030 Agenda for Sustainable Development 2019-2021 includes the strengthening of international and regional cooperation, and country capacity to prevent, reduce and recover IFFs as one of three priority areas.<sup>4</sup>

**1. The economic impact of IFFs on sustainable development: a brief overview**

Concerns about the impact of IFFs on economic development are all the more justified when considering the wider picture of net financial transfers (or net resource transfers) that have typically flowed from developing to developed countries over recent decades. External resources that are deemed necessary to fund development generate return flows of interest payments and profit remittances which must be funded by the developing country and can outweigh any earnings flows. This net transfer of financial resources is here defined as the difference between net capital inflows and net income payments to foreign capital, including net changes in international reserves. It is the financial counterpart, but with opposite sign, to the balance of trade in goods and non-capital services.<sup>5</sup> Since this is a net position, a negative sign means that there is a loss of domestic resources and therefore some part of the value of domestic production is unavailable for domestic use. Figure 1 depicts the aggregated net financial resource transfers from developing to advanced countries between 2000 and 2017 for 134 developing countries, with and without net IFFs, as well as separately, net Official Development Assistance (ODA, defined as ODA net of loans and credits for military purposes).<sup>6</sup>

**Figure 1**  
**Net resource transfers, net illicit financial flows from developing countries to developed countries and net ODA flows, 2000-2017**  
 (Billions of current USD)



Source: UNCTAD secretariat calculations based on UNCTADstat, OECDStat, World Development indicators (WDI) and Global Financial Integrity (2019).<sup>7</sup>

The persistence and size of net financial resource transfers from developing countries – peaking at \$977 billion in 2012 in the period of observation - is closely related to the rapid growth of private capital flows since the mid-1990s, and the concomitant strong expansion of developing country gross

external assets and liabilities. This particularly pertains to the accumulation of foreign-exchange reserves as a means of self-insurance to contain the adverse effects of sudden reversals of non-resident portfolio capital inflows.

IFFs add to this wider systemic picture, as per figure 1. While currently available aggregate estimates on IFFs vary due to their hidden nature and differing methodologies to measure these, they are clearly net negative. The estimate used here refers to funds illegally earned, transferred, or utilized across borders, including proceeds from aggressive tax practice. Alternative estimates will change the size of the gap between the dotted and straight lines in the lower part of figure 1 but will not close it. The net financial resource transfers from developing to developed countries, including IFFs, far exceed any compensation by net ODA to developing countries, as can easily be gleaned from figure 1.

In the absence of an internationally agreed measures of IFFs (see section III), main partial estimates help to illustrate the order of magnitudes involved:

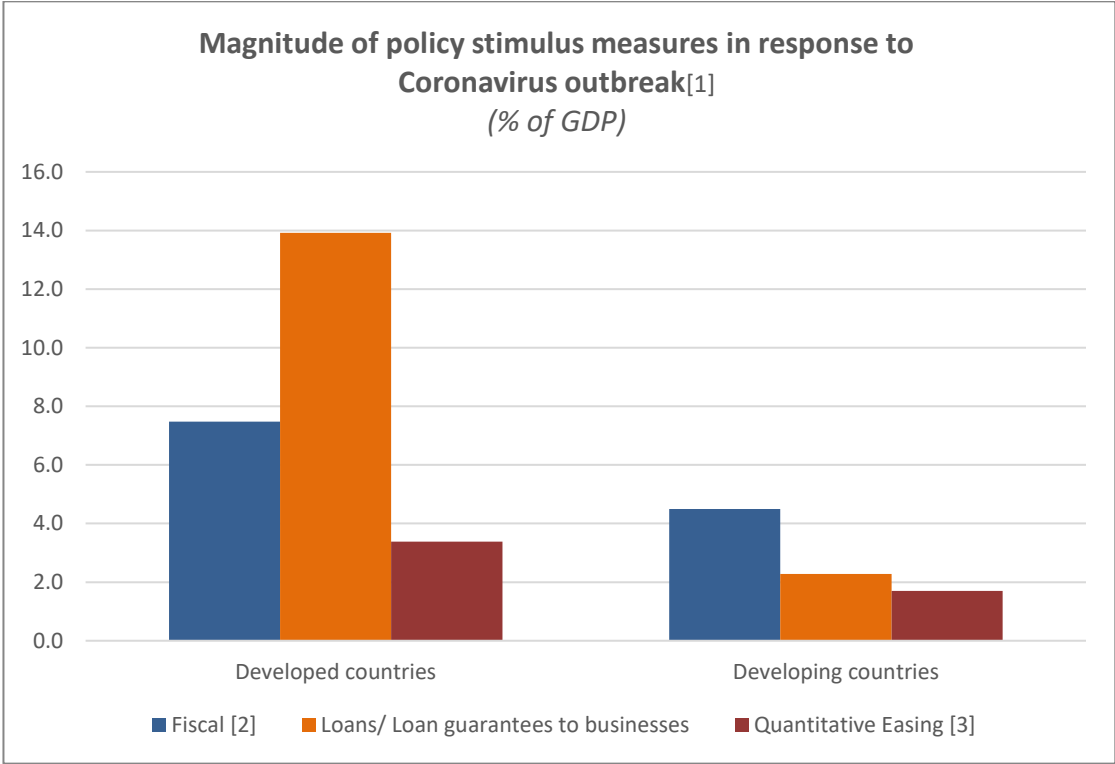
- a) UNODC estimated that, in 2009, IFFs stemming from criminal proceeds amounted to some 3.6 per cent of global GDP, equivalent to about \$ 2.1 trillion, with illicit drugs generating the largest share of income from transnational organized crime. As a share of GDP, all crime proceeds tend to be higher in developing countries and to be laundered more frequently abroad.<sup>8</sup>
- b) Recent estimates on revenue losses caused by tax-motivated IFFs, in developing countries only, point to values in the range of \$49-\$193 billion.<sup>9</sup> As a proportion of GDP, the regions most affected are Africa and Latin America and the Caribbean, with revenue losses accounting for 2.3 per cent of their GDPs, while, in developing Asia and Oceania, the figure is lower at 1.7 per cent. Moreover, tax-motivated IFFs affect revenue raising capacity most strongly in low-income and lower-middle income countries, due to the higher proportion of corporate tax in their total revenues.<sup>10</sup>
- c) The 2015 Report of the AU/UNECA High-Level Panel on Illicit Financial Flows from Africa suggests that, at a conservative estimate, IFFs overall from the continent, amount to between \$30-\$60 billion per year and have increased rapidly over the past decade. Related studies suggest that IFFs from Africa exceeded amounts required to cover the continent's external debt in 2008 and may have been equivalent to all of official development assistance (ODA) received by Africa between 1970-2008.<sup>11</sup>
- d) UNCTAD estimated that, in 2015, IFFs overall averaged 5 percent of GDP in least developed countries and 36 percent of their tax revenue, with some countries registering as much as 12-16 percent of their GDP and well above 60 percent and up to 115 percent of potential tax revenues lost to IFFs.<sup>12</sup>

