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Let it all come out in the Wash: Heavy Duty Action Required

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Let it all Come Out in the Wash; Heavy Duty Action Required.

University Honors Senior Project
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Let it all Come Out in the Wash; Heavy Duty Action Required

The purpose of this project is to further research the process of money laundering, what it does, what is being done about it, and how can it be reduced. Money laundering is the act of "cleaning dirty money" by exchanging it with fresh money. The "dirty money" are profits or proceeds that come from or are going to illegal activities. Terrorists, gangsters, and white-collar criminals are often associated with laundering money. Currently, with the War on Terror, many new tools have become available to law enforcement. However, money laundering is a crime that is nearly impossible to detect in its late stages and must be identified early. It is too much to hope for that money laundering can be brought to a halt, but it is entirely possible that new methods may be discovered with which to fight the crime of money laundering.
Let it all Come Out in the Wash; Heavy Duty Action Required

Money laundering is a serious financial crime that affects all nations around the globe. In fact, if it were categorized as a country’s economy, yearly money laundering funds would equal Spain’s economy\(^1\). While it is not known how much money is laundered every year, a 2002 United Nations report pegged the amount around $6,000 billion of which only around 2% is seized per year\(^2\). Numerous criminal and terrorist organizations use money laundering to funnel funds through legitimate businesses into illegal enterprises. These businesses act as a smokescreen to conceal the destination of the money. It is a crime that leaves a difficult trail to follow, owing to the trillions of transactions processed every day around the globe. Where the money goes, how it slips past screens, and what can be done to improve the process of detection are important areas I would like to address in this paper. Also, I will propose how to reduce the ways money can be laundered due to more effective legislation, identification of weak points, and an increase in punishment for those caught for money laundering.

Owing to the difficulty in tracking these funds, understanding how money is laundered is the first step to stemming the flow. In the first step of the process, money is taken from its illegal acquisition by placing it in a financial location for later conversion. Because they are heavy cash industries banks, casinos, and antique dealers are prime locations for swapping out money from illegal activities. It is difficult to regulate these private industries without heavily affecting businesses. In the case of banks, they are


already the most heavily regulated industries in the United States. Due to trillions of transactions throughout the world every day, it becomes very difficult to pick out those that might be illegitimate.

The next step in the laundering process is layering the money, which involves concealing the true origins of the funds by completing numerous transactions that will become difficult to trace throughout the vast financial network. This is the most complex stage, and once money goes through this process, it is very difficult to pick up. Experienced accountants and others in non-financial jobs aid money launderers by working the ins and outs of the network. The electronic network in place by financial institutions also aids money laundering in several ways. Just as it speeds up legitimate transactions, it does the same for money laundering. The addition of increased capability leads to increased chances to launder money. The more transactions that are added in, the harder it is to pick out funds that are "dirty."

The final and most compelling step in the process is the integration into the economy. Here is where the money is swapped out at its final destination. Due to the efficiency of the global network, the entire process can be done over the course of several days. If investigators do not know what to look for, the odds are very slim that they will be able to find any trace of wrongdoing. The complex process takes very little time, and within hours to days, the money disappears.

For a more concrete view of how the entire process works, we can examine an actual instance that happened to Maytag. Maytag is a huge American producer of appliances and ships its products worldwide. In this instance, Maytag was unknowingly an intermediary in a drug profits laundering scheme. Here's how the process worked: A
Colombian drug lord wanted to convert dollars earned in the United States into pesos at home. At the same time, a Colombian importer needed dollars to pay for Maytag refrigerators bought in the United States and shipped into Colombia. A peso broker swapped their respective currencies, and Maytag ended up with drug money for its refrigerators. Pesos went to the drug lord with no paper trail except from the peso broker. The refrigerators went through legal distribution channels to enter Colombia\textsuperscript{3}. The only reason this was discovered was due to the knowledge of the drug lord. The FBI had been keeping an eye on all of his transactions and discovered the trail of dirty money across international lines.

A simpler example involves basic gambling. Casinos operate very heavily on cash-based revenues. It is quite an easy task to take ill-gotten funds into a casino, trade them in for chips, play a few games, and cash out again, taking different bills out. The criminal behind the scheme is willing to lose a little money in order to change out what he or she brought in. Nobody except money laundering rings ever cares what bills they get.

