

**MONEY LAUNDERING METHODOLOGIES
AND INTERNATIONAL
AND REGIONAL COUNTER-MEASURES**

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In the last few decades crime has become more organised, more sophisticated and increasingly international in nature. It has also become more profitable.

In response, many countries have developed legislative, law enforcement and financial sector initiatives to deal with organised crime. A key initiative has been to increase the focus on financial aspects of crime. One aim of this approach is to identify criminal assets in order to facilitate their confiscation. Another is to use the investigation of suspicious financial activities as a means to detect previously unknown criminal activities. A third is to use financial trails to provide an evidentiary link between key organisers and specific criminal acts. As a result, in many of the countries where criminals operate, it is no longer safe for them to deposit bags full of cash into bank accounts, or live luxurious lifestyles with no apparent source of legitimate income without such suspicious behaviour being reported to the proper authorities.

Today, money laundering has become a critical issue for any significant criminal enterprise. Successful money laundering enables criminals to:

- *remove or distance themselves* from the criminal activity generating the profits, thus making it more difficult to prosecute key organisers ;
- *distance profits* from the criminal activity - to prevent them being confiscated if the criminal is caught;
- *enjoy the benefits of the profits* without bringing attention to themselves; and
- *reinvest the profits* in future criminal activity or in legitimate business.

This paper will briefly examine money laundering from a number of perspectives. This will include a description of its nature and scope, a description of some of the methods by which criminal proceeds are laundered, a discussion of the significance of money laundering to the international community and an overview of some of the measures which are currently underway to counter money laundering internationally and regionally.

Defining Money Laundering: Its Nature and Scope

Definition

In lay terms money laundering is most often described as the "turning of dirty money into clean money". Generally, the act of conversion and concealment is considered crucial to the laundering process. Perhaps the simplest definition then, is that money laundering is *the process of converting cash, or other property which is derived from criminal activity, so as to give it the appearance of having been obtained from a legitimate source.*¹

One of the first formal definitions of money laundering to gain international recognition is that found in the United Nations' *Convention Against Illicit Traffic in Narcotic Drugs and*

¹Paper presented by Mr Rick McDonnell, Head Asia/Pacific Secretariat, FATF, entitled "An Overview of the Global Money Laundering Problem, International Anti-Money Laundering Standards and the Work of the Financial Action Task Force" delivered at the International Conference on Global Drugs Law, New Delhi, 28 February 1997.

Psychotropic Substances (commonly referred to as the 1988 Vienna Convention).² The key elements of this definition include the *conversion* of illicit cash to a less suspicious form, so that the true source or ownership is *concealed* and a *legitimate source* is created. This definition was used by many countries when they drafted anti-money laundering laws.

The Vienna Convention definition applies specifically to the laundering of the proceeds of drugs trafficking. In turn a number of nations initially limited their own legal definitions (and changes to regulations, banking practices, etc.) to the laundering of drug profits. Subsequently, there has been a move to extend the definition of money laundering to include proceeds of other serious criminal activities including smuggling, fraud, serious financial crime and sale of stolen goods. A 1996-1997 survey by the Financial Action Task Force (FATF) of money laundering measures noted that along with drug trafficking, financial crimes (bank fraud, credit card fraud, investment fraud, advance fee fraud, bankruptcy fraud, embezzlement and the like) were the most frequently mentioned sources of proceeds of crime.³ Many countries have now taken action to extend the scope of their money laundering offence to include a wider range of predicate offences because it has been recognised that drug profits are only one source of laundered funds.⁴

Estimating the Size of the Problem

The desirability of estimating the amount of money laundering that is occurring world-wide has been recognised for some time. Yet, producing a reliable estimate has proven to be problematic (if not impossible) largely because it is, by definition, a concealed activity.

However, some figures have been developed which give some indication of the extent of the problem. In 1987 the UN estimated drug trafficking world-wide at US\$ 300 billion, much of which would be laundered. Other estimates have been made that US\$300 billion to US\$500 billion of "dirty money" is placed into world financial systems *each year*, or roughly 2% of global GDP.⁵ While some of this money would be spent or reinvested in criminal activities, it may be assumed that a portion of this amount would be amassed and continue to increase the total world stock of assets acquired with illicit funds by organised crime groups.