It is clear, therefore, that IFFs across currently employed measurement methodologies disproportionately affect the poorest and most vulnerable developing countries, with often already weak governance structures and low tax revenues. Alongside many middle-income developing countries, these also are the countries with the highest additional investment requirements relating to the 2030 Agenda.

More recently, the Covid-19 pandemic has further, and dramatically so, put the spotlight on the limitations of all developing country governments to marshal their budgetary resources in times of crisis. The immense harm done by IFFs in routinely squeezing these already limited resources

evidently affects their ability to mobilize domestic resources for longer-term development goals and address the SDG financing gap<sup>13</sup> But it also affects their ability to bridge short-term liquidity shortages arising from large exogenous shocks.<sup>14</sup> The strains on developing countries’ public budgets and their limited ability to respond is evidenced by a significant expenditure gap between developed and developing countries in their fight against the fallout of the current pandemic (see figure 2).

**Figure 2**<sup>15</sup>  
**Covid-19 rescue measures: Magnitude of policy stimulus packages by developed and developing countries [1]**  
 (% of GDP)



Source: UNCTAD secretariat calculations based on national sources as reported by the IMF, the IFF and the OECD<sup>16</sup>.  
 Notes: [1] As of 25 May 2020 [2] Short-term deferral measures, i.e. tax payments deferred from one quarter or month to the next, are not included. [3] Estimate of additional asset purchases by Central Banks in response to the Coronavirus outbreak.

**2. Measuring IFFs within the SDG monitoring framework: A statistical perspective<sup>17</sup>**

Since IFFs are deliberately hidden, can take many forms and use varying channels, their measurement is challenging. Challenges differ across countries, depending on their institutions, types of activities generating IFFs, statistical practices and national priorities. This calls for space for country-specific solutions and flexible application of methods in line with a common framework.

Statistics need to be based on definitions that can be applied across countries to enable comparability. From a practical perspective, statistics cannot be based directly and exclusively on legal considerations since legal frameworks are not consistent across jurisdictions and are often reactive (e.g., with significant time lags before new activities are declared illegal) leading to differential treatment across countries and time. Thus, crime statistics are based on an International

Classification of Crime for Statistical Purposes (ICCS) consisting of actions and behaviours measured regardless of what is considered a crime by the national legislation. The activities that generate IFFs therefore need to be analysed carefully and placed in a framework that can identify the various components giving rise to illicit activities, as well as classified using a discrete, exhaustive and mutually exclusive classification aligned with existing statistical frameworks and principles. Many illicit activities are intertwined. To avoid duplication, separate accounting for income generation and management is needed consistent with the System of National Accounts (SNA) and other statistical frameworks.

## **2.1. Conceptual developments and reclassification of SDG indicator 16.4.1 as a Tier II indicator**

UNCTAD and UNODC have undertaken coordinated action to develop the statistical measurement of IFFs. The initial steps, during 2017-2019, involved analytical studies on IFFs and a review of methods applied across countries and internationally, through a series of expert consultations including contributions from national statistical offices, financial intelligence units, tax authorities, academia, non-governmental and international organisations. The meetings, in various fora, highlighted the need to agree on concepts and definitions and recommended further engagement with national statistical authorities.

To this end, UNCTAD and UNODC established a joint statistical Task Force on the measurement of IFFs<sup>18</sup> in January 2019 to define statistical concepts, assess data availability, develop statistical methods, and review relevant country-level activities. The Task Force's work is based on analytical studies on the aspects to be addressed in developing a method for SDG 16.4.1.<sup>19</sup> As a result of the Task Force's work, the custodian agencies presented in October 2019 a reclassification request at the 10<sup>th</sup> session of the Inter-Agency and Expert Group on Sustainable Development Goals Indicators (IAEG-SDGs). The IAEG-SDG endorsed the direction taken, and reclassified indicator 16.4.1 from Tier III to Tier II, meaning that it is conceptually clear and based on internationally established standards, while data are not yet available from countries.

## **2.2. Statistical definition of IFFs for SDG indicator 16.4.1**

For the purpose of this SDG indicator, IFFs are defined as *financial flows that are illicit in origin, transfer or use that reflect an exchange of value and that cross country borders*, with the following features:

- a) Illicit in origin, transfer or use. A flow of value is considered illicit if it is illicitly generated (e.g. originates from criminal activities or tax evasion), illicitly transferred (e.g. violating currency controls) or illicitly used (e.g. for financing terrorism). The flow can be legally generated, transferred or used, but it must be illicit in at least one of these aspects. Some flows that are not strictly illegal may fall within the definition of IFFs, e.g. cross-border tax avoidance which erodes the tax base of a country where that income was generated.
- b) Exchange of value rather than purely financial transfers. Exchange of value includes exchanges of goods and services, and thus financial as well as non-financial assets.
- c) IFFs measure a flow of value over a given time, as opposed to a stock measure, which would be the accumulation of value.



- d) Flows that cross a border. This includes assets where the ownership changes from a resident of a country to a non-resident, even if the assets remain in the same jurisdiction.

SDG indicator 16.4.1 should measure the “total value” of IFFs. While useful as an indication of the size of the IFF problem, this could limit applicability for policy guidance. A more granular measure and a finer typology would help to identify the main sources and channels of IFFs and provide guidance for national and international interventions targeting them. Such a typology would also enable disaggregation of currently legal IFFs from those that are not at present.

