6

Criminalising Money Laundering

Criminalising money laundering must be the starting point of any credible anti-money laundering strategy.

> FATF Recommendations 4 and 5 state:
> *Each country should take such measures as may be necessary, including legislative ones, to enable it to criminalise money laundering as set forth in the Vienna Convention. Each country should extend the offence of drug money laundering to one based on serious offences. Each country would determine which serious crimes would be designated as money laundering predicate offences.*
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> *As provided in the Vienna Convention, the offence of money laundering should apply at least to knowing money laundering activity, including the concept that knowledge may be inferred from objective factual circumstances.*

6.1 The Elements of the Vienna Convention

The elements of the Vienna Convention laundering offence, together with illustrations of some of the forms they might take in practice, are set out below.

- **Conversion** – this includes the exchange of one currency for another, or the exchange of cash for travellers' cheques or other negotiable instruments or securities. It covers the trading of securities. It could be taken to include the acceptance of cash or cheques for deposit in an account, converting the money into an accounting record.
- **Transfer** – this covers any form of money transmission service, including wire transfer.
- **Concealment** – this might be taken to cover acceptance of deposits, as well as activities such as the establishment of trusts or companies to hold assets.
- **Disguising the true nature, source, location, disposition, movement, rights with respect to, and/or ownership of funds** – this is very similar to concealment and includes offshore trust and company formation activities.
- **Acquisition** – this might include the receipt of funds through correspondent accounts with other financial institutions, or acceptance as a trustee.
- **Possession** – this might cover holding funds on behalf of another party, particularly when there is a degree of discretion over the disposition of the funds.
- **Use** – this might cover discretionary investment of funds held for a client.
- **Participation, association, conspiracy, attempting, aiding, abetting, facilitating and/or counselling** – this might cover a wide range of advisory services, including investment advice and brokerage services.

6.2 The Commonwealth Model Law

To assist Commonwealth countries to develop their national legislation, the Commonwealth Secretariat has produced a Model Law for the Prohibition of Money Laundering (known as 'the Model Law'). The Model Law is intended for use by common law countries and covers all of the issues addressed by the FATF Recom-

mendations. An 'all crimes' money laundering offence was included.

Commonwealth Heads of Government, at their meeting in Auckland in November 1995, agreed that a common legislative approach would facilitate international co-operation and invited member states to draw benefit from the Model Law.

6.3 Criminal Activities Constituting Serious Crime

In 1995 Commonwealth Heads of Government agreed to tackle the laundering of the proceeds of serious crime. There is however no universal definition of 'serious crime', and it is for each country to determine which predicate offences should be included. There are various approaches that can be taken:

- **Including a list of specific offences** – such lists invariably include drug trafficking, and may also cover blackmail, extortion, kidnapping and other activities associated with organised crime, arms trafficking, financial fraud, fiscal (tax) evasion, bank robbery and other highly profitable crimes. The list is usually capable of extension through secondary legislation.
- **Defining serious crime based on the severity of the sentence** – this may be expressed in terms of the maximum or minimum length of sentence or size of fine available. In some cases, additional highly profitable crimes may be included, even though the actual sentence available is below the chosen threshold.
- **Basing a definition on the category of court in which the prosecution may be conducted** – where there are magistrates' courts covering lesser offences and higher courts covering more serious ones, laundering offences may be restricted to those which can or must be tried in the higher courts.
- **Providing a definition that covers all criminal activity** – this approach would allow laundering prosecutions relating to the proceeds of any criminal activity, including economic crimes.

This is an issue that has been considered by Commonwealth Law Ministers, and in the light of their consideration, the Commonwealth Model Law adopts a definition based on the severity of the sentence. However, this does not preclude the possibility of using other approaches that might be more appropriate in the circumstances of an individual country.

6.3.1 Economic Crimes

A number of countries have deregulated their economies in order to improve the efficiency of production and use of resources. However, the trend towards financial and economic deregulation has both a positive and a negative impact on the problems of economic crime. On the positive side, by removing the regulations and restrictions that are subject to abuse, certain forms of economic crime automatically fall away. For instance, it is impossible to have a crime of exchange control evasion if there are no exchange controls.

