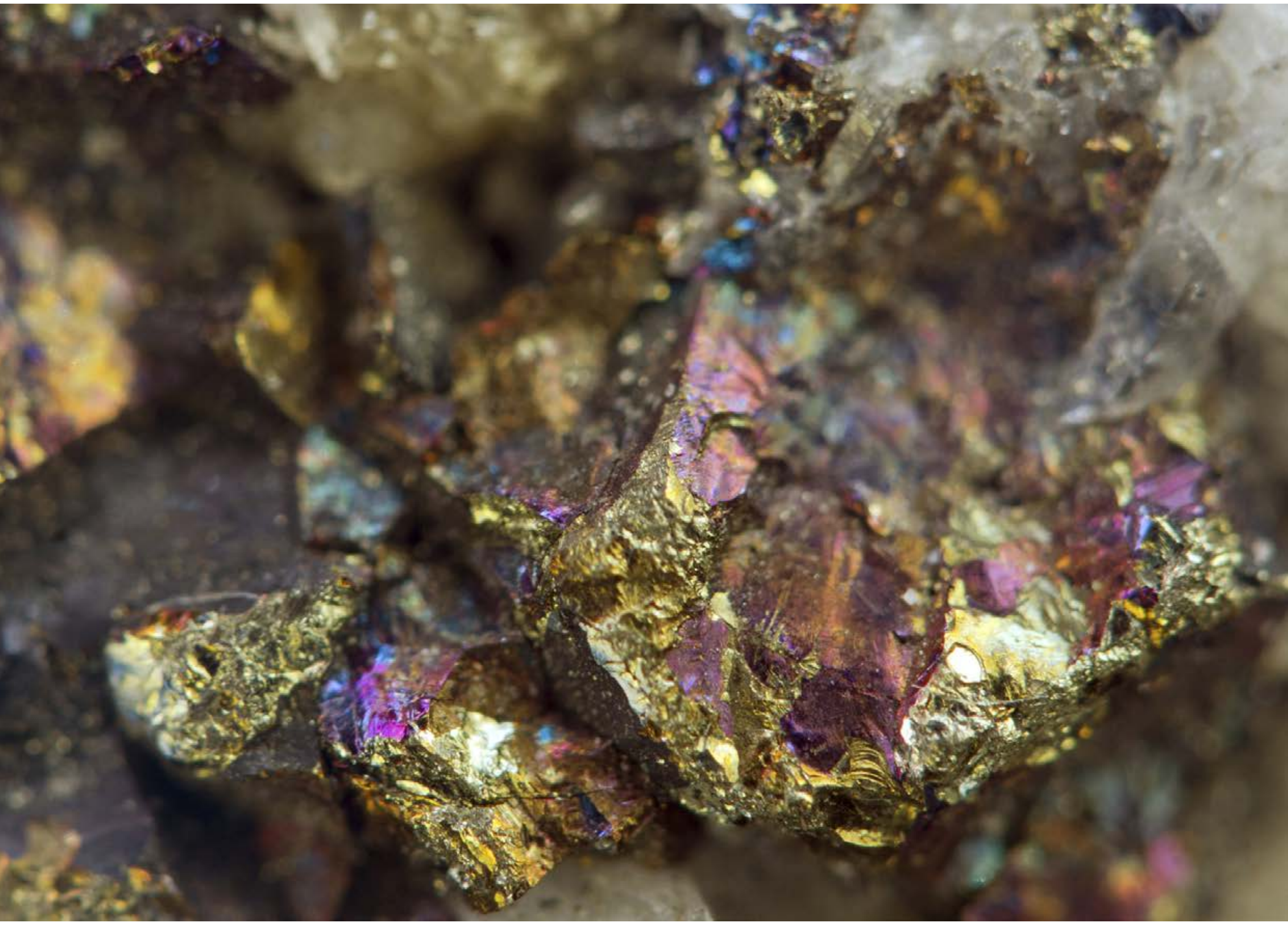
RESPONSIBLE BUSINESS CONDUCT

DUE DILIGENCE IN COLOMBIA'S GOLD SUPPLY CHAIN

Where does Colombian gold go?



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About the OECD Due Diligence Guidance for Minerals

The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (OECD Due Diligence Guidance) provides detailed recommendations to help companies respect human rights and avoid contributing to conflict through their mineral purchasing decisions and practices. The OECD Due Diligence Guidance is for use by any company potentially sourcing minerals or metals from conflict-affected and high-risk areas.

