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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 criminal funds. Failure to prevent the 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 that laundered money makes up 2 to 5 per cent of the world's gross domestic product – almost US$600 billion, even at the lowest estimate.

Of particular interest to the Commonwealth is the fact that with the liberalisation of developing countries' economies, laundered money can enter the financial system in the guise of assistance to ailing economies and an increase in 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 arrive.

The ability to launder the proceeds of criminal activity through world financial systems is vital to the success of criminal operations. Strengthening the prudential supervision and reputation of the financial system 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.

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

Some countries also appear to be more willing than others to import the proceeds of crime. Jurisdictions with inadequate financial supervision are often the ultimate destination of illegal flows. Money that begins life as the proceeds of a drug deal or an illegal arms sale 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 on transnational organisations to reduce both national and regional vulnerabilities and to take action against crime and corruption. Increasingly, 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.

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 are also available to the launderer through the informal channels of the parallel economy, for example the kerb market, which exists in a number of Commonwealth countries.

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 of a luxury item (for example, 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.

There are three stages to the money laundering process:

- ❖ **Placement** – the physical disposal of cash proceeds derived from illegal activity;
- ❖ **Layering** – 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** – 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 is often associated solely with banks and other similar financial institutions. Action to combat money laundering has therefore traditionally focused on the banks, reflecting the historic 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, it should 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, must cover 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;
- others dealing in high value commodities and luxury goods.

2.5 Basic Principles of Money Laundering Prevention

The following basic principles of money laundering prevention, contained in the Financial Action Task Force Recommendations, are common to all countries:

- ***Money laundering should be criminalised, determining as appropriate which serious crimes should be covered in addition to drugs.***
  (FATF Recommendation 4)
- ***Banking secrecy laws must not conflict with, or inhibit, the effectiveness of the money laundering strategy.***
  (FATF Recommendation 5)
- ***Administrative and regulatory obligations to guard against money laundering should be imposed on all credit and financial institutions and all other professions dealing with customer funds.*** (FATF Recommendations 10–29)
- ***Obligations should be placed on all banks and non-banking financial institutions to ensure that if they know or suspect that funds stem from criminal activity they report those suspicions promptly to the competent authorities.***
  (FATF Recommendation 15)
- ***Appropriate law enforcement mechanisms should be put in place to process, investigate and prosecute suspected reports of money laundering.***
  (FATF Recommendation 7)

- ***An effective enforcement programme should include increased multilateral co-operation and mutual legal assistance in money laundering cases where possible.*** (FATF Recommendation 3)
- ***Appropriate measures should be put in place to confiscate the proceeds of crime, sharing the confiscated assets with other jurisdictions as may be appropriate.*** (FATF Recommendation 7)
- ***Countries should consider implementing feasible measures to detect or monitor the physical cross-border transportation of cash and bearer-negotiable instruments.*** (FATF Recommendation 22)
- ***Consideration should be given to imposing a requirement on financial institutions and intermediaries to report all transactions above a certain amount.*** (FATF Recommendation 23)
- ***Countries should take measures to develop secure techniques of money management as a means of replacing cash transactions.*** (FATF Recommendation 24)
- ***The potential for money laundering through companies, trusts and other structures should not be overlooked.*** (FATF Recommendation 25)

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

2.6 The Benefits of Reduced Vulnerability

2.6.1 Environmental Protection

The impact of serious crime and corruption, within both 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 of regional and local institutions, will lead to an 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 will make those institutions more effective and efficient, and will reduce 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 which make it possible to follow the criminal money trail and confiscate the proceeds of crime can result in the detection and recovery of 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.