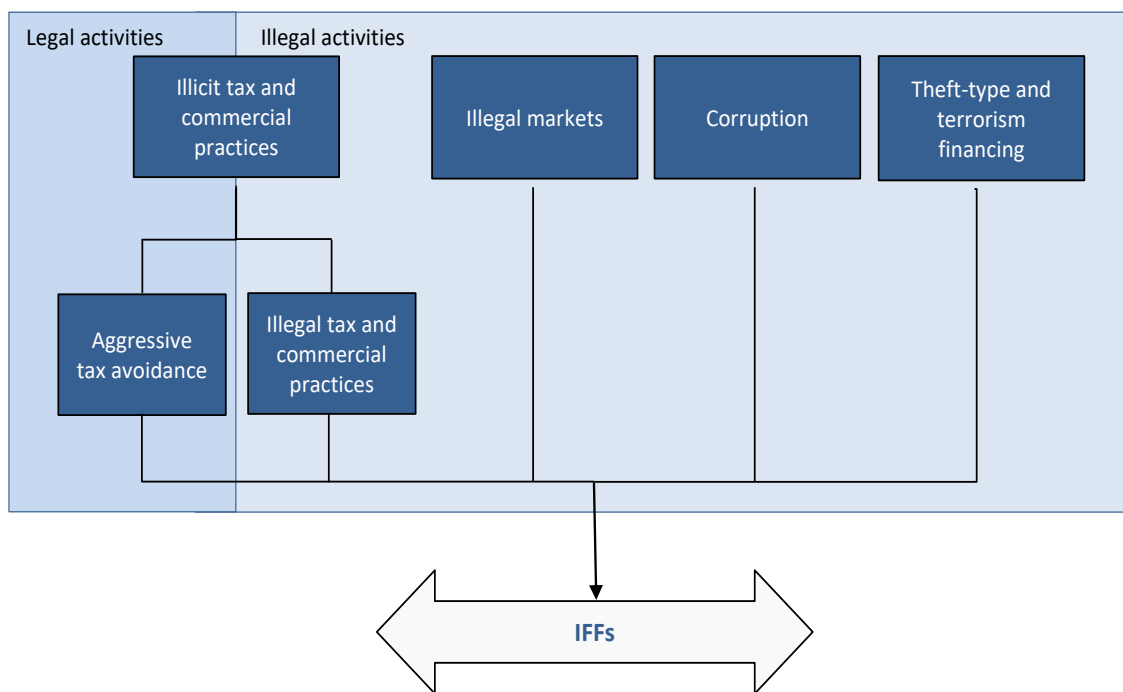
While flows of capitals of illegal origin should be considered IFFs when crossing a border, since their origin is in illicit activities, it can be challenging to determine the illicit origin of certain flows as the distance from the illicit origin increases. IFFs can also originate from legal economic activities but become illicit when financial flows are managed and transferred, for instance, to evade taxes or to finance illegal activities. Given the added complexity of differing national laws and practices, and with IFF measurement being a statistical exercise rather than an audit or judicial one, it is not possible to define the scope of measurement in terms of legality. The indicator is, therefore, constructed based on a typology of behaviours and activities generating IFFs. This is in line with the ICCS<sup>20</sup> that lists and defines activities, many of which may generate IFFs. This classification is a good point of departure, even though not all IFFs might map onto this framework, as IFFs that are not part of illegal activities may not be covered. For a complete coverage of IFFs, an additional classification complementing the ICCS would be required.

IFFs can be classified from many angles: sources, channels, impacts, actors involved, and motives. A useful typology should prioritize a perspective that enables effective action to curb IFFs and therefore a link to the activities from which IFFs arise. Figure 3 therefore looks at the underlying activities rather than the IFFs themselves, distinguishing, accordingly, four categories of IFFs:

- a) Illicit tax and commercial IFFs. These include illicit practices by legal entities, arrangements and individuals with the objective of concealing revenues and reducing tax burdens through evading controls and regulations. This category can be divided into two components:
- i) Illegal tax and commercial IFFs. These include illegal practices such as tariff duty and revenue offences, tax evasion, competition offences and market manipulation, amongst others and included by the ICCS. Most of these activities are non-observed, hidden or informal, and part of the so-called shadow or grey economy that generates IFFs.
  - ii) IFFs related to tax avoidance. IFFs can also be generated from legal economic activities through aggressive tax avoidance. This includes the manipulation of transfer pricing, strategic location of debt, intellectual property provisions and tax treaty shopping. These flows need to be carefully considered, as they generally arise from legal business transactions and only the illicit part of the cross-border flows belongs within the scope of IFFs.
- b) IFFs from illegal markets. These include trade in illicit goods and services, with corresponding financial flows generated across borders. Such processes often involve a degree of criminal organisation aimed at creating profit. They include illegal trafficking of goods, such as drugs and firearms, or services, such as smuggling of migrants. IFFs are generated by the flows related to international trade of illicit goods and services, and by cross-border flows from managing the illicit income from such activities.

- c) IFFs from corruption. UNCAC defines acts considered as corruption which are consistently defined in the ICCS. These include bribery, embezzlement, abuse of functions, trading in influence, illicit enrichment. When the economic returns from these acts generate cross-border flows, they are considered IFFs.
- d) IFFs from theft-type activities and financing of crime and terrorism. Theft-type activities are non-productive activities that entail a forced, involuntary and illicit transfer of economic resources between two actors, including theft, extortion, illicit enrichment, and kidnapping. In addition, terrorism financing and financing of crime are illicit, voluntary transfers of funds between two actors with the purpose of funding criminal or terrorist actions. When the related financial flows cross country borders, they constitute IFFs.

**Figure 3**  
**Categories of activities that may generate IFFs**



Source: UNODC and UNCTAD.