One of the few detailed efforts made to quantify money laundering in a particular country is found in a report by the Australian Transaction Reports and Analysis Centre (AUSTRAC). A

²Money laundering is defined in Article 3 Section 1(b) of the Convention as follows:

The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph (a) of this paragraph, or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;

The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph (a) of this paragraph or from an act of participation in such an offence or offences

Subparagraph (a) refers to illicit drugs.

³FATF op.cit. p.3.

⁴ This includes almost all members of the Financial Action Task Force (FATF). FATF op.cit. p.9.

⁵ Quoted in Raine, L.P. and Cilluffo, F.J. eds *Global Organised Crime: The New Empire of Evil*, Centre for Strategic and International Studies, Washington, 1994.

variety of methods were used to determine an estimated range for money laundering in Australia. The report concluded that a range of between A\$1.0 billion and A\$ 4.5 billion would appear to be a sensible interpretation of the information provided, with some confidence that the most likely figure is around \$3.5 billion.⁶

Anecdotal evidence from individual investigations would also suggest that money laundering is occurring at significant levels. An investigation of an Australian narcotics ring revealed A\$ 77 million was laundered through financial institutions in a number of countries. Another investigation into a Chinese based fraud syndicate revealed A\$ 60 million laundered through Australian financial institutions. A US DEA operation in 1994 revealed a scheme which was estimated to have laundered approximately US\$ 1.2 billion through Dominica Republican money changers and Puerto Rico during 1993.⁷

Despite these estimates, no authoritative global figure is yet available. A 1996 meeting of FATF experts debated the practicality of continuing attempts to estimate the size of the problem. While some looked to the importance of having an accurate estimate in measuring the success of anti-laundering measures, others noted that the lack of available statistics and the difficulties with methodology would render the production of a statistically significant estimate difficult and time consuming. FATF has established an Ad Hoc Group to address this issue.⁸

What might be concluded then? Money laundering would certainly seem to be a significant problem amounting to hundreds of billions of dollars a year, and part of those funds would be adding to an international stock of illicit cash and assets purchased with proceeds of crime, thereby increasing the strength of a number of transnational organised crime groups. It can also be concluded that if the above estimates are accepted, money laundering globally now presents not only a problem for criminal justice systems but also a macroeconomic problem. This latter issue will be discussed in more detail below.

However, there is as yet no truly reliable quantification of the magnitude of money laundering globally. Work is currently in progress to develop an appropriate methodology for this purpose. A reliable estimate is needed not only to determine the magnitude of the problem but also to determine whether, over time, counter-measures are being successful.

Methods of Laundering the Proceeds of Crime

The main methods by which money is laundered have become increasingly well documented in recent years. There has been some increase in sophistication and some development in methods used, mainly in order to circumvent money laundering countermeasures which have been instituted in a number of the larger economies.

The banking system remains one of the most important vehicles for money launderers. This can involve, for example, using banking bearer instruments such as bank drafts, telegraphic transfers to transmit funds internationally and the establishment of loan back schemes.

⁶John Walker Consulting Services, *Estimates of the Extent of Money Laundering in a through Australia* AUSTRAC, September 1995, p.39.

⁷*The Supply of Illicit Drugs to the United States* National Narcotics Intelligence Consumers Committee, August 1995, p.77.

⁸FATF op.cit. p.2.

The use of banks has been made more difficult in a number of countries by the introduction of anti-money laundering measures such as suspicious or significant cash reporting requirements and the disallowing of false names or anonymous accounts. Still, despite the introduction of these measures the banking system continues to remain a major avenue for launderers. These measures, however, have increased the number of detected cases and appear to have forced launderers to develop new methods in order to avoid detection. These may include such simple measures as "smurfing" or structuring, that is making numerous small deposits which fall below levels that would trigger a significant or suspicious cash transaction report, using relatives, third party or false names on accounts; or more sophisticated measures such as the use of shell companies.

Example:

Individuals in Australia used false or misleading identification details at a number of different banks and different bank branches, and purchased telegraphic transfers to accounts in Hong Kong and Canada. In excess of A\$1.3 million in cash was transferred out of Australia with all the transactions being under A\$ 10,000 to avoid the cash transaction reporting threshold. This syndicate was also found to have moved money from Australia through the cash purchase of bank drafts which were carried to Hong Kong. Again the purchases of bank drafts were all in cash and were below the A\$ 10,000 threshold.