About this study

This report is part of a series of assessments on Colombian gold supply chains and the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. It analyses conditions of mineral extraction and related risks.

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Cofunded by the European Union

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Introduction

Unlike other gold producing regions around the world (West Africa, Great Lakes region), gold smuggling has only become an issue recently in Colombia. During the 1990s and early 2000s, drug kingpins and former paramilitary commanders purchased gold in neighbouring countries (Panama, Venezuela, México, Chile) with revenues from drug trafficking, smuggled it into Colombia and sold it to local traders to launder the money (El Tiempo 2010; OECD, 2016). However, this phenomenon was not a prominent issue and gold smuggling consisted principally in importing gold from neighbouring countries illegally. Moreover, after the dismantling of the Medellin and the Cali drug cartels in the 90s and the demobilization of the paramilitary groups in the mid-2000, this phenomenon was thought to have dwindled.

Nevertheless, as legal exports continued surpassing reported gold production between 2003 and 2011, Colombian authorities finally started looking into these potential contraband flows. Although no reliable estimate exists regarding illegal gold exports, in 2014, the Inspector General's Office (Procuraduría General) and the National Tax and Customs Agency (Dirección de Impuestos y Aduanas Nacionales) estimated that in 2012 and 2013, close to half of the total gold exported by Colombia could have been smuggled into the country from neighbouring countries (Portafolio, 2014). Today, experts believe that between 10 and 25 tonnes of gold (between 15% and 30% of total production) could be smuggled out of Colombia every year (information from the Planning Unit Energy Mining - UPME - and interviews with international traders). In turn, this means that since around 80% of domestic gold production is estimated to be illegal, the vast majority of this illegal gold production appears to be legally exported.

Official gold exports from Colombia[1]

The landscape of companies purchasing gold from Colombia has changed in the past five years as a result of new regulations introduced by the Colombian authorities.

A new generation of buyers

In 2012, four large-scale refiners (Metalor, Johnson Matthey, Argor-Heraeus and Republic Metals) accounted for close to 93% of the official purchases of Colombian gold. Following the introduction of a new regulatory framework for gold traders[2] and increased public attention to the issue of illegal mining and its links to criminal organisations and non-state armed groups (OECD, 2016), the share of purchases from these traditional buyers dropped to 64% in 2015 and to 25% in 2016 while Colombian gold export reached 31 tonnes in 2015 and 42 tonnes in 2016 (SIMCO, 2017). According to gold brokers consulted, this drop can also be explained by their interest in higher volumes than the ones currently produced in Colombia (interview).

A new generation of buyers has emerged, and new investors and capital entered the Colombian market as a result of this change in regulation. A review of 2016 export data shows that 10% are now brokers (Sun Valley and FC Stone), close to 12% are refiners based in Florida (e.g. Universal Precious Metals, Auramet International, WPN Miami Inc.), and 35% are US subsidiaries of established refiners in Turkey, India and the UK (Asahi Refining, IGR and NTR

[1] Review of Colombian gold trade flows is based on a review of export data (HS Codes 7108120000 and 7108130000) between 2012 and 2015 as found in LegisComex.

[2] In December 2012, Decree 2637 created the Single Register of Mineral Marketers (RUCOM)

Metals) that are members of the London Bullion Market Association (LBMA) or are certified by the Conflict Free Smelter Program (CFSI). After setting up a subsidiary trading company in the Cali Free Trade Zone in 2015, NTR has established itself as the largest buyer of Colombian gold with 22% of all exports. Gold brokers consulted suspect that some of these refiners are then reselling to traditional large-scale refiners once they have consolidated larger volumes; this modus operandi serves to legalize criminal gold or gold from producers without licence (interview).

Changes in supply

The composition of suppliers has also changed. In 2012, the four large refiners mentioned above sourced almost exclusively from International Traders (*Comercializadoras Internacionales - CIs*). Close to 25 CIs trading gold operated in Colombia at the time, out of which nine (eight of which were based in Medellín) accounted for 90% of the sales (volumes sold in 2012 by each CI ranged from 2 to 15 tonnes). Each of the large four refiners had relationships on average with two to three CIs as their preferred suppliers. In turn, each CI relied heavily on one or two refiners for the bulk of their sales (e.g. 83% of CI Goldex's exports went to Republic Metals; 83% of CI S&JIL went to Metalor) (Legiscomex, 2017). 9% of Colombia's gold was supplied by Mineros S.A., Colombia's only LSM producer at the time.