### 2.3. Factors defining the statistical methodologies for IFFs

Existing proposals to measure IFFs can be grouped in two main approaches: Top-down methods measure IFFs by modelling inconsistencies in aggregated data, such as currency demand, international trade and the capital account of the balance of payments (BoP). Bottom-up methods measure IFFs starting by analysing an illicit activity, defining the flows that identify as IFFs, producing estimates for each. Overall estimates are obtained by aggregating from a lower to a higher level. Consistent with the statistical framework presented, where different types of IFFs are defined in relation to the activity generating them, a bottom-up and direct measurement approach is proposed. IFFs can be generated in two different stages<sup>21</sup> linked to:

- a) Income generation referring to cross-border transactions that are performed in the production of illicit goods and services or cross-border operations that directly generate illicit income for an actor during an illicit activity. Inward or outward IFFs occur when the operation in question is performed across a border.
- b) Income management referring to cross-border transactions finalised to use the (illicit) income for investment in (legal or illicit) financial and non-financial assets or for consuming (legal or illegal) goods and services. If spent abroad, the operation is an outward IFF. If stemming from illicit activity outside a jurisdiction but spent in the domestic jurisdiction, an inward IFF is generated.

In sum, this approach considers the multi-dimensional nature of IFFs, comprising different activities, including flows originating from illicit activities, illicit transactions to transfer funds that have a licit origin, and flows stemming from licit activity being used in an illicit way. It identifies main types of IFFs to be measured and lays out a framework based on existing statistical definitions, classifications and methodologies, in line with the SNA and BoP. The proposed disaggregated and bottom-up approach is in line with international efforts to measure non-observed economic activities.

#### **2.4. Data requirements for measuring IFFs**

National statistical systems already have some of the data needed to measure IFFs, but these data are scattered across a range of authorities. For instance, existing national accounts and BoP statistics that include estimates of illegal economic activities and the non-observed economy, provide a good starting point for the measurement of IFFs. Relevant data may be held by the police and ministries of justice, financial intelligence units and government agencies collecting information on seizures and criminal offences. In addition, tax authorities collect relevant data for assessing tax gaps and exchange country-by-country reporting data on MNEs, although these data are often collected for purposes other than statistical analysis. Statistics on international trade in goods and services can provide useful information on commercial IFFs.

According to a recent International Monetary Fund (IMF) survey<sup>22</sup> on the measurement of the informal economy, over 60 per cent of national statistical offices collate relevant data on illegal, underground, and informal activities. While these are largely domestic, many also generate cross-border flows. There also is systematic data collection on crime-related IFFs. UNODC, for instance, compiles statistics on drugs as reported by countries, including data on demand, supply, prices, drug characteristics, seizure data.

It is likely that additional sources of information will need to be identified to measure IFFs consistently. Compiling statistics on IFFs requires access to data held by different authorities. National statistical offices, as the focal points for the compilation of SDG indicators, should bring the necessary stakeholders together to measure IFFs.

### 3. Current international legal and policy frameworks to combat IFFs: achievements and remaining challenges

While statistics, for the reasons explained, cannot be based directly and exclusively on legal considerations to measure different types of IFFs, existing international regulatory and legal initiatives to combat IFFs have so far largely developed along two broad tracks: One to tackle primarily tax-motivated IFFs originating from cross-border operating MNEs, and another to tackle organised crime and grand corruption, as well as related financial flows.

#### 3.1. Tax-motivated IFFs: Base erosion and profit shifting by multinational enterprises<sup>23</sup>

The most important international response to tax-motivated IFFs by MNEs is the OECD/G20-led Base Erosion and Profit Shifting (BEPS) project, launched in 2013.<sup>24</sup> This aims at an international consensus by the end of 2020 to establish an up-to-date method to tax MNE profits on the basis of where profit-generating economic activities take place and generate value. Current international corporate tax norms, adopted by the League of Nations in the 1920s, most importantly include the separate entity principle, which considers affiliates of MNEs to be independent entities, and the arm's-length principle, whereby the taxable transactions between different entities of MNEs are treated as unrelated. These principles have become less appropriate as intermediate products and intangible assets have assumed growing shares in international transactions and production has increasingly been organized in global value chains, allowing MNEs to easily allocate their most valuable assets and the bulk of their profits to subsidiaries in low-tax jurisdictions or tax havens, with a proliferation of tax-motivated IFFs in the process.

The BEPS project has a number of milestone achievements: In June 2016, it established an Inclusive Framework to ensure comprehensive implementation of its recommendations. Under this Framework two main steps were taken: First, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (or the Multilateral Instrument (MLI), entered into force on 1 July 2018. The MLI allows jurisdictions to integrate results from the BEPS project into their existing networks of bilateral double tax agreements and to reduce opportunities for double non-taxation by MNEs. Second, the Common Reporting Standard (CSR) on automatic exchange of information was introduced, designed to increase cross-border transparency and exchange of information for tax purposes. Additional measures and BEPS Actions to increase transparency and cross-country exchange of information for tax purposes make tax inspection by national authorities easier and may eventually serve as a basis for comprehensive cross-border tax audits of MNEs.

Nevertheless, important challenges remain. Despite its wide membership (with 137 members as of December 2019, of which 76 developing countries and territories) the Inclusive Framework suffers from legitimacy concerns given a limited role of developing countries in decision-making. Another worry for developing countries is the added complexity of the new standards and their applicability to some of the specificities of their economies, which further stretch often limited capacities of their tax authorities. Moreover, many observers expect tax disputes to increase with the added risk of potentially intransparent arbitration procedures. There also is a concern that the soft law created by the BEPS project may evolve into hard law, as is already the case, for example under the World Trade Organization (WTO) or bilateral investment treaties (BITs).

