5

Developing National Strategies

5.1 The Basis of Successful Anti-Money Laundering Strategies

Strategies to combat money laundering need to be wide-ranging, involving governmental and private sector action in legal, regulatory, financial and law enforcement fields. To ensure that any proposed anti-money laundering strategy is capable of achieving its aim, and of functioning effectively in a given political, social and economic environment, it is essential that laws, regulations and administrative actions are developed that take account of the context in which they must operate. This means that all interested parties should participate in the development and administration of anti-money laundering programmes.

Experience has shown that to achieve a successful anti-money laundering strategy within any jurisdiction, the following factors must be present:

- the political will to tackle serious crime and the associated laundering of the proceeds of those crimes;
- effective sympathetic legislation and obligations to criminalise money laundering;
- a comprehensive risk assessment and definition of the financial sector to ensure that all who are likely to be involved are covered;
- a supportive enforcement structure based on:
  (a) a central reporting point for suspicions of money laundering;
  (b) trained financial investigators;
  (c) guarantees of confidentiality;
  (d) feedback from the law enforcement agencies;
- management of the displacement factors and the informal sector;
- effective means of providing international co-operation.

5.1.1 The Formation of a National Co-ordination Committee

The formation of a dedicated National Anti-Money Laundering Co-ordination Committee (NCC) has proved to be an indispensable prerequisite to the success of the anti-money laundering strategy within a number of countries and has assisted in achieving the political will to succeed. The potential strategies chosen by each country will determine the people or institutions who should be involved. However, the high-level membership of the NCC should comprise individuals who can be expected to be impartial in their assessment of national vulnerabilities, trends and objectives. Recommendations for legislative, regulatory or policy enhancements must emanate from the NCC which must then determine the momentum for action.

It is suggested that the NCC should consist of the Law Ministry/Attorney-General's Chambers, the police and/or other special investigation bodies such as customs investigators, anti-corruption and serious fraud offices, the Central Bank/Banking Supervision and the Finance Ministry. These major governmental bodies will be in a position to assess various issues which will be relevant to the chosen strategy. In particular they will understand:

- the formal financial system, its general capacity and work methods;

- the criminal justice system, including the capacity of the law enforcement sector, and the constraints, if any, in the existing legal system;
- the capacity for international co-operation and mutual legal assistance;
- the civil law insofar as it relates to the relationship between financial institutions and professionals, on the one hand, and their customers, on the other.

The NCC will need to take the preliminary decisions on the implementation of the FATF 40 Recommendations. Some of the recommendations are mandatory and therefore require action to be taken. One such area is the requirement to report suspicious transactions (Recommendation 15). Other recommendations do not require mandatory action and the issue in respect of these is whether action is either necessary or possible in all circumstances. One of the subjects that will fall into this category is the implementation of cross-border currency movement reporting (Recommendation 22).

5.2 Recognising Issues of US Extraterritoriality

Countries whose currencies are inter-related with the US dollar will need to have particular regard to the US anti-money laundering strategies. The USA will choose to apply its anti-money laundering legislation with extra-territorial effect if criminally derived funds are moved through the US dollar clearing system. US legislation provides the authority to take targeted, narrowly tailored and proportional action against those jurisdictions, foreign financial institutions or types of transactions that pose particular money laundering threats to the USA. Countries whose economies are heavily dependent on the US dollar may wish to consider applying the US Treasury Office of Foreign Assets Control (OFAC) restrictions specifying designated nationals, funds or jurisdictions with which the USA does not permit business to be conducted.

5.3 Developing Strategies for Offshore Financial Centres

5.3.1 The Potential Impact of Offshore Financial Centres

Many developing countries have looked to the development of offshore financial centres (OFCs) as a key to economic development. Consequently, the economies of many Commonwealth countries now depend, to a large extent, on income generated by the offshore financial sector. Traditionally, the major offshore centres have been located in UK Crown Dependencies and Overseas Territories but other Commonwealth countries are also expanding their offshore banking services.

OFCs tend to attract business through offering a range of financial and professional services, combined with an attractive tax regime. Activity is primarily conducted on behalf of non-residents. Consequently, many become known as 'tax havens' and this is often believed to be synonymous with money laundering havens. This perception needs to be carefully managed.