Following the implementation of regulations for traders (i.e. the implementation of the National Registry for Mineral Traders - *Registro Unico de Comercializadores Mineros – RUCOM*), three CIs that remained actively in business and managed to meet the new legal standards accounted for 71% of the sales. During this transition period, it is probable that CIs that closed their doors and had a strong vertical integration within their supply chain (e.g. controlled networks of local buyers. See OECD, 2015; OECD, 2016), looked to redirect their flows of gold to other CIs (e.g. there are indications that owners of CI S&JIL asked their suppliers to redirect their gold to CI Meprecol). Other CI owners established new operations in Free Trade Zones (FTZ) (e.g. CI Giraldo & Duque and CI Ramirez), particularly in Cali. These new operations are also believed to have absorbed some of the traditional flows of gold from unauthorized producers, including from Antioquia and Chocó (OECD, 2017). And rumours that some of the CI export gold illegally (see next section "gold smuggling").

By 2016, with increasing scrutiny over suppliers, the remaining three CIs maintained just over 40% of Colombian gold exports. While keeping a steady flow to traditional refiners, these CIs have looked to diversify their clients by selling smaller amounts to new US-based refiners looking to source from Colombia (e.g. CI Meprecol continued to supply to Metalor as its main client, while looking to establish a business relationship with Universal Precious Metals). In addition to purchasing from the remaining CIs, these new US-based refiners are bypassing them and sourcing directly from local traders/consolidators (e.g. in 2016, Universal Precious Metals bought an average 160 kg from twelve local consolidators; through its subsidiary in Colombia, NTR bought on average 445 kg from 28 local consolidators) ensuring a steady flow of smaller amounts (Legiscomex, 2017). According to miners and traders consulted, these consolidators are allegedly sourcing from artisanal and small-scale miners with legally obtained titles, but there are reports that those legally registered channel gold from unauthorized producers (OECD, 2017).

In addition to traditional vertical integration between CIs, local traders/consolidators and artisanal and small-scale miners, some brokers have started to invest in small-scale operations to implement "streaming" or "closed pipe" operations that ensure them a constant supply of legally produced gold. Sun Valley, an investment fund/broker has invested in CICGSA, a local refiner and international trader, as well as in local small-scale mining projects that meet Colombian legal requirements. Other companies like X-Quadra (now Falcon Investments) are looking to do the same.

Contraband flows of gold

Gold smuggling into Colombia

During the 1980s and 1990's gold was used by Colombian drug cartels to convert illicit cash from drug trafficking into stable legal and exchangeable assets. Gold bullions purchased on the international market with drug money were illegally imported into Colombia, then smelted and falsely declared as produced from local mines before being re-exported legally. However, although for many years, traditional refiners in Medellin laundered part of the proceeds of Pablo Escobar's drug trafficking, using gold as a money-laundering vehicle, did not necessarily imply gold smuggling into Colombia. Drug cartels also used to buy legal gold in Europe or countries such as Uruguay or Panama. The gold was either sold or re-exported legally and the proceeds were laundered through the international banking system (La Nacion, 2016).

In the 1990s and 2000s, non-state armed groups engaged in gold smuggling. They not only imported gold to launder the proceeds of drug trafficking, but also captured part of the royalties returned to the producing municipalities, and fraudulently recovering false VAT claims from fake gold export declarations (EL Tiempo, 2014; Dinero, 2002).

However, gold smuggling consisted principally in importing gold from neighbouring countries illegally. Smuggling Colombian gold out of the country was not a prominent issue, since there were very few advantages in doing so. Evading the payment of royalties and export taxes offered too little incentives compared to the risks of having its gold confiscated. Drug cartels and illegal armed groups preferred paying an additional 5 % taxes rather than taking the risk of losing merchandise. Since due diligence in Colombia's gold supply chain was incipient, illegal gold could be easily sold and re-exported legally.

Gold smuggling out of Colombia

In the wake of the Goldex scandal in 2014-2015, however, and when the new legislations and restrictions on gold exports came into force (see OECD 2016), laundering money through gold not only became more difficult in Colombia, but international traders and refiners also became more reluctant to buy illegal gold from Colombia. On the one hand, although smuggling bullions of gold into Colombia remained quite easy, laundering the revenues of gold smuggling in the Colombian financial system was more complicated. On top of that, the 2012 new legislation on the redistribution of royalties contributed to discourage criminal groups to over-declare artificially gold production and to pay the 4% royalties on it, since there was much less money to fraudulently recover from redistributed royalties, than before. As a result, exporting gold illegally became attractive again, as it allowed selling part of the Colombian illegal and criminal gold production on the international markets.

