

What is money laundering?

According to one political commentator it is all about deception, its aim is to convince relative authorities of the legal origin, existence and/or application of illegal sources of income and the subsequent possession of that income. Money laundering plays a fundamental role in facilitating the ambitions of drug traffickers, terrorists, organised crime syndicates, inside dealers, tax evaders as well as many others who need to avoid the kind of attention from authorities that sudden wealth brings from illegal activities. This facility is the placing of such proceeds beyond the reach of asset forfeiture laws. Hence, money laundering is an essential task carried out by all organised crime groups, and therefore if treated and analysed properly could be the tool with which authorities could prosecute organised crime syndicates. This is a definition given with by one political commentator on the matter; the concept is still a subject of controversy in criminological parlance. Many of the definitions given by the individual FIUs in various countries are related to money laundering in the context of drug trafficking, but as has been mentioned previously it is not just drug traffickers that must launder money but all organised crime syndicates.

Another definition is *"The conversion or transfer of property, knowing that such property is derived from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence or offences to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from serious crime"*

The UN defines it as *"Money laundering is a process which disguises illegal profits without compromising the criminals who wish to benefit from the proceeds. It is a dynamic three-stage process that requires: first, moving the funds from direct association with the crime; second, disguising the trail to foil pursuit; and third, making the money available to the criminal once again with the occupational and geographic origins hidden from view".* [United Nations Global Programme Against Money Laundering](#) .

Methods and Stages of Money Laundering

There are three stages involved in money laundering; placement, layering and integration.

Placement –This is the movement of cash from its source. On occasion the source can be easily disguised or misrepresented. This is followed by placing it into circulation through financial institutions, casinos, shops, bureau de change and other businesses, both local and abroad. The process of placement can be carried out through many processes including:

1. *Currency Smuggling* – This is the physical illegal movement of currency and monetary instruments out of a country. The various methods of transport do not leave a discernible audit trail [FATF 1996-1997 Report on Money Laundering Typologies](#).
2. *Bank Complicity* – This is when a financial institution, such as banks, is owned or controlled by unscrupulous individuals suspected of conniving with drug dealers and other organised crime groups. This makes the process easy for launderers. The complete liberalisation of the financial sector without adequate checks also provides leeway for laundering.
3. *Currency Exchanges* – In a number of transitional economies the liberalisation of foreign exchange markets provides room for currency movements and as such laundering schemes can benefit from such policies.

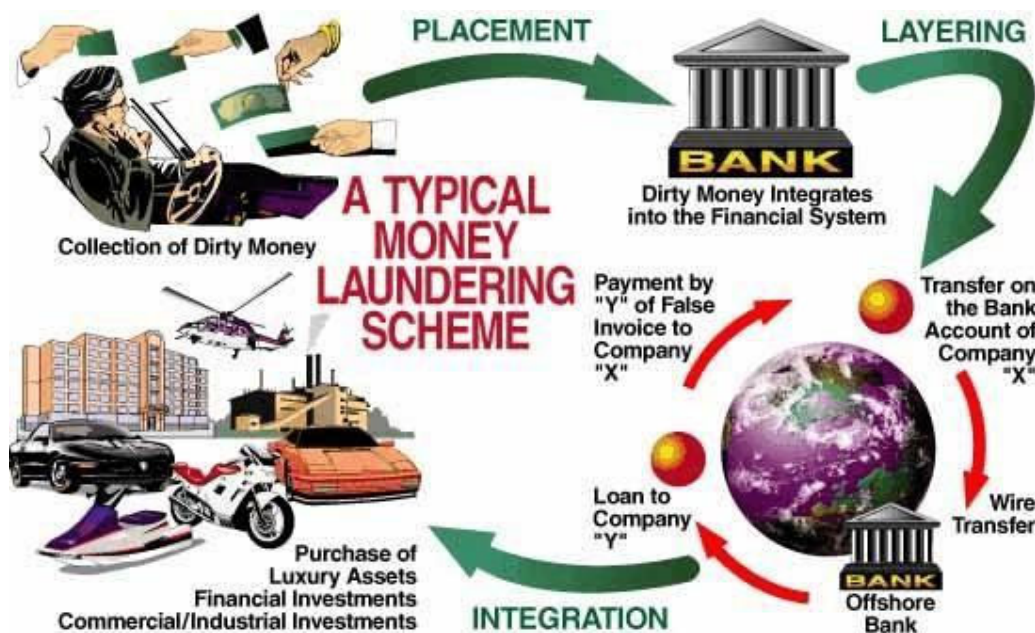
4. *Securities Brokers* – Brokers can facilitate the process of money laundering through structuring large deposits of cash in a way that disguises the original source of the funds.
5. *Blending of Funds* – The best place to hide cash is with a lot of other cash. Therefore, financial institutions may be vehicles for laundering. The alternative is to use the money from illicit activities to set up front companies. This enables the funds from illicit activities to be obscured in legal transactions.
6. *Asset Purchase* – The purchase of assets with cash is a classic money laundering method. The major purpose is to change the form of the proceeds from conspicuous bulk cash to some equally valuable but less conspicuous form.