Countries with significant or developing OFCs need to be specially aware of the particular attractiveness of the offshore financial services market to money launderers and national strategies need to take account of the enhanced risks. The particular characteristics of OFCs that might be adopted to attract foreign business through preferential tax treatment, exchange control incentives, minimal disclosing requirements, soft regulation and enforced secrecy are also of particular interest to criminals. For example, the misuse of international business companies and mini-trusts set up in OFCs with strong secrecy laws are a cause of particular concern to the international community.

The UN Offshore Forum has identified minimum performance standards that must be achieved by all offshore centres. The performance standards have been set at a level within reach of all jurisdictions hosting OFCs, yet high enough to challenge mainstream jurisdictions as well. The performance standards incorporate core principles and standards promulgated by the FATF, the Basle Committee on Banking Supervision and other international bodies.

The Report of the G-7 Financial Stability Forum released in May 2000 noted that offshore financial activities do not pose a threat to global financial stability provided they are well supervised and co-operate with other jurisdictions. However, the Report concluded that OFCs that are unable or unwilling to adhere to internationally accepted standards for supervision, co-operation and information sharing create a potential systematic threat to global financial stability. International sanctions and reprisals can be expected against OFCs that remain in this category.

5.3.2 Uses of Offshore Financial Centres

The OECD Financial Stability Forum has categorised the uses of OFCs as follows. The Forum believes that some of these uses are more benign than others!

Offshore Banking Licences: A multinational corporation sets up an offshore bank to handle its foreign exchange operations or to facilitate financing of an international joint venture. An onshore bank establishes a wholly owned subsidiary in an OFC to provide offshore fund administration services, for example fully integrated global custody, fund accounting, fund administration and transfer agent services. The owner of a regulated onshore bank establishes a sister, 'parallel' bank in an OFC. The attractions of the OFC may include no capital tax, no exchange controls, light supervision, less stringent reporting requirements and less stringent trading restrictions.

Offshore Corporations or International Business Companies (IBCs): IBCs are limited liability vehicles registered in an OFC. They may be used to own and operate businesses, issue shares or bonds, or raise capital in other ways. IBCs may be set up with one director only. In some cases, residents of the OFC host country may act as nominee directors to conceal the identity of the true company directors. In some OFCs, bearer share certificates may be used. In other OFCs, registered share certificates are used, but no public registry of shareholders is maintained. In many OFCs, the costs of setting up IBCs are minimal and they are generally exempt from all taxes. IBCs are a popular vehicle for managing investment funds.

Insurance Companies: A commercial corporation establishes a captive insurance company in an OFC to manage risk and minimise taxes. An onshore insurance company establishes a subsidiary in an OFC to reinsure certain risks underwritten by the parent and reduce overall reserve and capital requirements. An onshore reinsurance company incorporates a subsidiary in an OFC to reinsure catastrophic risks. The attractions of an OFC in these circumstances include a favourable income/withholding/capital tax regime, and low or weakly enforced actuarial reserve requirements and capital standards.

Special Purpose Vehicles: One of the most rapidly growing uses of OFCs is the use of special purpose vehicles (SPVs) to engage in financial activities in a more favourable tax environment. An onshore corporation establishes an IBC in an OFC to engage in a specific activity. The issuance of asset-backed securities is the most frequently cited activity of SPVs. The onshore corporation may assign a set of assets to the offshore SPV, for example a portfolio of mortgages, loans or credit card receivables. The SPV then offers a variety of securities to investors based on the underlying assets. The SPV, and hence the onshore parent, benefits from the favourable tax treatment in the OFC. Financial institutions also make use of SPVs to take advantage of less restrictive regulations on their activities. Banks, in particular, use them to raise Tier I capital in the lower tax environments of OFCs. SPVs are also set up by non-bank financial institutions to take advantage of more liberal netting rules than faced in home countries, reducing their capital requirements.

Asset Management and Protection: Wealthy individuals and enterprises in countries with weak economies and fragile banking systems may want to keep assets overseas to protect them against the collapse of their domestic currencies and domestic banks, and outside the reach of existing or potential exchange controls. If these individuals also seek confidentiality, then an account in an OFC is often the vehicle of choice. In some cases, fear of wholesale seizures of legitimately acquired assets is also a motive for going to an OFC. In this case, confidentiality is very important. Many individuals facing unlimited liability in their home jurisdictions seek to restructure ownership of their assets through offshore trusts to protect those assets from onshore lawsuits. Some OFCs have legislation in place that protects those who transfer property to a personal trust from forced inheritance provisions in their home countries.