According to testimonies, strict regulation of gold sourcing introduced in 2015 (OECD, 2016) fostered gold contraband coming from Colombia. CIs had to start turning away gold from local traders who could not provide legal documentation about the origin of their product. At this time, law enforcement agents started tracing flows of contraband gold leaving Antioquia to

Venezuela by airplane and arriving in Curacao and Aruba (interview). Traders consulted noted that there are direct flights from Medellín and Bogotá to Curacao, Aruba and Barbados taking hundreds of kilograms of gold from unauthorized producers every month via human curriers or parcel services (interview).

Panama could possibly be another grey area for Colombian illegal gold. Although from the 1970s onwards, moreover after ex paramilitary chief Salvatore Mancuso's statements in 2010, the Colombian authorities had been aware of gold smuggling from Panama into Colombia as way of laundering money from drug trafficking, there are new indications that non-negligible quantities of gold sourced from non-authorised Colombian producers could also be smuggled out to Panama.

In 2015, official gold imports registered by the Free Trade Zone of Colon in Panama valued 28 million dollars (approximately 800 kg of gold) mainly from Colombia and Venezuela (interviews), while the same year, official gold exports by Colombia to Panama amounted for less than 100, 000 US dollars. Part of the explanation could come from the fact that gold exports to Panama by international traders located in Colombian FTZ do not appear in official figures. However, in the same time (2015), official gold exports from the FTZ of Colon to other countries (mainly Europe and the USA) amounted for 58 million dollars (without mentioning illegal gold exports), whereas in 2015, Panama did not have a significant gold production (interview with Panamanian and foreign custom officers based in Panama).

Despite the lack of evidence, it is likely that contraband gold could also be exiting Colombia through its southern border. Small-scale miners in Chocó and Antioquia reported that Brazilian entrepreneurs, who are experts in assembling dredges (known locally as Brazilian dragons) and backhoes, have established unauthorized mining operations and smuggle some of the production back to Brazil directly or via Venezuela (interviews; El Tiempo, 2015). Similarly, authorities and traders consulted expressed concern for the potential use of Ecuador as a platform to export gold smuggled out of Colombia (interviews). A small number of gold traders in Ecuador have trading offices in Colombia, making it easy for them to shift flows of gold sourced from unauthorized producers to their Ecuadorian subsidiaries either by road, or by sea via the Colombian port of Buenaventura or the Ecuadorian port of Esmeraldas (interview; Ojo Publico, 2015).

The discovery of large-scale gold contraband operations from Chile, Peru, Ecuador, Bolivia and Argentina to US and Dubai-based refiners has further raised alarms about Colombia potentially serving as a hub for gold smuggled through its Pacific Coast. The recent arrest of an NTR executive in Cali as part of an FBI investigation into the links between him and a gold-smuggling operation of illegally produced gold from Peru through Chile, has further raised concerns (El Tiempo, 2017; Bloomberg, 2017; Vireite, 2017). Already in 2013 authorities in Colombia alerted to unreported gold from Peru and Chile being processed by Colombian traders (CIs like Giraldo & Duque and Goldex) and exported as produced in Colombia (interviews with international traders, 2016, 2017; El Espectador, 2015).

Prevalence of Guidance Annex II Risks once gold leaves Colombia

The recent development of new regional routes for gold smuggling, the evidences of Colombia serving as a hub for contraband gold coming from other countries, the suspicions against international refiners buying Colombian gold from a source with a potential risk, and the new accusations against the FARC for having exported gold to Surinam from the mines they controlled illegally pose new threats and raise new challenges to the implementation of due diligence measures in Colombia's gold supply chain.

Since the early 2010s, US authorities have singled Curacao as hub for gold smuggled from Guyana into Surinam as well as from Venezuela (Kaieteur News, 2012), but it could also be receiving significant volumes of gold coming from Colombia. Traders in Curacao and Aruba then sell the gold to traders in Miami, sometimes via their subsidiaries in the British Virgin Islands, or directly to Europe (mainly to the Netherlands), further diluting the potential for traceability (interview).