Perhaps most significantly, while a recent OECD-proposal,<sup>25</sup> for the first time, moves beyond the arm's length principle and the rule that companies need to pay taxes only in jurisdictions where they have a physical permanent establishment, towards a fractional apportionment scheme, this only insufficiently addresses the concerns of developing countries: Thus, the main increase in fiscal revenue from this scheme would accrue to developed countries, since this would include only 'residual profits' – excluding basic ('routine') profits – even though all profits of MNEs are ultimately based on their worldwide operations. Moreover, the proposal bases the revenue allocation only on sales, thereby excluding criteria relating to physical production processes, such as employment, that would be particularly important for developing countries. Finally, the BEPS project has yet to address tax competition through a proposal for implementing a minimum global corporate tax rate.<sup>26</sup>

Another core challenge arises from the increasingly pervasive digitalization of the economy, that further erodes the assumptions underlying current international corporate tax norms to determine where taxable value is created and how to measure and allocate this between countries. This is because (i) digitalization reduces the necessity of physical presence in the markets where enterprises operate, while under current norms this is a requirement for taxation in foreign states; (ii) its greater reliance on intangible assets further invalidates the arm's length principle and increases the scope for profit shifting towards low-tax jurisdictions; and (iii) an important part of digitalized business models rely on user-generated value that existing tax norms cannot capture. Measuring the resulting profits is effectively impossible because data provision and user participation generally occur at zero nominal prices. Foregone fiscal revenues from digitalization are particularly high for developing countries because they are less likely to host digital businesses but tend to be net importers of digital goods and services. While the BEPS project increasingly includes considerations on digitalization in recognition of this problematic, its recent proposal of a fractional apportionment scheme does not, for instance, include the suggestion by the Group of 24 to retain users of digital platforms, or "significant economic presence" of such platforms.<sup>27</sup>

The United Nations Committee of Experts on International Cooperation in Tax Matters and its Subcommittee on Tax Challenges related to the Digitalization of the Economy has worked independently of the BEPS project, by undertaking capacity-building activities and by updating the United Nations Practical Manual on Transfer Pricing for Developing Countries. Its focus on the interests of developing countries is also reflected in its seeking simplicity and administrability and stressing that reforms "of corporate tax rules applicable to cross-border transactions, including digital transactions, should include considerations of revenue implications for all countries and their impact on broader sustainable development objectives".<sup>28</sup>

There are various ways at the national level in which base erosion or profit shifting can be curbed before a global tax agreement is reached. For example, the "sixth method" for transfer pricing is useful for large commodity-exporting developing countries, as it aims to establish a clear and easily administered benchmark price for transactions.<sup>29</sup> The method involves adopting a market price instead of prices agreed between unrelated parties, thereby reducing underreporting of the values of a country's exports. In addition, capacity-building in tax matters is also clearly important for effective action. In this regard, Kenya has established a training program on advance transfer pricing and Viet Nam has increased the number of audits conducted by the tax authorities to be better able to enforce the country's transfer pricing rules. In both cases, substantial additional tax revenues have been raised.<sup>30</sup>

Moreover, and in the absence of global solutions, several developed and developing countries have explored temporary unilateral domestic tax measures for the digitalized economy.<sup>31</sup> One example is the excise or equalization levy that several countries are considering or have started to apply to revenues from activities such as advertising, sales and data processing, as well as to companies that exceed a certain threshold of revenues from these digital services globally and in their own tax jurisdiction. Policymakers in these countries will be aware that the challenges raised by tax-motivated IFFs are global and therefore require global solutions to avoid country-specific measures that risk causing regulatory inconsistency, uncertainty and controversy. Yet, such unilateral measures provide undeniable benefits, if only because the OECD's aspiration to reach a global solution by 2020 appears ambitious and because such measures can generate sizable additional revenues.<sup>32</sup> Paradoxically, such steps may help to highlight the urgency of reaching a global tax agreement in an inclusive manner that takes due account of developing countries' interests and capabilities to effectively implement revised tax laws and norms.

### **3.2. IFFs relating to organised crime and grand corruption<sup>33</sup>**

The international community already has a robust architecture to address IFFs related to organised crime and grand corruption and to support the recovery and return of stolen assets. This includes UNCAC and the UNTOC in addition to thematic and regional anti-corruption treaties, such as the conventions of the Organization of American States, the League of Arab States, the African Union, the Council of Europe and the Organisation for Economic Co-operation and Development (OECD), and the Financial Action Task Force International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation Financing (FATF Recommendations). The main international institutions and initiatives dealing with organized crime, grand corruption and the recovery and return of proceeds of crime include UNODC, the OECD, the World Bank, the FATF, and the Stolen Asset Recovery (StAR) Initiative (a joint partnership between UNODC and the World Bank). Moreover, there are other bodies with important contributions in this domain, including the Conference of the States Parties to the UNCAC as the main policymaking body of the United Nations in the area of anti-corruption and the Conference of the Parties to UNTOC in the area of transnational organised crime.

UNCAC is the only legally binding global instrument on all forms of corrupt behavior. The Convention contains not only a set of binding legal commitments in the areas of prevention, criminalization and law enforcement, international cooperation and asset recovery, it also provides a self-contained legal basis for international cooperation. In the area of asset recovery, UNCAC provides a framework for the prevention, detection, tracing, seizure, freezing and confiscation as well as the return and disposal of the proceeds of corruption. UNCAC is an effective tool to prevent and minimize risks associated with IFFs, regardless of their specific definitions. UNCAC provisions, if implemented effectively, help countering IFFs resulting from corruption offences but also from other underlying crimes, including money-laundering, IFFs through the formal and informal financial sectors, and through the physical cross-border transportation of funds. The UNCAC Implementation Review Mechanism, a peer review mechanism to review States parties' implementation of the Convention, produces a wealth of data on progress and challenges encountered in preventing and criminalizing corruption, law enforcement, international cooperation and asset recovery.<sup>34</sup>

The FATF Recommendations provide a comprehensive and consistent framework of measures to combat money laundering. The recommendations have been revised several times to reflect risks, implementation, efficiency, universality and internal coherence. They detail the requirements for effective anti-money laundering and combating the financing of terrorism (AML/CFT). The FATF recommendations list 21 categories of designated predicate offences, including corruption and bribery, tax crimes related to direct and indirect taxes, insider trading and market manipulation, environmental crime, smuggling (including in relation to customs and excise duties and taxes), trafficking in human beings and migrant smuggling, participation in an organised criminal group and racketeering, and fraud amongst others, providing a powerful tool to prevent IFFs and to increase member States' ability to reliably raise and retain domestic resources.