Tax Planning: Wealthy individuals make use of favourable tax environments in, and tax treaties with, OFCs, often involving offshore companies, trusts and foundations. There is also a range of schemes that, while legally defensible, rely on complexity and ambiguity, often involving types of trusts not available in the client's country of residence. Multinational companies route activities through low-tax OFCs to minimise their total tax bill through transfer pricing, i.e. goods may be made onshore but invoices are issued offshore by an IBC owned by the multinational, moving onshore profits to low-tax regimes.

Tax Evasion: There are individuals and enterprises who rely on banking secrecy and opaque corporate structures to avoid declaring assets and income to the relevant tax authorities.

While all these services are designed to assist legitimate businesses, they may also prove to be attractive to money launderers seeking to hide their illicitly gained assets. Those countries seeking to develop as OFCs must therefore be careful to deter criminal money, while still attracting legitimate international businesses.

5.3.3 Criminal Threats to the Development of Offshore Markets

The expansion of global financial markets has not been without its problems. There has been increased volatility of capital flows as money has moved from market to market in search of short-term returns. This is an issue that is already concerning Commonwealth governments. A comparable threat comes from the increasing quantities of criminally derived and criminally controlled money flowing through the international system. These flows do not necessarily respond to normal economic stimuli, moving instead in response to changes in banking secrecy or financial regulation. Such movements result in unpredictability and hence the instability of the financial institutions through which they pass.

This instability should be of particular concern to those governments seeking to establish or develop their financial sectors. Criminal money may flow rapidly into new centres, providing an illusion of success and a short-term boost to national savings. They may flow away equally rapidly as conditions change, attracted by another centre, or merely moving to complicate detection.

Those governments that resist the temptation to soak up short-term flows from money laundering are likely to find themselves laying the foundations of a financial sector that can make a contribution to the economy over the longer term. By setting high standards of financial regulation, and by introducing effective money laundering counter-measures, they are likely to attract high-quality financial institutions, which will not only provide a source of revenue directly, but which will contribute to wider economic development within the country.

While this point is relevant to all countries, it is particularly crucial to those seeking to develop as OFCs.

5.3.4 Competitiveness

Because they look for business outside their own jurisdictions, OFCs are, to a greater or lesser degree, in competition with each other. This is particularly true of centres in the same time zone: for instance, all Caribbean and Caribbean rim OFCs are effectively competing for business from the USA, Canada and Latin America, while Pacific OFCs are competing for business from east Asia and Australasia. Some areas of OFC activity are not so dependent on time zones, and Offshore Business Centres (OBCs), in particular, may be used by customers world-wide.

This high level of competition tends to make individual OFCs reluctant to take any step that might cause them to lose business to a rival centre. Past experience has demonstrated that changes in tax regimes, or political instability, can cause very rapid outflows of business. Indeed, many offshore trusts are established in such a way that they can move to a new jurisdiction overnight, in the face of any threat to their situation.

Reputation

Because of the sensitivity of much OFC business to any threat (real or imagined) to their situation, OFCs must move carefully in introducing new legislative or regulatory positions. However, the business is also likely to be sensitive to any scandal occurring within the jurisdiction, especially if it is related to the financial sector.

Several international financial centres that have attracted business through low regulatory standards and minimal vetting of bank licence applicants have subsequently suffered badly from the collapse of financial institutions, and the uncovering of fraud and money laundering within their jurisdiction. Such centres have then found it very difficult to re-establish themselves as viable financial centres.

However, where reasonable standards have been maintained, it has been possible for some OFCs to introduce progressively tighter regulatory requirements and money laundering legislation without losing much business, and the little that has been lost has soon been replaced by new, higher quality business attracted by the higher standards that have been introduced.

