

2

Money Laundering: The Need for Action and the Benefits to be Obtained

2.1 What is Money Laundering?

Money laundering is the process by which criminals attempt to hide and disguise the true origin and ownership of the proceeds of their criminal activities, thereby avoiding prosecution, conviction and confiscation of the criminal funds. Failure to prevent laundering permits criminals to retain the funds or recycle them to fund further crimes.

2.2 Why Take Action?

In recent years, there has been increasing recognition of the need to attack money laundering in order to fight serious crime effectively. Former IMF Managing Director, Michael Camdessus, has estimated the amount of laundering at 2–5 per cent of the world's gross domestic product – almost US\$600 billion, even at the lowest end of the scale. However, there are no estimates of how much of this is immediately spent by criminals and their organisations, and how much is laundered.

Of particular interest to the Commonwealth is the fact that, with the liberalisation of developing countries, laundered money can enter the financial system in the guise of assisting ailing economies and increasing inward investment. However, the unwitting acceptance of such 'dirty funds' can cause significant problems in the medium to long term as the funds frequently depart as swiftly as they arrived.

The ability to launder the proceeds of criminal activity, through the financial systems of the world, is vital to the success of criminal operations. Strengthening the prudential supervision and reputation of the financial system, the professions and other vulnerable business sectors through effective anti-money laundering measures is an essential prerequisite of achieving and maintaining the potential benefits of domestic and foreign financial liberalisation.

2.2.1 The Government View

From the point of view of national governments, there are four principal reasons for tackling money laundering:

- Failure to prevent money laundering permits criminals to benefit from their actions, thus making crime a more attractive proposition. It also allows criminal organisations to finance further criminal activity. These factors combine to increase the level of crime.

- The unchecked use of the financial system for this purpose has the potential to undermine individual financial institutions and ultimately the integrity of the entire financial sector. It could also have adverse macroeconomic effects and affect the exchange rate through large transfers of capital flows, and could lead to rent-seeking and distorted resource allocation.
- Unchecked laundering may engender contempt for the law, thereby undermining public confidence in the legal system and in the financial system, which in turn promotes economic crime such as fraud, exchange control violations and tax evasion.
- Money laundering facilitates corruption; ultimately, the accumulation of economic and financial power by unscrupulous politicians or by criminal organisations can undermine national economies and democratic systems.

2.2.2 The Financial Sector Interest

Both the financial sector as a whole and individual financial institutions have a keen interest in taking action. There are two principal reasons for this:

- The long-term success of the financial sector depends on attracting and retaining legitimate funds. These funds are attracted and retained because of the nature of the products and services, the quality and reliability of the service, and the reputation of the centre.
- Laundered money is invariably transient in nature. It damages reputations and frightens away the honest investor. The money launderer is a criminal and, if successful, will launch further attacks on the financial sector. It is therefore a matter of self-interest to protect the reputation of the financial sector by doing all that is possible to assist the authorities in detecting and prosecuting crimes.

2.2.3 The Interest of the Professions

While the long-term success of individual legal and accountancy firms is not so dependent on the reputation of the profession as a whole, greater public scrutiny is being given to professional integrity and any involvement by a professional firm with criminal money or terrorist financing will irreparably damage the reputation and long-term future of the firm concerned and will bring into question the integrity of the profession itself.

2.3 The Importance of Regional and National Initiatives: The Link to Economic Development and International Recognition

Crime is universal, but some countries export more of it than others. Countries lacking an effective criminal justice system pose a disproportionate threat to the wellbeing of

more stable societies. They are a major source of cross-border flows of dirty money and one bad apple in a regional barrel can taint all of its geographical neighbours.

Some countries also appear more willing than others to import the proceeds of crime. Jurisdictions with inadequate financial supervision are often the ultimate destination of these flows. Money that begins life as the proceeds of a drug deal or an illegal arms trade is often laundered through a neighbouring country to avoid detection and confiscation in the country of origin.