Although it is still unclear what kind of connections between drug trafficking and gold smuggling remain, there is evidence to suggest that certain buyers in Miami could still be involved in both. For instance, a gold trading office in Miami (Cupremeco U.S.A), with links to suppliers in Curacao and the Caribbean, is owned by a family condemned for laundering money in the 1990's for the Cali Cartel (El Tiempo, 1995).[3] Similarly, in 2009, a series of arrests revealed a connection between drug trafficking networks and gold smuggling through Aruba and Bonnaire to The Netherlands, Belgium and Austria (Pearl, 2009). The leader of this outfit was recently captured in Cali (Diario, 2016).

The proliferation of gold smelters and subsidiary offices of gold refiners in the region – some in Free Trade Zones - has further raised concern about the sourcing of contraband gold. Smelters in Antigua, Barbados, and Curacao, and the recent opening of two gold refineries in Surinam (one owned by Kaloti Prescious Metals, and the other one by Tony Goetz) (interviews with gold traders working in the region) suggest that these are becoming important hubs to smelt and resell significant quantities of gold. However, Colombian official figures do not report any gold export to these countries.

In the case of Surinam, some reports suspect a vast operation of money laundering, considering President Bouterse's long-standing relationships with the FARC and criminal organisations, the on-paper refinery capacity of 60 tonnes a year, while Surinam only produces 18 tonnes of gold annually (Global Dispatch, 2017), and the low quantities of gold actually refined (the main activities are reportedly limited to smelting gold before being re-exported) (interview). In May 2017, the FARC were further accused of having smuggled gold from the mining regions they controlled to Surinam, and then laundered those gold revenues into Panamanian banks, with the help of a former Salvadoran ex-FMLN commander, Jose Luis Merino, alias Commander Ramiro, who advised the Colombian guerrilla during the Havana peace talks (Diario1.com, 2016).

[3] Between 1993 and 1994, the Cali Cartel bought gold from Italian jewelers (Universe Gold Enterprises and Aurea International Trading) that was exported to Panama, where it was then sold, and the money repatriated to Colombia

Risk assessment and mitigation efforts by authorities, intermediaries and refiners

Due diligence standards implemented by buyers of Colombian gold have also changed in the past five years. In 2012, 98% of gold produced in Colombia was purchased by refiners in the LBMA Good Delivery List. This rate dropped to 89% in 2015, and to 55% in 2016 (or 69% if you consider that one of the companies is audited by CFSI), following the implementation of the RUCOM and other measures restricting the purchase of gold from sourced that did not have an adequate legal standing (OECD, 2015).

In addition to the gradual reduction of audited buyers, there are growing concerns that audits themselves are not thorough enough to uncover cases of gold smuggling or gold purchased from unauthorized sources in high risk areas. It is important to note that most supply chain audits are focused on determining if refiners have adequate and functioning management systems in place to carry out supply chain due diligence. These audits are not forensic financial audits to detect illegal activities. The recent investigation into NTR-Elemental's involvement in a regional gold-smuggling operation has put into question some of these auditing mechanisms. Although the CFSI program audited NTR's US operations and not its subsidiaries in Latin America, it failed to uncover some of the underlying risks noted above (Bloomberg, 2017).

Law enforcement agents in Colombia are currently investigating international traders, but cannot divulge information to potential buyers or certifiers due to the secrecy restrictions of legal proceedings. The National Tax and Customs Agency (*Dirección de Impuestos y Aduanas Nacionales - DIAN*) is investigating at least six cases –at least two located in Free Trade Zones - of tax evasion and potential export fraud and money laundering of Colombian international traders (interviews with law enforcement agents, 2016). In addition, the Attorney General's Office is looking into transactions made by Colombian traders in the past five years for potential cases of money laundering or terrorism financing (El Espectador, 2017), but has similar restrictions in terms of divulging information about ongoing cases.

Moreover, although Colombian law enforcement agencies are making important efforts to fight money laundering (e.g. The national financial intelligence unit - UIAF, the Police's criminal investigations division - DIJIN, and the border police unit - POLFA), too little attention is paid to gold smuggling from Colombia. As smugglers appear to be using similar routes as the ones employed by drug traffickers, the task is not easy. Colombian authorities need to develop/reinforce intelligence cooperation with neighbouring countries and international organisations like Interpol, Gafisud.

Similarly, some international traders have made strides to improve the way they ensure the traceability of their gold purchases, but many don't undertake full risk assessments on their suppliers or on the regions where the gold is produced. Ensuring that gold purchased comes from a legal supplier does not eliminate the risk that they provide direct or indirect support to non-state armed groups or have links to serious abuses.

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