5.3.5 The Need for a Sound Regulatory Regime for the Offshore Financial Sector

While domestic banks are generally covered by a strong regulatory regime conducted in accordance with the Basle Principles and Standards, this is not always true of offshore banks which can be regulated to a variety of standards by governments and other agencies. A strongly regulated financial sector without any distinction between onshore and offshore activities is an essential prerequisite for money laundering prevention. An adequate legal framework, clearly defined entry requirements, screening of owners and directors, and an effective system of ongoing supervision are all necessary to protect the integrity of the financial system.

Relationships with Overseas Authorities

By their nature, regulators in OFCs are likely to have frequent contact with regulators in other jurisdictions, seeking legitimate information about the activities of financial institutions. At the same time they may well be subject to 'fishing expeditions' conducted by foreign revenue authorities, seeking information to help them develop a case against a suspected tax evader. It is important that the means exist to offer suitable co-operation in both cases, while not breaching confidentiality by responding inappropriately.

One of the most effective ways of achieving this is through the negotiation of Mutual

Legal Assistance Treaties or, less formally, Memoranda of Understanding, with those jurisdictions that most frequently make requests for assistance. These agreements can specify the circumstances under which a request for assistance will be considered, the nature of assistance that might be provided and any restrictions that might be placed on the onward transmission of information.

5.4 Establishing Co-operation and a 'Partnership Approach'

The success of any basic strategy requires the commitment of all involved – legislators, regulators, enforcement agencies and the financial sector. Experience suggests that an important feature of a successful strategy is partnership among all concerned.

5.4.1 The Role of the Financial Sector

The pivotal role that the financial sector can play is often also largely overlooked. A properly trained and motivated financial sector can make a substantial contribution to money laundering prevention, even in the absence of a workable criminal justice system. But equally, a financial sector that has not been consulted and trained, and which believes that the requirements are either an unnecessary breach of customer confidentiality, or are impracticable in their delivery, can frustrate even the best laws and investigatory capacity, while still working within the strict letter of the law.

In all jurisdictions throughout the world, the financial sector supervision and law enforcement elements of the anti-money laundering strategy must be regarded as complementary. The first is designed to prevent abuse, the second to deal with it when it occurs. This distinction is important, but has not always been recognised by countries when they are preparing their prevention strategy.

5.4.2 The Role of Law Enforcement

The role of law enforcement agencies within the prevention strategy is vital to the financial sector. If trust, respect and understanding between the two sectors are absent, the financial sector will withhold its co-operation in the fear that it is placing its staff at risk and breaching customer confidentiality unnecessarily. Suspicious transaction reports will not be made to a law enforcement agency that cannot be trusted to treat them confidentially, or which does not have the expertise to use the intelligence responsibly and wisely.

5.4.3 The Need for Reciprocity

Co-operation between the financial sector and law enforcement agencies needs to be reciprocal. Financial institutions are acutely sensitive to any damage to their reputation and they will want the minimum of publicity about any money laundering investigations in which they become involved. Where they have effective anti-money laundering systems in place, the financial investigator's task of tracing criminal money will be facilitated and law enforcement agencies will tend to co-operate in keeping the operation out of the public eye. However, where a financial institution frustrates an investigation, there is less cause for the investigators to co-operate and the involvement of the institution in a money laundering operation is more likely to become public, with the adverse consequences for that institution's reputation that inevitably follow such a revelation.

5.5 The Development of Policies

5.5.1 Legislative Policy

The following legal actions are generally required to ensure that the criminal justice system can provide a sound base for a national anti-money laundering strategy:

- ❖ The laundering of the proceeds of crime should be made a criminal offence in domestic legislation. Such legislation should make possible the identification, seizure and forfeiture of the proceeds of such crimes;

- Full ratification and implementation of the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention);
- Enactment of measures that will permit or require financial institutions to provide to competent national authorities information about the identity of their customers, account activity and other financial transactions;
- A review of banking secrecy laws and enactment of the necessary amendments to ensure that disclosure of financial institutions' records can be made available to competent authorities;
- Assessment of the need for increased multilateral co-operation and mutual legal assistance in money laundering investigations, prosecutions and extradition cases;
- Laws compatible with the Commonwealth Model Law for the Prevention of Money Laundering should be adopted, where applicable;
- Implementation of bilateral and multilateral agreements to allow for the equitable sharing between governments of property that has been forfeited as a result of co-operative efforts in the investigation and prosecution of money laundering cases;
- If financial institutions suspect that funds stem from a criminal activity, they should be requested to report their suspicions promptly to the competent authorities;
- Financial institutions, their directors and employees should be protected by legal provisions from criminal or civil liability for breach of any customer confidentiality if they report their suspicions in good faith, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred;
- Financial institutions, their directors and employees should not be permitted to warn their customers when information relating to them is being reported to the competent authorities (tipping off).