Layering – The purpose of this stage is to make it more difficult to detect and uncover a laundering activity. It is meant to make the trailing of illegal proceeds difficult for the law enforcement agencies. The known methods are:

1. *Cash converted into Monetary Instruments* – Once the placement is successful within the financial system by way of a bank or financial institution, the proceeds can then be converted into monetary instruments. This involves the use of banker's drafts and money orders.
2. *Material assets bought with cash then sold* – Assets that are bought through illicit funds can be resold locally or abroad and in such a case the assets become more difficult to trace and thus seize.

Integration – This is the movement of previously laundered money into the economy mainly through the banking system and thus such monies appear to be normal business earnings. This is dissimilar to layering, for in the integration process detection and identification of laundered funds is provided through informants. The known methods used are:

1. *Property Dealing* – The sale of property to integrate laundered money back into the economy is a common practice amongst criminals. For instance, many criminal groups use shell companies to buy property; hence proceeds from the sale would be considered legitimate.
2. *Front Companies and False Loans* – Front companies that are incorporated in countries with corporate secrecy laws, in which criminals lend themselves their own laundered proceeds in an apparently legitimate transaction.
3. *Foreign Bank Complicity* – Money laundering using known foreign banks represents a higher order of sophistication and presents a very difficult target for law enforcement. The willing assistance of the foreign banks is frequently protected against law enforcement scrutiny. This is not only through criminals, but also by banking laws and regulations of other sovereign countries.
4. *False Import/Export Invoices* – The use of false invoices by import/export companies has proven to be a very effective way of integrating illicit proceeds back into the economy. This involves the overvaluation of entry documents to justify the funds later deposited in domestic banks and/or the value of funds received from exports.



Factors that facilitated and sponsored the explosion of money laundering

1. The globalisation of markets and financial flows, most evident in the advent of the Internet. The creation of the single market means that money can now travel in nanoseconds, meaning that multiple jurisdiction leaps are made effortlessly on a daily basis.
2. Deregulation of financial markets has brought with it no consistency or coherence in respect of anti-money laundering regulations; simultaneously today's global market place has brought with it very few if any restrictions.
3. Globalisation implies global competition, meaning more competitors and increasing pressure to deliver profits. The proceeds of crime are massive meaning that the people who control them can yield great influence with legitimate businesses, which are hungry, sometimes even desperate for profits.

The funds involved in money laundering are increasing rapidly and the most recent estimate provided by the FATF suggests that the aggregate size of global money laundering is between 2% and 5% of world economic output, or between \$590 billion and \$1.5 trillion, most of which is gained from illicit drug trafficking, but also from corruption, fraud and organised crime.

The Internet and Money Laundering

According to some commentators on money laundering the Internet provides a new and undetectable method of money laundering, otherwise known as cyberlaundering. Yet, according to Nigel Morris-Cotterill in his book *How Not to Be a Money Launderer*, 2nd edition (Brentwood: Silkscreen Publications, 1999), the Internet is nothing more than a messaging system. To move money, banks move information by whatever messaging system available:

from physically moving lumps of gold from one place to another to processing checks. In this context, the Internet is simply an updated check system or a more efficient, cheaper, and more secure means of moving financial information. The FATF has pointed out that identifying customers is the primary problem arising from Internet usage, and that problem is just the same in any relationship conducted at a distance.

However, some use claims of cyberlaundering as an excuse to move towards more extensive regulation of the Internet. Even if it were possible to create effective regulation of the Internet—a dubious proposition—such an undertaking merely would raise the barriers to entry for poor nations. The Internet can benefit large parts of the world at a low cost by reducing isolation and allowing remote communities the chance to provide services and publish catalogs of locally produced goods. Tighter regulation would only exacerbate the "digital divide" between rich and developing economies.

Macroeconomic Consequences of Money Laundering

The integrity of the banking and financial services marketplace is heavily reliant on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is perhaps one of the most valuable assets of a financial system and institution. Therefore, on a macro level, money laundering poses a risk to confidence in the financial system and its institutions. *"The soundness and confidence in the financial system as a whole could be seriously jeopardised thereby losing the trust of the public..."* if the financial system is caught laundering criminal proceeds (Gordon Brown, speech on money laundering on 28 November 2000). The Bank of England is making a concerned effort to ensure that the City of London upholds its reputation as a 'clean' financial centre. Given the emphasis on name and reputation in attracting and maintaining business in the finance world, it would not be difficult to imagine the decline of a reputable financial centre were it to become synonymous with laundering criminal proceeds. Hence, the importance of confidence and the need for transparency in the financial system should not be understated, especially as in the case of the City of London; it makes a significant contribution to certain country's Gross Domestic Product (GDP).

