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REGULATING ILLICIT GOLD

Obstacles and Opportunities in the United States

ABOUT C4ADS

C4ADS (www.c4ads.org) is a 501(c)(3) nonprofit organization dedicated to data-driven analysis and evidence-based reporting of conflict and security issues worldwide. Our approach leverages nontraditional investigative techniques and emerging analytical technologies. We recognize the value of working on the ground in the field, capturing local knowledge, and collecting original data to inform our analysis. At the same time, we employ cutting edge technology to manage and analyze that data. The result is an innovative analytical approach to conflict prevention and mitigation.

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LEGAL DISCLAIMER

ACKNOWLEDGEMENTS

C4ADS would like to thank all those who provided data, insights, and guidance during this project. Finally, the author would like to thank his fellow team members, Thomas Ewing, Mary Utermohlen, and Anna Wheeler, without whom this report would not have been possible.

C4ADS would also like to thank its technology partners:

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EXECUTIVE SUMMARY

US lawmakers and public officials recognize the trade in illicit gold as a pressing environmental and social problem, but no comprehensive regulatory framework exists under which to stop the flow of illicit gold to the United States. The challenge of tracing gold supply chains is complicated by four key factors: gold's physical and commercial characteristics; the growing sophistication of illicit gold trading networks; corruption in source, transit, and destination countries; and the fragmentation of the global gold market. Although two laws partially address this regulatory gap in the United States, neither provides a strong set of rules that apply equally to public companies and private entities. This brief draws on C4ADS analysis of the illicit gold trade to identify obstacles facing regulators and companies as they seek to achieve compliance with conflict minerals regulations, highlight the limitations of existing US laws pertaining to illegal gold and other minerals, and explore several potential areas in which these regulations can be strengthened or extended.

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INTRODUCTION

The illicit trade in gold and other minerals, like the illicit trade in wildlife, fish, and plants, is recognized by US lawmakers as a pressing environmental and social problem.[1] Unlike plants, fish, and wildlife, however, the United States has no legislation prohibiting the import of illicit gold, which means that gold extracted or transported illegally in foreign jurisdictions is legal to trade and own within the United States. Without a law on illegal gold to enforce, how can the US government prevent illegally mined gold from being traded within its own borders?

Several obstacles impede action on illicit gold. First, gold's unique physical and commercial characteristics make it nearly impossible to trace its origin, and to monitor its chain of custody. Second, miners and gold traders develop methods to undermine or exploit rules on illegal gold mining, gold smuggling, and money laundering. Third, systemic corruption facilitates the illegal extraction and smuggling of gold, creating an environment in which rules are easily circumvented through bribery and fraud. Fourth, the emergence of new refineries, trading hubs, and transit jurisdictions in recent decades has created an increasingly fragmented patchwork of gold regulations around the world, making coordinated action difficult.

Two existing laws partially address the regulatory gap in the United States. The Dodd-Frank Act of 2010 requires that publicly traded companies monitor and report on tin, tantalum, tungsten, and gold sourced from the Democratic Republic of the Congo and adjoining countries. The Bank Secrecy Act of 1970 requires that precious metals dealers maintain anti-money laundering protocols, and report suspicious activity to the US government. Neither law, however, provides a comprehensive set of rules that apply equally to public companies and private entities that import gold into the United States.

The flow of illicit gold to the United States and other destination countries imposes negative effects on source countries, where the quest for gold often leaves behind deforestation, mercury pollution, and other forms of environmental degradation. By fueling conflict and providing revenue to transnational criminal networks, the illicit gold trade also undermines the national security interests of the United States and other destination countries.

This brief draws on C4ADS analysis of the illicit gold trade to identify obstacles facing regulators and companies as they seek to achieve compliance with conflict minerals regulations, highlight the limitations of existing US laws pertaining to illegal gold and other minerals, and explore several potential areas in which they can be strengthened or extended.

OBSTACLES TO REGULATING ILLICIT GOLD

Companies face a number of obstacles in the design and implementation of robust due diligence practices, including gold's unique physical and commercial characteristics, the growing sophistication of the illicit gold trade, systemic corruption, and an increasingly fragmented global market for gold.