The options for criminalising money laundering are set out in Chapter 6.

5.5.2 Financial Sector Strategy

Financial institutions and their regulatory and supervisory authorities should work together in an effort to prevent the laundering of the proceeds of crime and to protect the reputation and integrity of the country's financial centres.

The vulnerability levels of any one financial centre to misuse by criminals are a direct result of the inter-relationship of the following factors:

(i) *The range of services offered by the financial sector* – the greater the access to international markets, the higher the vulnerability. The provision of services such as off-the-shelf companies, anonymous accounts and bearer instruments only increases the vulnerability to criminal misuse;

(ii) *The size and maturity of the financial sector and the institutions* – the more immature the centre the less selective it can be as it seeks to maximise business opportunities within a highly competitive market, and therefore the greater its level of vulnerability. There is a similar vulnerability factor for the small immature institution, even within a mature financial centre. The converse also applies in that the more mature the centre, or the larger the institution (especially branches and subsidiaries of international groups), the greater the selectivity of business that is required to protect its reputation;

(iii) *The effectiveness of financial sector supervision* – the nature and level of effective supervision will impact on vulnerability. For example, the rigour of the licensing procedures, the frequency of ongoing compliance monitoring and the extent of variation between supervision of the onshore and the offshore sectors will all affect the integrity and effectiveness of the financial sector;

(iv) *The existence of legislation criminalising money laundering* – opening the doorway to banking information and permitting asset seizure and confiscation will reduce vulnerability;

(v) *The displacement factor* – while money laundering generally begins in the traditional banking sector, as preventative measures are taken in that area, the criminal will extend his activities to the non-banking financial sector where regulation is often less stringent. Ensuring that supervision and regulation of all companies and businesses offering financial services is conducted to similar standards will provide a significant degree of protection.

5.5.3 Empowering the Financial Sector

Legislation on its own is not sufficient to construct an effective regime for preventing money laundering. An appropriate institutional structure within which the law operates is crucial; specific measures are needed to protect the financial sector from being used to launder the proceeds of crime.

Many countries make the mistake of believing that all they need to do is to concentrate their efforts on enacting anti-money laundering legislation and on the role of the law enforcement. Such a strategy may well serve to assist an investigation and prosecution once a crime has been committed, but it will be of little use in preventing the proceeds of criminal activity from entering the financial system, or preventing the laundering of the proceeds of crime.

However, the commitment of the financial sector and its staff to the role that they are required to play is an essential ingredient. Unless the financial sector itself 'buys into' the obligations laid upon it and the underlying procedures, the strategy will have little effect. Hearts and minds must therefore be reached.

The role and contribution of the financial sector should be based upon compliance with the spirit of the Basle Principles, and adherence to the FATF financial sector recommendations. In essence, the financial sector's contribution lies in:

- knowing its customers;
- keeping necessary records;
- co-operating with the enforcement agencies through reporting of knowledge or suspicion about money laundering;
- providing other information promptly when legally required to do so.

However, money laundering legislation is not intended to turn financial institutions and their employees into detectives. Staff should not be expected to go looking for signs of criminal activity, but neither should they be permitted to play a merely passive role. It is important that financial institutions and their staff are trained to recognise indications of money laundering and to report their suspicions at the earliest opportunity. While financial institutions owe a duty of confidentiality to their customers, the maxim that 'there should be no confidence in iniquity' must apply. It is also a fact that no financial institution can afford to turn a 'Nelsonian blind eye' to possible criminal activities being carried on by its customers. Failing to ask the right questions merely to avoid receiving incriminating evidence should not provide any defence against a charge of assisting to launder the proceeds of crime.

The development of financial sector obligations is considered in Chapter 7.