Other potential macroeconomic consequences of unchecked money laundering have been cited by the [International Monetary Fund](#) as inexplicable changes in money demand, contamination effects on legal financial transactions and increased volatility of international capital flow and exchange rates owed to unanticipated cross-border asset transfers. The latter point is especially important and poses a big risk to the EU financial system as money laundering has a direct effect on the Foreign Exchange Market (FOREX) of an economy. The FOREX market is vulnerable owed to the volume of cash involved in the trade. The apparent fund movement, especially from illegal sources, from one jurisdiction to another is capable of exacerbating the exchange rate volatility. This can be devastating especially when there is no corresponding increase in production: hence the domino effect on regulating cash flow and inflation.

The Risks to Financial Institutions

Financial institutions, such as banks, stockbrokers, life assurance firms and so forth, who either intentionally or unintentionally launder money, are also at risk and is another problem associated with money laundering. Banks are susceptible to risks from money launderers on several fronts. There is a thin line between a financial institution suspecting that it is being used to launder money and the institution becoming criminally involved with the activity. Banks that are exposed as laundering money are most certain to face costs associated with the subsequent loss of business on top of vast legal costs.

At the very least, the discovery of a bank laundering money for an organised crime syndicate is more than likely to generate adverse publicity for the bank. This is exemplified by the case of E.F.Hutton, a US brokerage house that received a fair amount of negative publicity for laundering criminal funds. A lack of confidence in a banking institution is likely to result in declining business as clients take business elsewhere.

However, a much graver risk that banks face is the risk of criminal prosecution for laundering money whether they know the funds are criminally obtained or not. There are EU laws and directives stating that if a financial institution in the EU is found to be assisting a money launderer and failed to follow the appropriate procedures as laid out by the EU, the individual employee and respective supervisors, including company directors are personally liable to imprisonment or fines or worse both. Seldom are bank directors aware that their institution is being used to launder money. The scenario is usually one employee colluding with a criminal group; this employee will circumvent the bank's depository procedures to launder money. However, the bank is still liable for the actions of its employees. Hence, it being essential that banks adopt and enforce the new legal procedures in deposit taking and keep tight controls on staff likely to be useful to money laundering. This is also the reason why the EU directives on money laundering include the 'know your customer' initiative.

fully paid, as the contracts purchased may be only one step in the course of a complex laundering chain that is untraceable. Thus, it is a probable scenario for huge losses to be incurred by legitimate investors, causing damage to the derivatives markets.

Hence, money laundering could pose a huge and worrying problem to the financial system of the EU. The various techniques used by organised crime syndicates could most definitely cause a lot of damage and should not be underestimated. Any damage caused by money launderers to the financial system in its entirety has the potential to affect all peoples of the EU.

A Conflict of Interest?

There are in fact two conflicts of interest that arise with banks compliance to such laws. Firstly, in this competitive world, bank officials are constantly under increasing pressure to bring in new business and increase profits. Indeed, it has been suggested that the only reason why many western banks stay afloat is because of the money laundering services they offer and perform. This can be exemplified by the case of the Bank of Credit and Commerce International (BCCI). In this case the bank needed to earn profits in order to cover up the huge losses from loans and trading and the simple solution of money laundering provided an easy way of doing this. The second conflict is that certain banks and countries have a competitive advantage in providing private banking services, i.e. client confidentiality. Bank secrecy laws exist in fifty nations around the world and for such banks this is a necessity for attracting clients. Any moves to abolish or continually override such laws are likely to be strongly opposed.

Social and Political Costs

There are also social and political costs of money laundering, which have the capacity to be serious if left unchecked or dealt with ineffectively. Laundering is a natural by-product of financial fraud; but simultaneously fraud is also a continuance, in some cases, of laundering where the fraud itself is financed by the proceeds of an earlier crime. Organised crime syndicates can infiltrate financial institutions and acquire control of large sectors of the economy through investment. Organised crime syndicates are in an opportune position to offer bribes to public officials and indeed governments. This implies corruption and laundering go hand in hand. The influence of organised crime syndicates in the economic and political sphere can weaken the social fabric, collective ethical standards and ultimately the democratic institutions of society.

However, what is probably of most importance is the fact that money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue. It is the dynamic that allows criminal activity of all descriptions to grow and expand. This process –the delivery channel of clean funds –is now so embedded

in the 'normal' business environment that chances of controlling it are small and therefore chances of eradicating it are slim to nothing.