Gold's Physical Characteristics

Gold's physical characteristics make it difficult to track. After being mined from the earth as ore, gold is typically refined at least twice along its chain of custody. This allows for gold from disparate sources to be melted down and combined, making the task of tracing gold to its point of origin all but impossible. Unlike many other internationally-traded commodities such as timber, oil, grains, and coal, gold is also highly compact, which means it can be easily shipped or smuggled across borders overland and, critically, by air.

Although overland smuggling routes play a critical role in the illicit gold trade, most international shipping of gold is done by air. While other commodities often arrive at US borders by maritime shipping routes, gold shipped to the United States typically arrives by air cargo. This method of transport makes gold imports to the US more difficult to track using commercial trade data than maritime imports. According to the US government, Section 431 of the Smoot-Hawley Tariff Act of 1930, which requires all vessels arriving in the United States to maintain a manifest recording information about the preceding voyage and cargo carried during the journey, applies only to maritime vessels. On this basis, which was upheld in a recent court ruling, US Customs and Border Patrol denies access to air cargo manifest data to all commercial trade data providers.[2] For investigative organizations such as C4ADS that rely on publicly available information to investigate illicit trade, this reporting loophole represents a significant obstacle to tracing supply chains into the United States (Box 1).

Box 1: *Illegal Mining in Costa Rica*

In August 2020, 27 people suspected of participating in a gold smuggling ring were detained by Costa Rican authorities. The range of alleged participants in the illegal enterprise included miners, testaferros ("front men"), accountants, and business owners who facilitated the gold's sale and transport. Among those arrested was a tax official who allegedly advised the group on how to launder the proceeds of its gold sales.[3]

Between 2018 and 2020, the group reportedly carried out illegal mining operations in the areas of Crucitas, Abangares, and Corcovado National Park. The gold, disguised as scrap metal, was exported to the United States through the Juan Santamaría International Airport, or smuggled into Nicaragua for export, according to authorities.[4] *According to Costa Rican authorities, the group exported approximately 2,500 kilograms of gold worth $60 million to the United States between April 2018 and August 2020.*[5] *Authorities alleged that the gold was exported by air to consignees in Houston, Texas; Miami, Florida; and Los Angeles, California.*[6]

Commercially available export data from Costa Rica accessed by C4ADS corroborated the authorities' allegations. Because US import records for the shipments were not reported, however, C4ADS could not identify the exporters' counterparties in the United States.

Gold's Commercial Characteristics

The task of tracking gold imports into the United States is further complicated by gold's unique commercial characteristics. Gold's wide range of commercial applications—as jewelry, a form of payment, a store of wealth, and a raw material in various consumer products—means that it can be classified by customs authorities as a commodity or currency. Although airline passengers must declare currency or monetary instruments such as gold coins valued over $10,000, non-monetized gold, often in the form of semi-pure doré bars, is not considered a form of currency and is thus exempt from any reporting requirements.[7] As a State Department official noted in a 2019 Senate hearing, it is therefore "legal for a passenger to fly into the United States with, for example, 50 pounds of gold bullion, worth $1 million at today's prices, without providing the same customs declaration information required when traveling with $1 million in cash."[8]

Once an airline passenger has successfully brought gold into the United States, that gold can be quickly converted to cash. A common method used by passengers is to sell the gold to private gold traders, who then wire the equivalent sum in dollars to a designated recipient.[9] Since gold is often classified as a commodity rather than currency, the reporting requirements for such transfers are minimal. Gold traders are only required to report wire transfers of $10,000 and above, and are not obligated under any circumstances to report on the nature of exchange.[10] By itself, a wire transfer does not indicate any underlying illicit activity, which means that wire transfer reports by themselves are not enough to track gold-for-cash exchanges.

Growing Sophistication of Illicit Gold Trade

Illicit miners and gold traders have developed complex schemes to circumvent or exploit mining regulations. These schemes often involve "front" people and companies employed to mask the origin and ownership of minerals. Miners who do not hold formal mining titles, for example, may strike informal arrangements to exploit the claims of registered title holders. Unregistered traders may use a third party, typically another miner who is authorized to mine or trade gold, to sell to refiners. Exporters may rotate shipments among a series of short-lived shell companies, confounding efforts by regulators and downstream users to identify shipments' beneficial ownership and true origins (Box 2).