An annual report which surveys money laundering methods has found that while the banking system remains an important avenue for money launderers, there has been a noticeable trend away from banks and increasing use of non-bank financial institutions, in particular bureaux de change, remittance businesses and non-financial professions. Such institutions not only provide services attractive to launderers, but they are also typically subject to fewer regulatory requirements than banks.⁹

There have also been reports of the use of the so called underground banking system, also known as the "hawala" or "hundi" system. A well established system, it is widely used for legitimate transactions, particularly in Asia.¹⁰ Unlike remittance companies or bureaux de change, these systems are not designed to handle *official* financial transactions and are not regulated. Not only do they provide complete confidentiality they also avoid a paper trail. These features make them particularly attractive¹¹

Example:

⁹FATF op.cit. p.4.

¹⁰This system is almost always associated with ethnic groups from Africa or Asia, and commonly involves the transfer of value between countries, but outside the legitimate banking system. The 'broker', which may be set up as a financial institution, or may be an ordinary shop selling goods, has an arrangement with a correspondent business in the other country. The two businesses have customers that want funds in the other country, and after taking their commission, the two brokers will match the amounts wanted by their customers and balance their books by transferring an amount between them for the time period e.g. once a month. FATF op.cit. p 7.

¹¹*The Supply of Illicit Drugs to the United States* National Narcotics Intelligence Consumers Committee, August 1995, p.77

A Pakistan heroin dealer in Oslo wanted to have his profits sent home to Pakistan. He approached a "hawala banker" who contacted a colleague in Karachi. The latter knew a local factory owner who wanted to purchase machinery in New York, but who, because of currency restrictions could not get his Pakistani rupees exchanged. The proceeds from the sale of heroin were sent to New York to pay for the machinery. The factory owner deposited his money, in rupees, with the hawala banker in Karachi, who paid it into the heroin dealers' local account.

Many countries have also noted an increase in the amount of criminal cash being smuggled out of their respective countries. Generally money is carried out of countries with strict financial regulations for deposit into the financial system in less regulated countries. This trend is seen as a reflection of the success of anti-money laundering measures in banks and other financial institutions.¹²

Example:

Australian law enforcement investigated the money laundering of A\$77 million which were the proceeds of a 1989 hashish importation. Of this total, A\$ 55 million in cash is believed to have been hidden in watermakers or desalinators and shipped out of the country to Singapore.

Money laundering has also been found within a wide range of commercial institutions and the propensity for this may increase as anti-laundering measures are brought into effect in the financial sector. Insurance, commodities, securities and real estate dealers have all been found to be used for money laundering purposes. The use of legitimate businesses for money laundering purposes has also been found to be widespread particularly in relation to fraud and other financial crime. Techniques used have included: false invoicing, commingling of legal and illegal monies, the use of loan back arrangements (whereby the launderer transfers proceeds to another country and uses them as security for a bank loan which is sent back to the original country), and layers of transactions through offshore shell companies. In addition, a significant amount of illegal proceeds has been invested in real estate.¹³

Example:

US authorities have investigated a Chinese heroin smuggling operation based in New York. This organisation controlled a multi state food supply business for hundreds of small Chinese restaurants. The deliveries to these restaurants usually included cash. An inflated invoice was provided to the restaurant which included the value of the supplies plus the cash. The cash was then added to the restaurant takings and banked accordingly. The owners of the restaurant then wrote a cheque for the inflated invoice amount to the supplier. The inflated total invoices were then used as their cost of supplies. The cash was deposited in banks, and bank money orders, postal orders and cash cheques were purchased and sent to Hong Kong. As the food supplier enjoyed a monopoly position he was able to use extortion tactics.

"Windfall" profits from gambling, inheritance or investments have also been used to explain excessive wealth.

¹²FATF op.cit. p.7.

¹³FATF op. cit. p.8.

Example:

In 1994 a couple were arrested by Malaysian Police for drug trafficking. Several valuable items were also seized including a motor vehicle and jewellery. The woman explained these assets by claiming a number of winnings from one of the national lotteries and she was able to produce documentary evidence to back these claims. Further investigations revealed a clerk from the lottery agency had forged the documentary evidence.

New Developments

As noted above, the anti-money laundering measures introduced by many countries in recent years have forced money launderers to change their methods to some degree. While in many instances this has resulted in fairly basic changes, such as smurfing or using bank accounts of associates, money laundering has in other instances become more sophisticated. Modern money launderers are making use of the whole range of the modern international financial system, including international electronic funds transfers; the establishment of front or shell companies and trusts; and the use of tax havens to disguise beneficial ownership and the purchase of existing businesses with laundered money.