Countries are evaluated against this comprehensive set of standards because policy gaps in one country lead to increased money laundering risks in all countries. Of particular relevance are preventive measures, including those related to customer due diligence, politically exposed persons (PEPs), correspondent banking, money or value transfer services, wire transfers, reliance on third parties and supervision of designated non-financial Businesses and Professions (DNFBPs, i.e. real estate agents, dealers in precious metals and stones, lawyers, notaries, accountants and trust and company service providers), as well as transparency and beneficial ownership of legal persons and arrangements. In this latter regard, FATF standards were strengthened in 2012 and 2014, including a definition of the beneficial owner and guidance to countries on enhancing the transparency of legal persons and arrangements. Recognizing the enormous impact tax crimes have on domestic resource mobilisation, these were added to categories of designated offences for money laundering in the 2012 revision of the FATF standards. Another priority area are DNFBPs, that have a growing involvement in money-laundering and therefore IFFs, but for which most countries lack effective implementation of AML/CFT standards.<sup>35</sup> Initiatives for public-private partnerships on information-sharing including in financial intelligence should also be encouraged.

However, implementation gaps and challenges remain here also. In response to the recognition, by the international community, that combatting IFFs requires a range of actions including deterring, detecting, preventing and countering such flows in source, transit and destination countries, policy attention is increasingly given to implementation gaps which impede effectiveness in several broad areas, namely (i) international cooperation, (ii) interagency cooperation, (iii) financial transparency, accountability and integrity and (iv) information-sharing on public-private partnerships. These overarching gaps and patterns have been identified in the first and second cycle of the UNCAC Implementation Review Mechanism and the FATF and FATF-Style Regional Bodies (FSRB) Mutual Evaluations.<sup>36</sup>

There are numerous reasons for continued limitations to effective implementation, including low capacity, a limited understating of regulatory expectations, lack of policy coherence, of regulatory clarity on policy and of political will. In low-income countries the lack of capacity across all agencies combined with a lack of coordination can impede effective implementation of robust AML/CFT policy, including investigations and prosecutions. Countries of all income levels struggle with areas related to lack of transparency, including lack of access to beneficial ownership, legal persons and arrangements and weak supervision of DNFBPs. Moreover, the lack of coherence in policy and law can impede efforts to increase transparency and in forming effective public-private partnerships. Nevertheless, financial transparency remains the cornerstone of any effective financial integrity frameworks.<sup>37</sup>

## **Recovery and return of stolen assets**

When asset recovery measures are successfully implemented, related IFFs will be “reversed” by returning stolen assets to their countries of origin. Nevertheless, the return of stolen assets is different from and cannot substitute for other types of financial flows.

Chapter V of UNCAC provides a comprehensive framework for stolen asset recovery. Several other provisions in the UNCAC stipulate measures relevant to the prevention of corruption and to asset recovery. This includes measures to prevent and criminalize the laundering of the proceeds of corruption, measures to allow for the effective freezing, seizure and confiscation of the proceeds of corruption, measures ensuring entities or persons, including States which have suffered damage as a result of an act of corruption have the right to initiate legal proceedings against those responsible for that damage in order to obtain compensation and procedures related to the request and provision of mutual legal assistance, law enforcement co-operation, joint investigations and use of special investigative techniques. UNODC provides regular updates on the implementation of chapter V of the UNCAC by States parties under review in the second cycle of the UNCAC Implementation Review Mechanism.<sup>38</sup>

The latest thematic report<sup>39</sup> provides a detailed overview of main challenges and the implementation of good practices, as identified in Chapter V of UNCAC. The most important challenges included the identification of foreign and domestic politically exposed persons (PEPs) and beneficial owners, reporting of foreign interests, effectiveness of the asset declaration system, prohibition of shell banks, as well as lack of resources of competent authorities. The most prevalent common good practices related to capacities to provide international cooperation on asset recovery measures, cooperation between requesting and requested States using the UNCAC as a legal basis for mutual legal assistance, information-sharing with relevant financial intelligence units and a wide range of counterparts, as well as the use of various networks and agreements to facilitate international cooperation further, and the return of property to bona fide third parties.

The Stolen Asset Recovery (StAR) Initiative, a partnership between the World Bank Group and UNODC, was established to help countries implement their obligations under the asset recovery chapter of UNCAC and supports international efforts to end safe havens for the proceeds of corruption. StAR works with developing countries and financial centers to prevent the laundering of the proceeds of corruption and to facilitate more systematic and timely return of stolen assets. It has assisted many countries in developing legal frameworks, institutional expertise, and the skills necessary to trace and return stolen assets. StAR has also developed guides and handbooks that cover different aspects of asset recovery, including a study on the Barriers to Asset Recovery developed in consultation with experts from around the globe.<sup>40</sup> This also introduces examples of good practices and offers practical recommendations and concrete steps for investigators and legal practitioners to effectively develop asset recovery cases.

## **4. Conclusions and ways forward**

While considerable progress has been made, in different institutional and policy-making contexts, to combat IFFs, over-arching remaining challenges stand out, independently of specific types of IFFs:



- a) The importance of continuing to promote cross-border financial transparency, accountability and transparency to combat IFFs effectively, through co-ordinated policy action in this regard as well through the strengthened development of official statistics to measure IFFs.
- b) The need to further strengthen international and interagency cooperation to enhance policy and regulatory coherence, clarity, and consistency to reduce IFFs effectively.
- c) In view of the disproportionately strong impact of IFFs on developing countries, the need to strengthen the role of developing countries in relevant multilateral decision-making processes and to provide further international support to strengthen national regulatory and administrative capacities to address IFFs. This is particularly relevant in the context of the twin challenges of increasing domestic resource mobilisation to meet Agenda 2030 and acute liquidity needs in response to the Covid-19 crisis.
- d) The fast-growing role of digital technologies and the need to take more systematic account of their impact on combatting IFFs. In addition to the challenges highlighted in regard to BEPS-issues, organized crime and grand corruption can increasingly make use of digital avenues to facilitate illicit cross-border non-financial and financial flows and activities. At the same time, the use of technology in regulation and supervision and the use of big data analytics, machine learning and new programming techniques provide tools and methods to better detect illegal financial transactions, predict economic crime and measure IFFs more accurately.