At the same time deregulation brings freedoms that can be abused by criminals, particularly those involved in other forms of activity that remain as economic crimes, such as tax evasion and corruption. Many countries suffer from high levels of economic crime which hinder their efforts to achieve sustainable economic growth.

It is important therefore to consider:

- how any approaches to tackling money laundering can additionally be used to combat the laundering of the proceeds of economic crime;
- what steps can be taken to monitor large inflows and outflows of capital/currency once regulations and restrictions are removed.

The issues relating to tax evasion and corruption are considered below.

6.3.2 Tax Evasion

The inclusion of tax evasion within the predicate offences for the criminalisation of money laundering is clouded by the perception that tax evasion is a domestic crime as opposed to an internationally recognised serious crime such as drug trafficking.

Public attitudes towards tax evasion are complicated by the generally held view that the payment of tax is something to be avoided whenever possible. This view generates an ever-growing 'tax planning' industry, serving corporations and individuals (particularly wealthy individuals) and advising them on how to minimise their tax liabilities. This often involves running as close as possible to the line that separates what is legal – tax minimisation – from what is illegal – tax evasion.

While countries that include all serious crimes within the definition of money laundering do not place tax-related offences in a different category from other serious crimes, many countries have taken the decision specifically to exclude tax-related offences from their money laundering legislation. In some countries, tax offences are still subject to the money laundering legislation, but information that might relate to the laundering of the proceeds of fiscal offences is not passed to the revenue authorities until another criminal offence is proved. Other countries have, however, involved their revenue authorities directly in their anti-money laundering regimes, and can effectively offset some or all of the costs of their operations against recovered tax revenues as well as against the confiscated proceeds of other crimes.

Evidence shows that where tax evasion has become a normal activity within a particular country, the inclusion of tax evasion within the criminal activities constituting serious crime can significantly improve government finances through increased levels of tax recovery.

Tax Evasion as a Smokescreen

The lack of consistency in the treatment of tax evasion has provided an additional opportunity for criminals. Money launderers involved in other crimes such as drug trafficking have frequently used tax reasons as a smokescreen for their unusual or abnormal transactions or instructions. In recognition of this growing practice, the FATF provided the following interpretation note in July 1999:

> *In implementing Recommendation 15, suspicious transactions should be reported by financial institutions regardless of whether they are also thought to involve tax matters. Countries should take into account that, in order to deter financial institutions from reporting suspicious transactions, money launderers may seek to state inter alia that their transactions are related to tax matters.*

6.3.3 Bribery and Corruption

Bribery and corruption raise similar problems of definition and ethics. In many countries the practice of offering bribes in order to obtain a contract or other advantage has become a normal part of business life. Likewise, public sector corruption, i.e. the abuse of public office for private gain, has become endemic in some countries. Corruption damages development and the possibility of laundering the proceeds of corruption through the world's financial systems allows it to occur on a massively larger scale than would otherwise be possible. Significant international initiatives are now in place to tackle the problems of bribery and corruption.

The OECD Bribery Convention

One of the major international achievements has been the conclusion of the OECD Convention on the bribery of foreign public officials in the course of international business transactions (the OECD Bribery Convention). Specifi-

cally, the Convention provides that the making or receiving of a bribe should be made a criminal offence and provides for the seizure of the bribe or the proceeds of the bribe.

Grand Corruption

The corrupt diversion of government funds and international aid money has become a significant problem for some Commonwealth countries. Illegally diverted funds are generally laundered through bank accounts, companies or trusts set up in other countries or offshore financial centres. Most financial institutions do not willingly seek to acquire such funds, and many are increasingly refusing to accept them if they are identifiable. The criminal and civil liabilities for banks and others who knowingly or unwittingly launder the proceeds can be significant in addition to the reputational risks.

Financial institutions that know their customers and the sources of their wealth and income can usually be expected to recognise abnormal financial flows and could be expected to become suspicious of the large financial flows generated by corrupt payments. Those funds can then be reported to the relevant authorities and the process of returning them can commence. However, difficulties arise in practice when the financial institution does not know that a foreign customer is a public sector official with potential access to substantial government funds. While there may be no doubt in relation to Heads of State and other very prominent individuals, many will not be recognisable as such.