Box 2. *Obfuscation Schemes in Peru*

In February 2020, a law enforcement operation involving 47 prosecutors and 1,000 police officers across five regions in Peru arrested 18 members of a criminal network allegedly dedicated to illegal gold mining and smuggling.[11] Officers seized documents, weapons, explosives, chemical agents, and gold from the group worth approximately $10 million.[12]

According to Peruvian authorities, members of the group, which included several Chinese nationals in addition to Peruvians, mined gold from nine concealed tunnels that had been dug into hillsides in the region of La Libertad.[13] The illegally mined gold was then laundered using fraudulent paperwork and transported to warehouses in the Port of Callao, where it was shipped to buyers in the United Arab Emirates (UAE), China, and Switzerland, among other countries.[14] The criminal group obfuscated its activities by exploiting a formalization system for artisanal miners in Peru called the Integral Registry of Mining Formalization (REINFO). The group used registration details of four artisanal miners on the formalization list to transport and legitimize its illegally mined gold.[15]

Peru's formalization process, designed to facilitate the transition of artisanal miners from informal to formal operations, has also been exploited in other ways by illicit mining networks. The process requires miners to submit "declarations of commitment" in which they pledge to bring their activities in line with the government's environmental standards. The policy was intended for miners who were already operating prior to the creation of the formalization process. In some instances, however, miners have entered new areas, begun to mine, and then submitted declarations to formalize their activities. As a result, the policy appears to have provided an impetus for new illegal mining in some areas.[16]

At multiple points of the supply chain, transnational criminal networks exploit illicit gold as a vehicle to launder money from other illicit activities, such as drug trafficking. Drug trafficking organizations may use drug revenues to fund mining and gold trading companies, selling to international refineries through shell companies.[17] When gold is not laundered through shell companies, it is often smuggled. Smugglers have devised a range of methods to avoid detection, often relying on airline passengers to move the gold in small quantities. In 2019, for example, Colombian authorities dismantled a gold smuggling operation in which human couriers transported small quantities of gold disguised as accessories to jewelers in a Panamanian free trade zone, who paid the couriers in finished jewelry to be smuggled back into Colombia.[18] The complexity and opacity of gold supply chains offer transnational criminal networks ample opportunity for both money laundering and direct profit.

Systemic Corruption

Corruption and institutional weaknesses can undermine efforts to enforce minerals regulations, leaving rules and protocols that exist on paper but not in practice. Although gold exporters are typically required to provide documentation describing their gold's origin, exporters can falsify documents or obtain authorization from corrupt officials with little concern that they will be penalized.[19] Closer to the gold's point of origin, miners may rely on corrupt or sympathetic local officials to expedite bureaucratic processes,[20] grant mining titles without environmental assessments,[21] or provide tip-offs on impending law enforcement action.[22]

Artisanal and small-scale mining typically occurs in remote areas where formal rules and procedures are not systematically enforced. Such conditions often give rise to alternative rules and practices, or "informal institutions," that structure incentives in ways that compete with those provided by formal institutions.[23] In some cases, the informal institutions that facilitate illicit gold mining also co-opt elements of the state through political influence or public corruption. These murky institutional boundaries encourage practices which may be prohibited by state law but are nonetheless viewed as legitimate by local actors. In the mining hub of Madre de Dios, Peru, for example, scholar Gerardo Damonte has argued that formal and informal institutions are so intermingled that they have merged into a kind of hybridized continuum in which actors "choose a course of action by combining normative and customary, moral, or traditional practices."[24]

Fragmentation of Global Gold Market

The global gold market has become increasingly fragmented, with complex supply chains spanning multiple jurisdictions. Countries such as China, the UAE, and Turkey have grown from relatively minor gold importers into major gold trading centers,[25] and a growing number of local refineries and processors have emerged in countries closer to the point of extraction.[26] Free trade zones in both origin and destination countries, which often impose minimal regulatory scrutiny on gold traders, add yet another layer of opacity to global gold supply chains.