In order to devise more sophisticated schemes there has been a noted increase in the reliance criminals place on professional money laundering facilitators. Experts have reported a significant number of cases involving lawyers, accountants, financial advisers, notaries, secretarial companies and other fiduciaries.¹⁴ In Australia law enforcement agencies have found lawyers have been used to assist in the purchase of property so that the source of funds is disguised; to establish nominee companies and trusts for launderers; to place cash proceeds in their trust accounts; and to arrange false loans.¹⁵ There is increasing evidence of the use of professional money launderers. A US money laundering expert has reported that undercover operations in America have shown that professional launderers' fees have risen from 6% of the money laundered to 25-28% today.¹⁶ This may be an indication of the increasing difficulty and risk involved in laundering money in a country where anti-money laundering measures are in force.

Another important development which is expected to dominate the anti-money laundering agenda in the near future is concern about the use of new payment technologies. Electronic money (often called "e-money", "digicash" etc.) has the potential to make it easier for criminals to hide the source of their proceeds and move those proceeds without detection.

At present these systems are still in their infancy but are growing in use and attractiveness. Law enforcement agencies are particularly concerned with the adequate supervision of e-money providers; the maintenance of accurate and adequate records of transactions and persons involved; the problems created by the small physical size of stored value cards (which make them more difficult to detect than currency) and the speed and volume that e-money promises. Another difficulty is that many of these systems are designed to operate internationally and in multiple

¹⁴FATF op.cit. p.8.

¹⁵National Crime Authority *Taken to the Cleaners: Money Laundering in Australia* Vol 1. December 1991, p.37.

¹⁶*Money Laundering: That infernal washing machine* The Economist 26 July 1997, p.20

currencies, presenting law enforcement with difficulty in determining jurisdictional authority.¹⁷

Money Laundering in Asia

There are a number of important factors in Asia which influence the money laundering methods used in the region. There are major drug production centres in the region (the Golden Crescent and the Golden Triangle), which provide a significant inflow of proceeds from international narcotic sales. There is also high level use, for both legitimate and illegitimate purposes, of alternative remittance systems. Cash is used to a high degree compared to other regions and there is a willingness to conduct large cash transactions (both legitimate and illegitimate).

In the region, several countries have observed an increase in the amount of cross border smuggling of cash and bearer instruments such as money orders or bank drafts.¹⁸ Other significant laundering methods found in the region include the use of both telegraphic transfers and alternative remittance services to send money overseas, the use of bearer instruments (such as bank drafts, stock certificates, bonds, insurance certificates), the use of third party or false name accounts at financial institutions, the purchase of items of value (such as luxury goods, gold, motor vehicles, real estate), false invoicing and the use of letters of credit.¹⁹

Globalization of Criminal Money Flows

One aspect of money laundering which is clear is the increasingly global nature of money laundering. This trend has been developing over the past few decades along with the globalization of crime in general. The development of global markets for illicit goods and services, the revolution in modern technology and in particular communications and transportation, the deregulation of financial systems and the reduction in border controls, and the emergence of new market oriented economies have all meant that criminals have developed a capacity to operate on a truly world-wide scale. This has also meant that debts can be incurred and profits generated across international boundaries necessitating the movement of criminal funds internationally.

The trends in globalization mentioned above have also provided benefits for criminals in the laundering of their proceeds. The much larger volume of legitimate capital moving at any one time in the world and the rapidly reducing official controls on that movement have made it possible for large amounts of proceeds of crime to enter world markets without attracting much attention. The increased need for criminal enterprises to use international funds transfers have also made them aware of the benefits of moving funds internationally to disguise them, effectively disrupting audit trails as law enforcement is stymied by jurisdictional and legal boundaries. In addition, the growing diversification of international financial instruments and the differences in controls in regulation between countries has provided those wishing to disguise funds with ample opportunity to do so.

¹⁷FATF op.cit. pp.13-14. FATF have noted that law enforcement must aim to work with the industry so as to include effective implementation of anti-money laundering measures before the system is abused.

¹⁸FATF op.cit. p.9-10.

¹⁹FATF Asia Secretariat, Disposal of Proceeds of Crime Money Laundering Methods Workshop *Report of the Expert Group* Hong Kong 14 November, 1996.

As a consequence of these changes, money laundering is not just a problem for the world's major financial centres - or indeed the lightly regulated offshore havens. No country which is integrated into the international financial system is going to escape the attentions of launderers. With the dismantling of exchange controls and the growing interpenetration of financial markets, access to one country's financial institution allows world-wide mobility of capital. As more advanced financial centre countries tighten their controls, those states with developing financial sectors are more attractive, particularly as their domestic currencies become convertible and old regulations and controls are lifted.