Commonwealth countries that are vulnerable to high levels of corruption or diverted aid funds might therefore consider maintaining a list of individuals who fall within this category. This could then be made available to international banks through their supervisory bodies and would permit all banks to monitor the accounts of political customers or family members and assist in the reporting of transactions that might be linked to corruption.

6.4 Secrecy versus Confidentiality

Banking confidentiality is widely recognised as playing a legitimate role in protecting the confidentiality of the financial affairs of individuals and legal entities.

This right derives from the general principle of privacy and the concept that the relationship between a banker and his customer obliges a bank to treat all its customers' affairs as confidential. All countries provide, to a greater or lesser extent, the authority and obligation for banks to refuse to disclose customer information to ordinary third parties.

In common law countries, the circumstances when the common law duty of confidentiality between a financial institution and its customers may be breached are set out in the Tournier decision (Tournier v National Provincial and Union Bank of England, 1924). The three most important of these circumstances in the context of money laundering are:

- ❖ when the bank is required by law to breach confidence;
- ❖ when breach of confidence is necessary in the bank's own interests;
- ❖ when breach of confidence is in the legitimate public interest.

Money laundering legislation normally defines circumstances in which a financial institution is required to disclose information to a designated authority. The financial institution is therefore protected from suit for breach of confidentiality by the need to disclose under compulsion of law.

Where banking confidentiality is enshrined in statute, it may be necessary to ensure that money laundering legislation provides adequate gateways (with appropriate checks and balances) through the confidentiality provisions to permit the disclosure of suspicions. Most confidentiality legislation permits financial institutions to pass on knowledge of criminal activity to the authorities, coupled with explicit statutory protection from breach

of customer confidentiality.

However, some Commonwealth countries extend customer confidentiality beyond the common law right, to the statutory right to secrecy. In these cases, legislation will usually provide that banks and other financial institutions must maintain, as secret, information concerning their affairs. Any person who discloses information relating to the identity, assets, liabilities, transactions and accounts of a customer will commit a criminal offence.

To be effective, anti-money laundering legislation must allow financial institutions to pass on their knowledge and their suspicions of money laundering to the relevant authorities. The continued existence of banking secrecy legislation, rather than merely a customer's right to confidentiality, will prohibit the development of an effective anti-money laundering strategy.

Commonwealth countries should also be aware that if banking secrecy legislation prohibits disclosure of customer information in response to a Foreign Court Order or a US subpoena in respect of a criminal investigation, that country will be officially classified by the FATF as a non co-operative jurisdiction (see Chapter 3, paragraph 3.3).

6.5 Implementing a Requirement to Report Knowledge or Suspicion of Money Laundering

In order for a national strategy to succeed, it is essential that financial institutions (and within them, individual members of staff) are required, by statute, to report any knowledge or suspicion of money laundering.

6.5.1 Determining Reporting Requirements

The FATF Recommendations recognise two different approaches to the task of reporting.

Firstly, institutions can be required to report knowledge or suspicion of money laundering related to specific customer or transactions; this is known as suspicious transactions reporting. FATF Recommendation 15 states:

> *If financial institutions suspect that funds stem from criminal activity, they should be required to report promptly their suspicions to the competent authorities.*

Secondly, institutions can be required to undertake routine reporting of transactions above a specified threshold; this is known as currency transaction reporting (CTR). FATF Recommendation 23 states :

> *Countries should consider the feasibility and utility of a system, where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount to a national central agency with a computerised data base, available to competent authorities for use in money laundering cases, subject to strict safeguards to ensure proper use of information.*

6.5.2 Suspicious Transaction Reporting

The idea that financial institutions should spontaneously report to the authorities transactions that they have conducted merely because they are suspicious of those transactions, or consider them to be unusual, is perhaps the most radical element of the suggested approach to combat money laundering. It often runs counter to other legislative/contractual commitments and to the natural instincts of most financial institutions, which place very strong emphasis on customer confidentiality.