An increasing amount of effort is being focused through the transnational organisations to reduce both national and regional vulnerabilities and to take action against crime and corruption. Increasingly, the level of international aid is being linked to the demonstration of political will to enact effective anti-money laundering strategies and to eradicate criminal finance and official corruption. Those countries that refuse to adopt international standards are finding that their economic development is hampered by a lack of international acceptance. Publicity is being given to the worst offending jurisdictions and financial institutions are being required to apply close scrutiny to transactions with these countries. Often, an entire region is affected and the need for both national and regional initiatives becomes vital.

The effects of this scrutiny is most apparent in the application of the FATF non-cooperative countries and territories strategy (see section 4.4) which recommends that countries such as the USA and the UK take measures to prohibit business with countries whose strategies to combat money laundering and terrorist financing are deemed to be wholly inadequate.

Experience suggests that the launderer favours institutions and services within poorly regulated, offshore havens, which offer guarantees of secrecy and anonymity. Such secrecy and anonymity is also available to the launderer through the informal channels of the parallel economy, (e.g. the 'kerb market' and the alternative remittance systems), which exist in a number of Commonwealth countries.

In recent years, significant international effort has been devoted to enhancing supervisory and regulatory standards and to developing international standards for combating abuse of the alternative remittance systems (see section 6.8). These measures to combat abuse must, of necessity, be implemented by both home and host states if they are to be effective.

2.4 The Money Laundering Process

There is no one method of laundering money. Methods can range from the purchase and resale of real estate, or a luxury item (e.g. a car or jewellery) to passing money through a complex international web of legitimate businesses and 'shell' companies. Initially, however, particularly in the case of drug trafficking and some other serious crimes, such as robbery, the proceeds usually take the form of cash. For instance, street level purchases

of drugs are almost always made with cash, and this cash needs to enter the financial system by some means.

The money laundering process is often described as taking place in three stages:

- **Placement** is the physical disposal of cash proceeds derived from illegal activity;
- **Layering** is the process of separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the audit trail and provide anonymity;
- **Integration** is the provision of apparent legitimacy to criminally derived wealth. If the layering process has succeeded, integration schemes place the laundered proceeds back into the economy in such a way that they re-enter the financial system and appear to be normal business funds.

The three basic steps may occur as separate and distinct phases. They may occur simultaneously or, more commonly, they may overlap. How the basic steps are carried out depends on the available laundering mechanisms, the requirements of the criminal organisations and the robustness of the regulatory and monitoring procedures of the financial sector.

Money laundering has traditionally been associated solely with banks and other similar financial institutions. Action to combat money laundering has therefore traditionally focused on the banks, reflecting the historical emphasis on the laundering of street cash derived from the sale of drugs. While it may be true that banking processes such as deposit taking, money transfer systems, lending, etc., do offer a vital laundering mechanism, criminals have responded to the counter-measures put in place by the banking sector and it must now be recognised that products and services offered by other types of financial and non-financial institutions are also attractive to the launderer.

Given the diverse channels through which money laundering proceeds are moved, an effective approach to combating money laundering must involve all aspects of the financial system. It must cover money that has already been 'placed' into the financial system and, of course, money derived from other forms of crime that has never been in the form of cash. The sophisticated launderer involves many unwitting accomplices:

- banks and securities houses;
- financial intermediaries;
- accountants and solicitors;
- surveyors and estate agents;
- company formation agents and management services companies;
- casinos and bookmakers;

- bullion and antique dealers;
- car dealers; and
- others who deal in high value commodities and luxury goods.

The basic techniques and mechanisms for money laundering continue to be well documented, primarily through the FATF typologies exercises (see section 4.1.5). A summary of this information is contained in Appendix A.