Given its universal membership, the United Nations is well-placed to strengthen its role in further reforming the international architecture to combat IFFs. In March 2020, the President of the United Nations General Assembly and the President of the United Nations Economic and Social Council jointly launched the High-Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel)<sup>41</sup>. This panel is expected to contribute to the overall efforts undertaken by member States to combat IFFs and to explore further coordinated actions in the following areas: financial and beneficial ownership transparency, tax matters, bribery and corruption and money laundering. The panel therefore provides a timely and inclusive forum to address over-arching issues arising in regard to IFFs, in particular.

Regarding the UN's efforts to establish an *agreed statistical methodology* to measure IFFs for the purpose of developing SDG indicator 16.4.1, while some elements of IFFs are more readily measurable, others are more challenging to estimate, including bribery, abuse of functions, illicit enrichment and illicit tax practices. Further work is needed in this regard, starting with those elements for which data are available and taking account of adjustments needed to avoid double-counting. While many countries already collect data on IFFs and other relevant statistics, it will be important to strengthen countries' capacity for comprehensive data collection and compilation of IFF-relevant statistics. UNCTAD and UNODC, with partner organisations, will support countries in improving their statistical capacity to estimate IFFs. A series of pilot studies are being conducted with volunteer countries, providing critical information to further refine the conceptual framework and to develop guidance on statistical methods to measure IFFs. The joint UNCTAD/UNODC statistical Task Force will continue to support countries in data collection and compilation with a view to developing a Practical Compilation Guide for the Measurement of IFFs based on its conceptual framework. This will include a classification of activities generating IFFs, linked to the types and channels of IFFs, with recommended methods to measure them. Further work will also aim at developing a nuanced measurement of IFFs to support policy action.

In relation to *tax motivated IFFs*, supporting even small steps towards unitary taxation of MNEs (i.e. taxing an MNE and their subsidiaries as a single firm based on their worldwide operations) and acceptance of the principle that the resulting tax should be shared based on negotiation between countries to help end tax competition and the use of tax havens, will be essential. Important steps in this regard would be the inclusion of the notion of ‘routine’ profits as a general principle to refine currently proposed fractional apportionment schemes for the taxation of MNE profits and further consideration of the significant economic presence approach suggested by the Group of 24. Moreover, criteria relating to physical production processes should gain more prominence in this regard. Clearer rules requiring public country-by-country-based reporting by MNEs area also urgently needed, not least to track the impact of tax-motivated IFFs under existing norms on developing countries’ domestic resources more clearly.<sup>42</sup>

Regarding *IFFs primarily related to organized crime and corruption*, the UNCAC Implementation Review Mechanism and the FATF and FSRB Mutual Evaluations provide a strong framework to reveal implementation gaps and develop policies and practical tools and guidelines to mitigate these and to strengthen the recovery and return of stolen assets. Through the Implementation Review Mechanism, around 4,000 technical assistance needs have been identified across over 100 countries for criminalization, law enforcement and international cooperation, which need to be addressed in a coordinated, effective and sustainable manner and should form the baseline of UN in-country programming. Furthermore, and pursuant to A/RES/73/191, a special session on challenges and measures to prevent and combat corruption and strengthen international cooperation will be convened in the first half of 2021.<sup>43</sup> With a view to renewing high-level commitment in the fight against corruption, the special session aims to adopt a concise and action-oriented political declaration, agreed upon in advance by consensus through intergovernmental negotiations under the auspices of the Conference of the States Parties to the United Nations Convention against Corruption. In order to reduce current implementation gaps further, both international policy coherence and cooperation as well as domestic interagency cooperation and a more synchronized whole-of-government approach are essential to avoid the unintentional consequences of a lack of regulatory clarity, such as, for example, concerns about “de-risking” strategies in the financial sector.<sup>44</sup> This, too, emphasizes the multi-agency and international response necessary to combat IFFs, that includes not only financial intelligence units, tax administrations, regulators, and customs agencies. standard-setting, supervision, and law enforcement, as well as finance ministries and central banks are all relevant to combatting IFFs.

## Notes

- 1 See, for example, the Financial Secrecy Index published by the Global Tax Justice Network at:  
2 E.g. Saez, E. and G. Zucman (2019). The triumph of injustice. WW Norton, October.  
3 E.g. Prichard, W. (2015). Taxation, responsiveness, and accountability in Sub-Saharan Africa: the  
4 dynamics of tax bargaining. Cambridge University Press.  
5 See: [https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/UN-SG-Roadmap-  
6 Financing-the-SDGs-July-2019.pdf](https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/UN-SG-Roadmap-Financing-the-SDGs-July-2019.pdf)  
7 This definition follows UNDESA (2011). World Economic Situation and Prospects 2011. United  
8 Nations Publication, New York.  
9 For detail, see UNCTAD (2020). Topsy-turvy world: net transfer of resources from poor to rich  
10 countries - Policy Brief No. 78.  
11 Global Financial Integrity (2019). Illicit financial flows to and from 148 developing countries:  
12 2006-2015.  
13 UNODC (2014). Estimating illicit financial flows resulting from drug trafficking and other  
14 transnational organized crimes. Research Report. Vienna, October.  
15 UNCTAD (2020). Trade and Development Report: Financing a Global Green New Deal, UN  
16 publication. Geneva, Table 5.1, p. 109.  
17 OECD (2014). Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in  
18 Low Income Countries. Paris.  
19 AU/UNECA Conference of Ministers of Finance, Planning and Economic Development (2015).  
20 Report of the High-Level Panels on Illicit Financial Flows from Africa, pp. 33 and 91.  
21 UNCTAD (2019). The Least Developed Countries Report: The present and future of external  
22 development finance – old dependences, new challenges. UN publication. Geneva, pp. 105-106.  
See also UNCTAD (2020). The Covid-19 shock to developing countries. Trade and Development  
Report 2019 Update 1, March and UNCTAD (2020). From the Great Lockdown to the Great  
Meltdown: Developing Country Debt in the Time of Covid-19. Trade and Development Report  
2019 Update 2, April.  
UNCTAD (2020). The Covid-19 shock to developing countries. Trade and Development Report  
2019 Update 1, March and UNCTAD (2020). From the Great Lockdown to the Great Meltdown:  
Developing Country Debt in the Time of Covid-19. Trade and Development Report 2019 Update 2,  
April.  
<sup>15</sup> See UNCTAD (2020). South-South Cooperation at the time of COVID-19: Building Solidarity  
Among Developing Countries. May.  
See: <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>;  
[https://www.iif.com/Portals/0/Files/Databases/COVID-19\\_responses.pdf?ver=2020-07-17-173749-  
083](https://www.iif.com/Portals/0/Files/Databases/COVID-19_responses.pdf?ver=2020-07-17-173749-083); and <https://www.oecd.org/coronavirus/country-policy-tracker/>.  
This section is based on the UNCTAD-UNODC Conceptual Framework for the Measurement of  
Illicit Financial Flows, prepared in May 2020. See: UNCTAD (2020): SDG Pulse. Recent  
conceptual and methodological development on measuring illicit financial flows for policy action.  
The Task Force is composed of statistical experts from Brazil, Finland, Ireland, Italy, Peru, South  
Africa and the United Kingdom, Eurostat, IMF, OECD, UNECA, UNSD, UNCTAD and UNODC.  
This includes work carried out by Eurostat, Global Financial Integrity, IMF, OECD, UNECA,  
UNSD, World Bank, UNCTAD, UNODC and academic studies. See:  
<https://unctad.org/en/pages/MeetingDetails.aspx?meetingid=2218>  
UNODC (2015). International Classification of Crime for Statistical Purposes, Version 1.0.  
Available at <https://www.unodc.org/unodc/en/data-and-analysis/statistics/iccs.html>.  
This basic typology is coherent with the main concepts of national accounts. Income generation  
refers to the set of operations that, in national accounts, relate to the production account and to the  
generation and distribution of income account, while income management refers to the set of  
operations that, in national accounts, relate to the capital and use of income account.  
IMF (2018). Preliminary Report of the Task Force on Informal Economy.  
<https://www.imf.org/external/pubs/ft/bop/2018/pdf/18-10.pdf>