5.5.4 Enforcement Agency Policy

It is only through the full and effective enforcement of laws and regulations that money laundering can be prevented and punished, and the proceeds from illicit drug trafficking and other criminal activities seized and forfeited. The effective enforcement of anti-money laundering legislation requires:

- the accurate and timely identification of persons, accounts and commercial transactions linked to criminal activity;
- the collection and analysis of such information in a timely fashion;
- effective and timely investigations of the illegal laundering of the proceeds of crime in support of criminal prosecutions;
- the tracing and forfeiture of criminal assets.

In order to achieve these aims, it is necessary to consider establishing or designating centres (financial intelligence units) within each country for the collection, analysis and sharing with competent authorities all relevant information related to money laundering. An effective enforcement policy also requires trained financial investigators to investigate suspicions of money laundering and to gather the evidence for a successful prosecution.

The options for financial intelligence and investigation units are set out in Chapter 8.

5.6 Identifying High Risk Business

5.6.1 Treatment of Countries with Inadequate Anti-Money Laundering Regimes

Given the international nature of both the global financial system and modern money laundering techniques, there is a danger that domestic action to tackle the problem will be undermined by criminal proceeds that have been introduced into the financial system from other countries. Once the money is in the financial system, it is harder to recognise its criminal origins, and thus to take action against it. A comprehensive approach to tackling money laundering must therefore include measures to deal with these flows.

Each jurisdiction will need to take a view on those countries that the international agencies, for example IMF, G-7, FATF, OECD, specify as non co-operative jurisdictions and those with serious deficiencies in their anti-money laundering strategies.

5.6.2 Risk Assessment in Financial Services

Commonwealth countries will need to take a view on the level of risk attached to the type of financial services offered within their financial sectors. Countries where cash is the normal medium of exchange will face an additional challenge and may need to consider imposing a mandatory cash transaction reporting requirement (see paragraph 6.4). As stated previously, in paragraph 5.3, the provision of offshore financial services, particularly those involving trusts and IBCs, present additional money laundering risks. Additional regulatory measures may be needed for the higher risk activities.

Financial institutions themselves should be encouraged to take a risk-based approach to the products and services they offer when setting their anti-money laundering policies and procedures. This should involve consideration of the geographical location of their customer base.

5.7 Identifying the Risks and Requirements for E-commerce and Internet Financial Services

E-commerce and the provision of internet financial services add a new risk dimension and open up new mechanisms for fraud, money laundering and tax evasion. FATF Recommendation 13 states:

> *Countries should pay special attention to money laundering threats inherent in new*

and developing technologies that might favour anonymity and take measures if needed to prevent their use in money laundering schemes.

5.7.1 The Potential for E-money Laundering

E-money systems can be attractive to money launderers for two reasons.

Untraceability

E-money systems provide anonymity, allowing the parties to the transaction to deal with each other directly without the intervention of a regulated financial institution. Consequently, the required audit trail may be missing. Powerful encryption may be used to guarantee the anonymity of money transactions.

Mobility

E-money systems may offer instantaneous transfer of funds over a network that, in effect, is not subject to any jurisdictional restrictions. Cash may be deposited into an unregulated financial institution. Placement may be easily delivered using a smart card or personal computer to buy foreign currency or goods.

5.7.2 The Need for Sound Regulation and Due Diligence

To prevent potential misuse of the internet and e-commerce financial services, it is recommended that Commonwealth countries apply the same prudential criteria and supervision when authorising virtual banks as they do to conventional banks. Authorisation should not be permitted if the virtual bank applicant does not maintain a physical presence within the jurisdiction.

Any financial institution offering internet products and services should be required to implement procedures to identify and authenticate the customer at least to the same standards as for face-to-face business. Financial institutions should then be encouraged to consider regular monitoring of internet-based business. If a significant proportion of the business is operated electronically, computerised monitoring systems that are designed to recognise unusual transactions and related patterns of transactions may be necessary to assist in recognising suspicious transactions.

5.8 Managing the Displacement Factors: Parallel Economies, Underground Banking and Alternative Remittance Systems

In many countries it is recognised that there is a significant 'parallel economy' in which money circulates. The global spread of ethnic groups from Asia has provided a world-wide network for the underground banking systems variously known as Hawala, Hundi or Chiti Banking. Through these systems, funds or value can be transferred from individual to individual, or from country to country, or any combination of them. However, the service is provided without questions, and without paperwork or the inevitable audit trail that the recognised banking procedures entail. The nature of the system is such that the anonymity of its customers is assured and those tasked with monetary control and surveillance find it almost impossible to examine.