Why Should Financial Institutions Report Suspicious Transactions ?

There are two main reasons why financial institutions should co-operate in combating money laundering by disclosing details of suspicious transactions.

The first is essentially a moral one. Financial institutions are 'good citizens' who have a duty to uphold the law, and this duty may at times override the duty of confidentiality that they owe to their customers if there is legitimate suspicion of wrong-doing. This issue of

confidentiality is discussed in more detail below.

The second reason why financial institutions should report suspicious transactions is that of simple self-interest – they need to protect themselves from fraud and protect their reputations. The basis of trust on which the financial system operates can easily be undermined by the involvement of financial institutions in criminal activity, even if the involvement is unintentional.

A financial institution that discovers it is holding criminal proceeds may be subject to criminal penalties under the common law (as an aider or abettor), or to a civil suit for constructive trust, even in the absence of anti-money laundering legislation. By disclosing its situation to the authorities, a financial institution will be able to put itself in a safer position.

The options for establishing a central agency to receive and evaluate the suspicion reports is set out in paragraph 8.1.

6.5.3 Protection for the Reporting Institution

While the legal situation protects financial institutions from civil action by clients or criminal liability for breach of confidence, it does not protect staff from reprisals if the fact that a disclosure has been made becomes known to the customer. This problem becomes significantly more acute if the report is made directly to the law enforcement agencies by the member of staff who is handling the transaction.

In some countries, legislation requires the identification of a senior manager within the institution who has responsibility for considering all 'suspicions', deciding if they should be passed to the authorities and generally controlling the institution's reporting procedures. This role is often referred to as the 'Money Laundering Officer'.

6.5.4 Currency Transaction Reporting

Under a Currency Transaction Reporting regime, financial institutions report any transaction or transfer of funds above a fixed threshold to a central agency. This information is then put on a database and made available to investigators.

CTR regimes can impose significant compliance costs on financial institutions and their customers, and if the reporting threshold is set at an inappropriate level they can lead to the agency to which the reports are being sent being overloaded with information. This will make it more difficult to analyse the information and identify money laundering transactions. However, from a government viewpoint, a well-run CTR system can potentially cover its costs. If resources and expertise are available to establish and maintain a computer-based CTR system, and the data are made available to revenue authorities for the pursuit of tax evasion, this may be an attractive option for some Commonwealth governments.

A CTR system is often deemed to prove helpful in three situations:

- where it is considered that the quality and educational standards of many staff, or the standard of the systems within financial institutions, are insufficient to exercise and apply the judgement necessary in a suspicion-based reporting regime. This may be considered a short-term phenomenon and implementing a routine CTR system may be an expedient starting point, legislation permitting;
- as a first step in monitoring and reporting. With money laundering, one of the choke points is at the point of conversion of notes into instruments (cheques, money transfer orders, etc.), with the most likely being the conversion of convertible currencies. Therefore, in the early stages of a strategy, the routine reporting of convertible currency transactions (thus excluding the more numerous domestic currency transactions) may be an effective initial option;

- the application of money laundering legislation to tax evasion and other forms of economic crime has the potential to improve government finances through increased levels of tax recovery. Where the fiscal benefits are potentially very high, there is scope for the introduction of a CTR system.

Often the most effective anti-money laundering regimes require both CTR and suspicion-based reporting, but CTR alone has been found to be ineffective.

6.5.5 Reporting International Capital/Currency Movements

While deregulation and liberalisation of the financial system require the removal of controls and restrictions over the 'free' flow of currency and capital, many jurisdictions maintain or implement a reporting procedure to permit the ongoing monitoring of such movements. Financial institutions may be requested to report to the Central Bank all movements of capital/currency, over a specified financial threshold, into and out of the country. Such a reporting procedure serves two purposes:

- it provides the Central Bank with essential statistics and information in respect of the balance of payments and other indicators;
- it also provides the Central Bank with the opportunity to recognise any unusual flows of capital/currency (by size, by source or by destination) which may be suspicious and warrant further enquiry.