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23 This section is based on UNCTAD (2019). Trade and Development Report: Financing a Global  
Green New Deal, United Nations Publication. Geneva, chapter V, section B.

24 See e.g. OECD (2013a). Action Plan on Base Erosion and Profit Shifting. Paris; OECD (2013b).  
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Development. Paris; OECD (2015a). Base Erosion and Profit Shifting, Final Reports. Paris.

25 OECD (2020), Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar  
Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy. Paris.

26 See UNCTAD (2019). Trade and Development Report, p. 111.

27 See [https://www.g24.org/wp-content/uploads/2019/03/G-  
24\\_proposal\\_for\\_Taxation\\_of\\_Digital\\_Economy\\_Jan17\\_Special\\_Session\\_2.pdf](https://www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf)

28 Committee of Experts on International Cooperation in Tax Matters (2020): Report on its nineteenth  
session (15–18 October 2019). Document E/2020/45-E/C.18/2019/12, page 12.

29 See, e.g., Grondona. (2018). Transfer pricing: Concepts and practices of the ‘sixth method’ in  
transfer pricing. Tax Cooperation Policy Brief No 2, South Centre, Geneva.

30 OECD (2014b). Part 2 of a Report to G20 Development Working Group on the Impact of BEPS in  
Low Income Countries. Paris.

31 For a list of measures see, e.g., KPMG (2020). Taxation of the digitalized economy. Developments  
summary, 3-June update, and Grondona V, A.M. Chowdhary and D. Uribe (2020). National  
Measures on Taxing the Digital Economy. Research Paper 111, South Centre, Geneva.

32 For a rough calculation of potential additional revenues from digital services taxes for developing  
countries, see UNCTAD (2019). Trade and Development Report, p. 113.

33 This section is based on inputs provided by UNODC.

34 See State of implementation of the United Nations Convention against Corruption report.

35 [http://www.fatf-gafi.org/publications/methodsandtrends/documents/best-practices-beneficial-  
ownership-legal-persons.html](http://www.fatf-gafi.org/publications/methodsandtrends/documents/best-practices-beneficial-ownership-legal-persons.html); [http://www.fatf-  
gafi.org/publications/fatfrecommendations/documents/rba-legal-professionals.html](http://www.fatf-gafi.org/publications/fatfrecommendations/documents/rba-legal-professionals.html);  
[http://www.fatf-gafi.org/publications/methodsandtrends/documents/concealment-beneficial-  
ownership.html](http://www.fatf-gafi.org/publications/methodsandtrends/documents/concealment-beneficial-ownership.html)

36 For FATF and FSRB Mutual Evaluations see: [http://www.fatf-  
gafi.org/publications/fatfrecommendations/documents/12-month-review-virtual-assets-vasps.html](http://www.fatf-gafi.org/publications/fatfrecommendations/documents/12-month-review-virtual-assets-vasps.html).

37 In countries with low rates of bank remediation and in low-income or fragile states, the abuse of  
legal money value transfer services and the use of illegal money transfer services also poses  
important challenges.

38 Progress in this area should be measured through SDG Indicator 16.4.1. The StAR Initiative’s Asset  
Recovery Watch database seeks to track efforts by prosecution authorities worldwide to go after  
assets that stem from corruption. The database is updated periodically and currently contains  
documentation on approximately \$8.2 billion in stolen funds that have been frozen, adjudicated or  
returned to affected countries since 1980 in relation to 245 cases. StAR is currently widening the  
scope of data collection through various measures, in cooperation with the OECD.

39 See: <https://www.unodc.org/documents/treaties/UNCAC/COSP/session8/V1910022e.pdf>

40 Available at: <https://star.worldbank.org/sites/star/files/Barriers%20to%20Asset%20Recovery.pdf>

41 <https://www.factipanel.org/documents>

42 See, e.g., Independent Commission for the Reform of International Corporate Taxation (2020).  
ICRICT response to the OECD consultation on the Review of Country-by-Country Reporting,  
[https://www.icrict.com/icrict-documentsresponse-to-the-oecd-consultation-on-the-review-of-  
countrybycountry-reporting](https://www.icrict.com/icrict-documentsresponse-to-the-oecd-consultation-on-the-review-of-countrybycountry-reporting).

43 See: <https://ungass2021.unodc.org/ungass2021/index.html>

44 See e.g. <https://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector>.