Although importers in jurisdictions such as Switzerland and the United States have come under pressure to stop sourcing gold from high-risk areas, many continue to source gold from intermediary jurisdictions with fewer regulatory scruples, such as the UAE.[27] The London Bullion Market Association, the world's largest gold industry accrediting authority, found that the refiners it certifies, mostly in Switzerland, imported 212 tons of gold valued at $13 billion from the UAE in 2018 alone.[28] Similarly, although the United States sanctioned Venezuela's gold industry in 2019, C4ADS analysis has found that US importers receive millions of dollars of gold from countries alleged to serve as transit jurisdictions for Venezuelan gold.

Intermediary jurisdictions in gold supply chains also include special economic zones in source, transit, and destination countries. A growing share of the global gold trade is routed through free trade zones, which facilitate trade flows subject to minimal taxation and regulatory oversight. This trend has been most clearly documented in major import centers such as Dubai,[29] [30] but is also true in countries closer to common source regions.[31] In Curaçao, which allegedly serves as a key transit point for Venezuelan gold exports, at least two refineries registered in free trade zones have allegedly exported Venezuelan gold to the United States, the Netherlands, the UAE, and Switzerland.[32] [33] C4ADS analysis also indicates that since 2015, small-scale and artisanal miners in Colombia increasingly sell gold to refineries located in free trade zones within the country's borders, which export mainly to the US.

SEC CONFLICT MINERALS RULE

In 2012, the US Securities and Exchange Commission adopted Section 1502 of the Dodd Frank Wall Street Reform and Consumer Act, which requires publicly traded companies to publicly disclose their use of conflict minerals originating in the Democratic Republic of the Congo (DRC) or adjoining countries.[34] The SEC rule applies to companies for which the use of tantalum, tin, tungsten, or gold (often referred to collectively as 3TG) is "necessary to the functionality or production of a product."[35] The SEC's reporting requirements aim to curb violent conflict and human rights abuses in the DRC by bringing greater public awareness to the source of minerals and promoting more rigorous due diligence of conflict minerals supply chains.[36]

The SEC reporting rule entails a three-step process for conflict minerals disclosure. First, the company (referred to as the "issuer") must determine whether conflict minerals are "necessary to the functionality or production of a product manufactured or contracted by that issuer to be manufactured."[37] If the company meets this definition, the company proceeds to the second step, which is to "conduct a reasonable country of origin inquiry regarding the origin of its conflict minerals."[38] If the company determines that its conflict minerals originated in the DRC or an adjoining country, it must exercise due diligence on the source and chain of custody of its conflict minerals, and include a Conflict Minerals Report as an exhibit to its specialized disclosure report.[39]

SEC Rule Limitations

The SEC rule is limited by two key factors: weak enforcement and loopholes in the reporting process. It is further limited by its exclusive focus on publicly-listed companies, and the narrow range of countries on which companies are required to report (see "Going Beyond the SEC Rule" below).

In 2014, the US Court of Appeals for the District of Columbia ruled that the SEC's conflict minerals disclosure requirements "created unconstitutional compelled commercial speech, violating the First Amendment."[40] In April 2017, three years after the ruling, the SEC announced it would suspend enforcement of its conflict minerals disclosure requirements.[41] In spite of these developments, many companies continue to monitor and report on conflict minerals in their supply chains: in 2019, a total of 1,078 companies filed Section 1502 special disclosures with the SEC.[42]

Although many companies continue to follow the SEC's three-step reporting process, the overall quality of reporting appears to have declined. Audits of companies' reporting practices in 2018 and 2019 by the Responsible Sourcing Network, a non-profit, found that average due diligence practices "fall short from the intent of the law and the expectations of stakeholders"[43] and that average due diligence reporting standards have worsened since 2017,[44] when the SEC stopped enforcing the law.

The decline in reporting quality may also stem from ambiguities embedded in the second step of the reporting process. Step 2 requires that issuers "conduct a reasonable country of origin inquiry regarding the origin of its conflict minerals," but does not specify what a "reasonable" inquiry involves. As the SEC notes, "the final rule does not prescribe the actions for a reasonable country of origin inquiry that are required, as the required inquiry depends on each issuer's facts and circumstances."[45] According to the SEC, this flexibility was intended to reduce the cost of compliance for smaller companies, which may lack the resources to conduct rigorous due diligence analysis. However, such language may also allow for lax reporting practices by companies of all sizes.