None of this is to argue that economic and financial deregulation is undesirable. Rather it is to point out that in a rapidly deregulating world there should be systems put in place to identify criminal funds without restricting the legitimate economy. The anti-money laundering measures presently being used in many countries provide a means for achieving this outcome.

Significance of Money Laundering for Governments

Having described the nature and scope of the money laundering problem it is necessary to turn to the question of why governments should make this a priority concern and spend significant resources in attempting to counter it. In many respects this is much easier to answer in relation to those countries which directly suffer the adverse effects of large scale criminal activities. The negative consequences of money laundering for other countries, and especially for those reaping apparent benefits as financial havens, are less obvious but nonetheless real.

The most obvious reasons to establish money laundering counter-measures are to stop criminals from achieving the benefits of money laundering outlined at the start of this paper. Specifically:

- to stop them from enjoying the personal benefits of their profits (this may act as a deterrent as well as a punishment);
- to prevent them from reinvesting their funds in future criminal activities (that is to strip them of their working capital base); and
- to provide law enforcement with a means to detect criminal activities through the audit trail and to provide an evidentiary link for prosecution purposes between criminal acts and major organisers.

There are other negative consequences of money laundering, however, which are found at a macroeconomic level. These arise due to the absolute size of criminal proceeds entering the financial system each year, and the even greater mass of accumulated funds and assets. These negative consequences are a feature of the money itself and thus are relevant to any country in which these funds move.

The main negative consequence is the impact money laundering can have on the stability of the financial system. A large scale money laundering operation, involving one or more of a country's financial institutions could, once detected, put at risk a smaller nation's entire financial system through the loss of credibility and investor confidence. The impact of the demise of the Bank of Credit and Commerce International (BCCI), which closed down in 1991 following the discovery of massive fraud and money laundering by US regulators, is a case in

point. The BCCI had grown to become the world's seventh largest private bank with assets of US\$23 billion and operations in 72 countries. The chief victims of the bank's malpractices were depositors and governments in developing economies. This affair also raised serious questions about the responsibilities and role of auditors and bank regulators and revealed a stream of corruption of government and banking officials in many countries where the bank operated.²⁰ The oncosts of such a failure can also provide additional burdens for governments. A compensation package was approved in which the BCCI's majority shareholders, the Government and ruling family of Abu Dhabi, had to pay US\$1.8 billion towards a global settlement fund over a period of three years (though this package was still subject to appeal).²¹

Even the potential for financial institutions to be used by money launderers can greatly damage a country's financial reputation and the institutions themselves. In 1996 the Seychelles announced it would offer anyone placing \$10 million or more in certain investments, immunity from prosecution. This was viewed in the international community as an invitation to money launderers. A warning was issued to all banks about entering into financial transactions with the Seychelles. The UK, the EU, the US and the OECD condemned this law. The law has now been shelved.²²

In a recent paper on the macroeconomic implications of money laundering, the International Monetary Fund (IMF) reported that the level of money laundering is highly significant in determining currency and money balances, and may have a perceptible influence on economic growth rates. It canvassed available empirical estimates to identify macroeconomic consequences of money laundering, which included:

- policy mistakes due to measurement errors in macroeconomic statistics arising from money laundering;
- volatility in exchange and interest rates due to unanticipated cross border transfers of funds;
- development of an unstable liability base and unsound asset structures of individual financial institutions or groups of such institutions, creating risks of systemic crises and hence monetary instability;
- effects on tax collection and public expenditure allocation due to misreporting and under-reporting of income;
- misallocation of resources due to distortions in relative asset and commodity prices arising from money laundering activities; and

²⁰Passas, Nikos *Structural sources of international crime: Policy lessons from the BCCI Affair* Crime, Law and Social Change 20, 1993, p.294.

²¹Mahmood, Shiraz *Current Developments in the BCCI Affair* Journal of Financial Crime Vol 3. No 2. 1995, p.152.

²²*Cleaning Up Offshore* Euromoney April 1996, p.128 and *Money Laundering: That infernal washing machine* The Economist 26 July 1997, p.19.