2.5 Basic Principles of Money Laundering Prevention

The following basic principles of money laundering prevention, contained in the FATF Recommendations, are common to all countries:

- Money laundering should be criminalised on the basis of the UN conventions and applied to all individuals and legal persons, determining as appropriate which serious crimes should be covered in addition to drugs (FATF Recommendations 1 and 2);
- Appropriate measures should be put in place to confiscate the proceeds of crime (FATF Recommendation 3);
- Banking secrecy laws must not conflict with or inhibit the effectiveness of the money laundering strategy (FATF Recommendation 4);
- Administrative and regulatory obligations to develop systems and controls guard against money laundering should be imposed on all financial institutions (FATF Recommendations 5–12, 15);
- Obligations should be placed on all financial institutions, that if they know or suspect, or have reasonable grounds to suspect, that funds derive from criminal activity, they should report those suspicions promptly to the competent authorities (FATF Recommendation 13 and 16);
- The obligations for developing anti-money laundering systems, controls and reporting procedures should be applied to designated non-financial businesses and professions, recognising, as appropriate, the concept of legal privilege (FATF Recommendations 16, 20 and 24–25);
- Financial and non-financial sector businesses, their directors and employees, should be protected against breach of confidentiality if they report their suspicions in good faith (FATF Recommendation 14);
- Appropriate, proportionate and dissuasive sanctions should be introduced for non-compliance with anti-money laundering or terrorist financing requirements (FATF Recommendation 17);

- Countries should not approve the establishment or accept the continued operation of shell banks (FATF Recommendation 18);
- Countries should consider implementing feasible measures to detect or monitor the physical cross-border transportation of cash and bearer-negotiable instruments and to imposing a requirement on financial institutions and intermediaries to report all transactions above a certain amount (FATF Recommendation 19);
- Appropriate measures should be taken to ensure that financial institutions give special attention to business relationships and transactions whose anti-money laundering and anti-terrorist measures are inadequate (Recommendations 21–22);
- Countries should ensure that financial institutions, designated non-financial businesses and professions are subject to adequate regulation and supervision and that criminals are prevented from owning and controlling financial institutions (Recommendations 23–25);
- Appropriate law enforcement mechanisms should be put in place to process, investigate and prosecute suspected reports of money laundering and a Financial Intelligence Unit (FIU) should be established as the national receiving centre for information on money laundering and terrorist financing (Recommendations 26–32);
- Countries should ensure that the transparency of legal persons and structures can be accessed on a timely basis (Recommendations 33 and 34);
- Countries should rapidly, constructively and effectively provide the widest possible range of mutual legal assistance in relation to money laundering and terrorist financing investigations, prosecutions and related proceedings, and provide the widest range of international co-operation to their foreign counterparts (Recommendations 36–40).

Success requires the commitment of all involved, both within and across jurisdictions, including legislators, regulators, enforcement agencies and financial institutions. An important feature of money laundering prevention is partnership between all concerned.

2.6 The Benefits of Reduced Vulnerability

2.6.1 Environmental Protection

The impact of serious crime and corruption both within the developed and developing regions of the world is significant. Taking the profit out of crime can have a significant impact both socially and economically. Criminal money in large amounts undermines the social, economic and political fabric of society and consequently affects the day to day life and environment of every citizen. A relatively crime-free society with a sound

and effective criminal justice system provides a healthier and safer environment in which to live and work.

2.6.2 Economic and Financial Analysis

The economic benefits of a sound, well-regulated financial system cannot be disputed and the fact that bad money drives out good is a well-known and documented fact. Ultimately, countries that fail to take action to guard against financial systems being used by criminals are in danger of having serious economic sanctions imposed upon them.

The involvement of national governments and regional/local institutions will lead to ownership of the problems arising from the laundering of criminal money and demonstrates the political will to act. Locally developed solutions will strengthen public and private capacity to respond effectively to new criminal threats as they arise. Strengthening existing institutional capacity within countries and regions makes these institutions more effective, more efficient and reduces their reliance on external assistance and donor aid.

Anti-money laundering programmes will help to identify and reduce fraud, tax evasion, breaches of exchange controls and other economic crimes. Procedures to follow the criminal money trail and confiscate the proceeds of crime can result in the ability to detect and recover significant amounts of corruptly diverted or embezzled government funds. The recovered and increased revenues can then be used for the benefit of society rather than increasing the wealth and profits of the criminal.