Going Beyond the SEC Rule

The SEC rule aims to lower demand for illicit gold and other minerals by raising consumer awareness of industry sourcing practices. But the rule falls short of achieving full supply chain transparency, which weakens its intended effect on public awareness. The United States should increase supply chain transparency by updating and expanding the SEC rule to include both public and private importers, a wider range of source countries, and more rigorous reporting requirements.

Europe has already taken a step in this direction (Box 3). In May 2017, the European Union passed Regulation (EU) 2017/821 (the Conflict Minerals Regulation), which imposes supply chain due diligence obligations on EU importers of 3TG originating from all conflict-affected and high-risk areas (CAHRAs).[46] The regulation sets out a series of rules that importers must follow tied to companies' internal management processes, risk management, and disclosure practices. The rule, which took effect in January 2021, directly affects some 600 to 1,000 EU importers, and indirectly affects about 500 smelters and refiners inside and outside the European Union.[47]

Box 3. *The EU Conflict Minerals Regulation*

What is required of importers?

EU importers—which are defined as "any natural or legal person declaring minerals or metals for release for free circulation"[48]—will be required to report to member states information such as the type and quantity of minerals imported, source country, and the names and addresses of suppliers. For imports from CAHRAs, or other areas where supply chain risks have been detected, importers must provide additional information on the mine of origin; any locations where minerals were consolidated, traded, and processed; and all taxes, fees, and royalties paid.

What is a CAHRA?

The EU defines CAHRAs as areas in a state of armed conflict, fragile post-conflict areas, areas with weak or non-existent governance and security, or areas with widespread and systematic violations of international law.[1] The European Commission plans to maintain a regularly updated CAHRA list, which will be provided by external experts.[49] The list is intended to be indicative but non-exhaustive, meaning that companies will be expected to comply with the regulations in conflict-affected or high-risk areas that are not listed.[50]

How is the rule enforced?

The EU rule will rely on member states to enforce compliance with the regulation. According to the European Commission, each member state will "order the [non-compliant] firm to address the problem within a given deadline, and follow up to makes sure it does so."[51] It is not clear whether failure to comply with the rule will result in any concrete penalties for firms.

Both the US and EU regulations are based to varying degrees on the OECD Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High-Risk Areas, which lays out a five-step process for companies to monitor and report on supply chain risks. The five steps require upstream and downstream companies to 1) establish strong company management systems, 2) identify and assess risks in their supply chain, 3) manage risks, 4) support third-party audits of smelters and refiners in their supply chains, and 5) publicly report on their due diligence efforts.

While both the US and EU regulations incorporate elements of the OECD Guidance, neither fully adheres to the five-step process. The US regulation applies only to publicly listed companies, and limits due diligence obligations to minerals sourced from a handful of origin countries. The EU regulation does not appear to explicitly require public reporting of source countries and suppliers – only that companies report to member states – and does not include strong mechanisms for enforcement. Limitations in both US and EU legislation therefore contribute to incomplete regulatory and public oversight of minerals industry practices, and leave loopholes open for bad actors to exploit.

BANK SECRECY ACT

While the SEC conflict minerals rule only applies to publicly-listed companies, another set of regulations applies to precious metals dealers. Under 31 U.S.C. Section 5312, dealers in precious metals, stones, or jewels qualify as financial institutions, which means that they are required under the Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the "Bank Secrecy Act" or BSA) to assist US government agencies to detect and prevent money laundering. Specifically, the act requires financial institutions to keep records of cash purchases of negotiable instruments; file reports of cash transactions exceeding $10,000 (daily aggregate amount); and to report suspicious activity that might signify money laundering, tax evasion, or other criminal activities.[52]

The BSA was first used to prosecute money laundering charges against a precious metals dealer in 2018, when Dallas-based refinery Elemetal LLC (also known as "NTR Metals") pleaded guilty to violating the BSA by failing to maintain an adequate anti-money laundering program.[53] Elemetal's plea came after three of its employees were convicted of laundering $3.6 billion in gold purchased from drug trafficking organizations in Peru, Ecuador, Bolivia, and Colombia.[54] According to the US Department of Justice, Elemetal failed to maintain an adequate anti-money laundering program in at least six ways,[55] all of which ultimately stem from a fundamental failure to practice due diligence on the company's suppliers.