- contamination effects on legal transactions due to the perceived possibility of being associated with crime.²³

Another IMF paper has noted that the allocation of world resources is distorted not only when labour and capital are used in criminal activities, but also when the proceeds of these crimes are invested in ways that are not consistent with economic fundamentals. Money launderers, it noted, do not allocate illicit funds around the world on the basis of expected rates of return but on the basis of ease of avoiding national controls. This contributes to a misallocation of resources on a fairly large scale.²⁴

Money Laundering Countermeasures

A wide array of international bodies are involved in international measures to counter money laundering.²⁵ An examination of some of the major international documents relating to money laundering countermeasures demonstrates that there is a significant unity of purpose internationally, and common agreement on a number of proposed actions to deny criminals the benefit of their illicit proceeds or access to the world's financial services industry. There is a marked consistency in which these documents recognise and endorse each other. Each new convention or agreement builds on the foundation of those that preceded it.²⁶

Many of these agreements propose measures which fall into three main categories:

- Legal
- Financial and Regulatory
- Law Enforcement

Legal

A significant aspect of most of these agreements is the call for the criminalization of money laundering (in some cases this refers solely to drug proceeds, but more recently includes proceeds from all serious offences). One of the most notable agreements in this regard is the 1988 Vienna Convention, which today has more than 114 signatories and which required signatories to criminalize the laundering of drug proceeds.

A number of bodies have assisted in the drafting of model money laundering laws. These include the UN Drug Control Programme (UNDCP)²⁷, the Organisation of American States

²³Quirk, Peter J. *Macroeconomic Implications of Money Laundering* June 1996, Working Paper, International Monetary Fund Monetary and Exchange Affairs Department WP/96/66 p27-28.

²⁴Tanzi, Vito *Money Laundering and the International Financial System* May 1996, Working Paper, International Monetary Fund Fiscal Affairs Department WP/96/55.

²⁵These include the Financial Action Task Force (FATF), the Council of Europe, the Commonwealth Secretariat, the International Monetary Fund (IMF), the Inter-American Drug Abuse Control Commission (CICAD), Interpol, the International Organisation of Securities Commissions (IOSCO), the Offshore Group of Banking Supervisors (OGBS), the United Nations Crime Prevention and Criminal Justice Division (UNCPCJD), the United Nations International Drug Control Programme (UNDCP), the World Bank and the World Customs Organisation (WCO).

²⁶Financial Crimes Enforcement Network (FINCEN) *Compendium of International Anti-Money Laundering Conventions and Agreements* 2nd ed January 1996.

²⁷The model law they have developed includes the reporting of transactions involving funds suspected of being proceeds of drug trafficking, reporting of international financial transfers, regulation of over the counter

(OAS) and the British Commonwealth group of countries. The model laws have been used by a number of countries in drafting their own laws.

Other legal initiatives include a call for measures for the identification, tracing and seizing of proceeds; legislation to enable competent authorities to confiscate laundered monies and property acquired from illicit sources; and legislation to permit extradition of individuals charged with a money laundering offence or related offence.²⁸

Financial and Regulatory

A number of financial and regulatory measures have been proposed, most significantly in the '40 Recommendations' of the Financial Action Task Force.²⁹ These include:

- an end to anonymous accounts in financial institutions and a requirement that they record and maintain records of the identity of their clients (commonly known as the 'know your customer' policy);³⁰
- special attention to be paid to complex, unusual and large transactions with some proposing that institutions be required to report such transactions to competent authorities;
- countries to consider implementing measures to detect or monitor cash at national borders; and
- the development of programmes in financial institutions to guard against money laundering including internal controls and employee training.

Law Enforcement

Law enforcement initiatives include calls for increased international cooperation by affording the widest range of possible assistance to other countries in money laundering investigations and prosecutions and providing mutual assistance to other nations.

This has resulted in the negotiation of a wide ranging international network of bilateral Mutual Assistance Treaties formalising the methods and means by which one country might assist another in investigations, prosecutions and confiscation.

exchange dealing (bureaux de change), requirements for casinos and customer identification in financial institutions. Financial Crimes Enforcement Network *Compendium* op.cit. p.12.

²⁸Found in the 1988 Vienna Convention and the Council of Europe's 1990 *Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime* (the Strasbourg Convention).

²⁹See the 1996 revised version: The Financial Action Task Force *Forty Recommendations*. Also in 1991 the then Council of the European Community adopted the *Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering*. This obliged credit and financial institutions to require proper identification from customers at the start of the business relationship and also when transactions over a certain amount took place or when money laundering was suspected.