5.8.1 Criminal Use of Underground Banking Systems

The underground banking system is purpose-made for criminal transactions. As the system does not leave an audit trail, it is easier for the criminal to launder his funds without detection, and consequently to retain their use as legitimate earnings. Evidence shows that criminals involved in illicit arms and gold smuggling, drug trafficking, terrorist-related crimes, fraud, bribery and corruption are using the underground systems on an increasing scale.

There is widespread concern that criminal use of the underground systems will continue to increase as more countries enact legislation to trace and confiscate the proceeds of crime passing through the international regulated banking system.

5.8.2 Implementing Counter Measures

Studies undertaken on behalf of Commonwealth Ministers have identified a number of counter-measures that can be considered for preventing wider use of the underground banking and remittance systems for money laundering:

- increased co-ordination of action within developing countries to conserve foreign exchange and prevent its leakage;
- removing the incentives for use of the underground systems by law-abiding citizens and isolating the criminal use;
- improving regulation and inspection to reduce smuggling and duty evasion
- ensuring that money laundering legislation and regulations embrace within their scope all financial activities, including money transmission and foreign exchange operations, rather than defining the scope by type of institution;
- ensuring that all businesses within the scope of the anti-money laundering legislation are authorised, supervised, inspected and sanctioned for non-compliance;
- introducing the concept of wilful blindness, i.e. that an institution should have known or suspected that the money could not have been legally earned or legally transferred;
- introducing a compulsory transaction reporting requirement linked to a strict regime of monitoring and regulation with criminal penalties for non-compliance.

5.8.3 Counter-Measures using the Interface with the Formal Banking System

The underground banking system is at its most vulnerable when it interfaces with the formal banking system; this interface between the formal and informal sectors may also provide an opportunity for tackling the problem. Financial institutions should, for instance, be encouraged to pay particular attention to the accounts that they suspect relate to underground banking operations – including foreign currency accounts and accounts held by trusts or offshore companies – whether or not the account holders are suspected of direct involvement in money laundering.

5.8.4 Restrictions on the Use of Cash

Cash-based economies are more prone to the increasing and undetected use of underground banking systems. It is therefore important to tackle the cash basis of the parallel economy by measures aimed at reducing the use of cash and, where necessary, improving the efficiency of the domestic banking system to make it more attractive. Where it is practical, salaries could be paid directly into bank accounts. Modern electronic methods of money management, such as the greater use of credit and debit cards, could be encouraged.

An effective intermediate step, however, might be to outlaw the use of cash payments for transactions above a certain size (for example, Italy has taken this approach). Large transactions would therefore require the involvement of financial institutions. This would ensure that those involved in the transactions were subject to formal identification, the transactions would be recorded and the process would be subject to the money laundering controls applied to the formal economy.

Such an approach could be introduced gradually, beginning with a relatively high threshold, which would be gradually reduced as the financial system developed in response to the opportunity that this would present.

5.9 Increasing Public Awareness

The offences and defences under the criminal law will generally need to apply to all citizens.

This will equally apply to anti-money laundering legislation.

For example, it should be an offence for any natural or legal person to provide assistance to a criminal, or to obtain, conceal, retain or invest funds that are the proceeds of criminal conduct. The penalties for committing such an offence without a reasonable excuse, for example that the accused person did not know about or suspect criminal conduct, or that s/he reported their knowledge at the earliest opportunity, should be significant.

However, in many countries where money laundering has been made a criminal offence, there is little public awareness of the reasons for this, or of the public responsibilities that this entails and the penalties for committing an offence. In addition, the responsibilities placed on financial institutions to identify their customers are generally not understood and will often cause inconvenience to genuine customers. Experience has shown that anti-money laundering measures will cause friction between the institutions and their customers if the underlying reasons and the social effects of not taking action have not been adequately explained.

To assist in persuading all citizens and institutions to play their part in the fight against crime and the laundering of the proceeds of crime, Commonwealth countries may wish to consider undertaking a public awareness-raising campaign linked to the effects of crime on society. Criminal money in large amounts, such as that derived from drug trafficking, 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.