Building Investigations Around BSA Violations

The Elemetal case yields several insights that may offer a path forward for investigation and prosecution of US gold traders that import illegal gold. First, the case provides specific risk factors that may indicate money laundering, tax evasion, or other criminal activities. These risk factors include irregularities in sales volume records, the use by foreign gold suppliers of "rotating front companies," and the involvement of foreign gold suppliers who represent themselves as "gold collectors."[56] Second, the case points toward sources of data that the US government has used to successfully investigate gold importers: customs declarations, sales volume records, communications records, and publicly available information. Third, the case suggests that to successfully prosecute US gold importers for BSA violations, investigators must demonstrate a pattern of failure to request or obtain adequate information as to the source and chain of custody of the gold.

CONCLUSION

The United States and European Union have both introduced regulations to stop illicit gold, among other minerals, from entering formal markets. In the United States, the SEC rule has done little to reduce the flow of illicit gold, due in part to reporting loopholes and weak enforcement. In the European Union, ambiguities in the conflict minerals regulation mean that the penalties for non-compliance, and the degree to which due diligence results must be publicly reported, remain unclear. Although both the US and EU rules are steps in the right direction, prior evidence suggests that illicit networks will evolve and adapt to new regulations.

Recent economic uncertainty has stimulated fresh demand for gold from a range of end consumers, which some analysts say portends future trends.[57] Will regulatory pressure from jurisdictions like the European Union simply redirect illicit exports toward more lenient jurisdictions? Will the growing complexity of the international gold trade complicate efforts by downstream users to trace the origin of gold in their supply chains? Without uniform regulatory standards across all gold trading jurisdictions, it will be difficult to ensure that supply chains are free of conflict, human rights abuses, money laundering, and other risks.

The United States can improve its current regulatory framework for illicit gold in at least six ways.

- Expand Dodd-Frank Section 1502 by imposing reporting requirements on private firms that trade gold and other precious metals, in addition to publicly listed companies, and by extending the geographic scope of the provision to include all conflict-affected and high-risk regions.
- Strengthen Dodd-Frank Section 1502 reporting requirements so that due diligence standards are uniform across all reporting companies, and coordinate with the non-profit and private sectors to create supply chain intelligence solutions in order to lower the cost of compliance for smaller companies.
- Implement a strong SEC rule to enforce Dodd-Frank Section 1504, requiring companies to disclose all project-level payments to governments.
- Centralize companies' due diligence reports in a publicly accessible database.
- Continue working with source country governments and civil society to promote anti-corruption, good governance, and transparency in extractive industry; to implement formalization programs for artisanal and small-scale miners; and to create alternative pathways to economic development in areas affected by illegal mining.
- Amend Section 431 of the Smoot-Hawley Tariff Act of 1930 to explicitly require public disclosure of shipping manifests from aircraft in addition to maritime vessels.
- Add trade in illicit gold and other precious metals as a class of transaction to be considered when making Section 311 primary money laundering transactions.

Absent a more comprehensive regulatory framework, investigators can maximize impact by building cases around BSA violations – particularly by exposing high risk upstream conditions in gold supply chains, and the trade relationships that tie high-risk mines to downstream users. It is difficult to demonstrate compliance failures on the part of importers without accessing internal documents such as emails or sales records, but analysts can use information such as customs records, mining titles, and corporate registries to map out the corporate networks and business activities of minerals suppliers. In particular, source country datasets on mining activity—which are often publicly available but unstructured and thus underutilized—can be structured, integrated, and analyzed to better understand trade volumes, chains of custody, and beneficial ownership, and to identify front companies and other mechanisms used to mask the origin and ownership of minerals. These networks can be assessed for risk by corroborating identifying information with additional data from sources such as local media reporting, law enforcement actions, or judicial records.

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