³⁰One of the first anti-money laundering initiatives came from the Group of 10's Committee on Banking Regulations and Supervisory Practices. In 1988 this group adopted an accord entitled *Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering*, more commonly known as the 'Basle Statement of Principles'. This accord included standards on customer identification, a determination not to offer services where there is a reasonable suspicion of money laundering activity, and cooperation with law enforcement.

The Financial Action Task Force (FATF)

The first international initiative to counter money laundering was the creation of the Financial Action Task Force. FATF is an intergovernmental body which began as an initiative of the Group of Seven countries in 1989. Membership currently consists of 26 countries and two international organisations.³¹

The main purpose of FATF is the development and promotion of policies to combat money laundering and specifically to prevent proceeds of crime from being utilised in future criminal activities and from affecting legitimate economic activities.³² At its heart lie the Forty Recommendations - measures which set out the basic framework for anti-money laundering efforts and are designed to be of universal application. These recommendations generally cover the initiatives described above. The recommendations have been widely accepted as a good policy basis for anti-money laundering measures.

FATF members have agreed to adopt these recommendations. This process is monitored through an annual self-assessment exercise as well as a more detailed mutual evaluation process.

Other Regional Initiatives

Caribbean

A separate and autonomous Caribbean Financial Action Task Force exists comprising countries in the Caribbean and northern South America. It has adopted the 40 Recommendations described above with some additional region-specific recommendations. It is an independent Task Force but is based on the FATF model. It has been operating for three years.

Asia/Pacific

In February 1997 a group called the Asia/Pacific Group on Money Laundering was established. Initially it will consist of 13 jurisdictions but it is hoped others will join. Its purpose is to:

1. Provide a focus for co-operative anti-money laundering efforts in the region;
2. Provide a forum in which:
 - (a) regional issues can be discussed and experience shared,
 - (b) through exchange of information, the study and analysis of the problems caused by money laundering can be facilitated, and

³¹The twenty six FATF member countries and governments are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, the Kingdom of the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States. The two international organisations are: the European Commission and the Gulf Cooperation Council.

³²Financial Action Task Force on Money Laundering *The Forty Recommendations*

- (c) the issue of illegal proceeds is handled and the criminal realities in the region can be taken into account;
3. Encourage the adoption, throughout the region, of international anti-money laundering standards;
 4. Enable regional factors to be taken into account in the implementation of international anti-money laundering measures;
 5. Encourage jurisdictions to implement anti-money laundering initiatives including more effective mutual legal assistance; and
 6. Co-ordinate or provide practical support, where possible, to countries in the region who request it.

The general Terms of Reference for the Group are annexed to this paper

Money Laundering and National Security

Recent events in Asia have demonstrated the speed with which currency markets can be undermined and the serious consequences that can result from these economic challenges. Such consequences go to the heart of the financial stability and hence the national security of a nation.

The ability of money laundering to create significant problems for national or even regional financial systems is increasing. In a recent speech to FATF members, the managing director of the IMF indicated that money laundering may involve 2-5% of world GDP. He noted that this “poses two sorts of risks: one prudential, the other macroeconomic. Markets and even smaller economies can be corrupted and destabilised....Lasting damage can clearly be done, when the infrastructure that has been built up to guarantee the integrity of markets is lost. Even in countries that have not reached this point, the available evidence suggests that the impact of money laundering is large enough that it must be taken into account by macroeconomic policy makers.”³³

It is clear that money laundering has become an issue relevant to national security if its consequences can affect financial stability and economic growth of nations. It is also clear that globalization of crime together with changes in world financial regulatory systems has produced a situation in which very significant amounts of criminal proceeds are able to move internationally in search of countries with favourable regulatory environments, or as a means to provide an apparently legitimate source for repatriated funds.

As some countries become more aware of the adverse impact of money laundering (and place onerous penalties on their financial institutions for taking part, wittingly or not, in money laundering) they will become more suspicious of engaging in financial relationships with

³³Michel Camdessus, Managing Director IMF, “Money Laundering: the Importance of International Countermeasures”, address to the Plenary Meeting of the Financial Action Task Force on Money Laundering, Paris, February 10, 1998.

countries that are known to be used by money launderers. This may have an increasingly adverse impact on financial transactions and relations within regional economies such as that of the Asia/Pacific.

The IMF has noted that "the freedom of movement of capital, without the necessary steps of levelling controls and regulation, has increased the importance of the differences in controls."³⁴ Until the laws, regulations and mechanisms designed to thwart money laundering are put in place consistently, effectively and globally, money laundering will remain an international problem.

Future Initiatives

It is the effort to create a common standard of control which has been the focus of many of the international countermeasures described above. It is clear that the main future initiative will be to continue in this endeavour.

There is concern, however, with the speed at which this effort is progressing. Some have provided suggestions for ways of increasing the pace of reforms. US Senator John Kerry has argued that America and its allies should wage economic war against countries that refuse to fight laundering. He even suggests that these countries should ban their citizens from trading with laundering havens.³⁵

Vito Tanzi, from the IMF, has suggested an alternative approach. That is that the world financial community should negotiate a minimum world-wide standard of statistical, banking, prudential and financial rules that would be binding on all countries. Countries which refuse to enact these standards should face punitive taxes on capital flows to and from their financial centres and have international legal recognition denied to financial transactions taking place on their soil.³⁶

There is also an increasing consensus emerging in the international financial and banking community about the need for international money laundering standards to protect the reputation and integrity of financial systems. It has been recognised that damage to reputations can have a significant negative effect on a financial institution and even on the system itself and hence there is growing "peer group" pressure to introduce effective counter measures.

Attention must also be given to changes in methods used for money laundering. Although our understanding of the methods of money laundering being used has increased in recent years the main emphasis still remains on the placement of illegal *cash* into the system. Research has indicated, however, the relationship between crime and currency demand has changed. This suggests that laundering methods have changed, moving away from the banking system and cash and toward parallel financial markets, sophisticated nonmonetary instruments, and possibly barter (even to debits and credits booked by organised criminal quasi-banks, for example, over the Internet). If this assessment is accurate then there is a need for the development of new counter-measures that will identify these mechanisms.³⁷

³⁴Tanzi, op cit. p.6.

³⁵*Money Laundering: That infernal washing machine* The Economist 26 July 1997, p.19.

³⁶Tanzi, op cit. p.13.

³⁷Quirk, Peter, J. *Money Laundering: Muddying the Macroeconomy* Finance & Development March 1997, p.8.

Continued and improved sharing of information and intelligence on money laundering methods is also crucial. This will necessitate the expansion of cooperative arrangements through mutual legal assistance agreements and the establishment of Financial Intelligence Units to collect information about suspicious and illegal transactions.

It would also seem desirable that a detailed training and technical assistance strategy be put in place globally and regionally for those countries which express a need for assistance in this area.

Those countries which have already gained substantial experience in implementing anti-money laundering measures could provide valuable experience, especially in the area of providing training for law enforcement investigators, the establishment of suspicious transaction reporting regimes, and the development of internal controls and staff training for financial and non-financial institutions subject to money laundering schemes.

The importance of money laundering issues in the Asia Pacific region, and the need for an integrated international response has been endorsed by the APEC Finance Ministers. The Joint Ministerial Statement produced at their fourth meeting on 5-6 April 1997 included the following:

Money laundering remains a priority concern because of the threat it can pose to the integrity of legitimate financial institutions. In this regard, we welcome the establishment of the Asia-Pacific Group on Money Laundering of which several APEC economies are members. We pointed out however that money laundering is a global phenomenon and in this regard, we encourage all other economies to join in a determined global effort to effectively address it. We ask the assistance of the relevant international organisations to integrate support for anti-money laundering activities in their operations to strengthen the integrity of financial systems.

This is a significant endorsement for anti-money laundering initiatives in the Asia/Pacific region and a number of jurisdictions have introduced money laundering laws while others are in the process of doing so. There is also a general consensus for a cooperative regional effort through a cohesive Asia/Pacific Group on Money Laundering.

The challenge therefore is to ensure that the Group has sufficient membership to comprehensively represent the region so that it can adequately consider regional issues to the benefit of each jurisdiction and the region as a whole.

SUGGESTED FURTHER READING

Compendium of International Anti-Money Laundering Conventions and Agreements, United States Department of Treasury, Financial Crimes Enforcement Network

Financial Action Task Force

- Annual Report 1996-97
- Forty Recommendations (1996 edition)
- 1996-1997 Report on Money Laundering Typologies

Gilmore, William C. *Dirty Money, The Evolution of Money Laundering Counter-Measures* Council of Europe Press, 1994.

Quirk, Peter J. *Macroeconomic Implications of Money Laundering* IMF Working Paper, 1996.

Tanzi, Vito *Money Laundering and the International Financial System* IMF Working Paper, 1996.

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