The Financial Action Task Force on Money Laundering (FATF) published 40 recommendations in 1990 to countries in an effort to curb the spread of money laundering. However, a closer look at these recommendations reveals them to be very general and broad, including such things as due diligence in keeping receipts. These recommendations are things that should be already standard practices. While more stringent laws are needed in order to keep money laundering to a minimum, work also needs to be done to protect the privacy of individuals who are not committing a crime.

\textsuperscript{3} Clark, Don. “Money Laundering and Maytag.” Discussion with Dr. Don Clark. University of Tennessee. 17 November 2004.
Banks are often the unwilling (or in some countries, the willing) victims of money laundering. The efficiency and relative strength of U.S. banks make them appealing targets. Because large amounts of cash are often seen as suspicious, criminals will often work through several banks to keep cash exchanged at a level that will attract little attention. While not the easiest way to launder money, it is accomplished with immense complexity and great speed, especially with electronic funds and over fairly short distances. The increased efficiency of strong banks is more alluring than other institutions that might be more risky.

However, the financial sector is not the only area being associated with money laundering. The FATF, in a 1997-1998 study involving the fields of accounting, auditing, and real estate, found that money laundering had been shifted to these fields to avoid legislation. Even as a country has tightly regulated its financial sector to keep dirty money out, the weak link is still present in the non-financial sector. With the trend toward globalization, an international solution is needed for handling this task.

Picking out illicit funds becomes much more complex when dealing with international rings. The United States is often a starting place for money laundering. Money is placed into our financial centers due to their efficiency and speed. Funds are often funneled through places with more lax banking laws. PriceWaterhouse Coopers, an international accounting firm, reported in February 2002 on countries failing international standards.

"The FATF has "black-listed" nineteen countries in the world for falling short on international money laundering policies. These countries include 3 in Europe: Russia, Ukraine, and Hungary. Central America and the Caribbean have 5 non-performing countries which are: Dominica, Grenade, St. Kitts & Nevis, St

Various countries have varying standards of banking. Most people know of the iron-clad security of anonymous Swiss bank accounts. However, Switzerland’s banking industry is coming under pressure from the European Union (EU) to lift some of the veil of secrecy around the business. In a Wall Street Journal article from November 2004, Swiss banks are reported to have signed an agreement with the EU regarding placing a withholding tax on EU customers. By placing a tax on the account, it becomes easier to see who banks within the Swiss borders: just look at who pays the taxes. Findings can be revealing—for example, when it is noticed that 56% of Switzerland’s banking assets come from outside the country. A criminal or terrorist organization often has assets in Switzerland because of that country’s tight protection of customer identities. Most accounts have no names attached to them, only account numbers. This helps protect client confidentiality but also protects people who would rather not have their money’s whereabouts known. It also makes it easier to move money into the country and keep it there for safety. The government may examine records, but only in the case of a criminal investigation after the fact or in the case of money laundering.

Switzerland is on one end of the pendulum. Swiss bank accounts are known for their security and secrecy. Most accounts in banks there are known only by numbers, with no names attached. The blacklisted countries often have few banking laws, and the ones that are on the books generally seem to be for looks. Most of those countries on the

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list are developing countries and need money regardless of its origins. This problem, where corruption enters the picture, is discussed later.

Banking secrecy is also tied in to the problems of money laundering. Secrecy between banks and clients has often been compared to client confidentiality agreements between lawyers and clients and doctors and patients. Banks and financial institutions assume a protectorate role against third-party intrusions from outside sources to protect their client’s interest. Banking information can reveal a wealth of information about an individual, from what they buy to what causes they support. When money laundering charges enter against a bank’s client, they must abide by the law and turn over relevant documents to authorities. However, these charges must carry significant weight in certain countries. In Switzerland, the “intentional and negligent disclosure of secret banking information is punishable by criminal penalties.” With these restricting penalties, banks must be absolutely sure about the charges before they do anything.

After the terrorist attacks on September 11, 2001, police agencies around the world gained increased powers to search financial records of suspected terrorists or other criminals in order to put a stop to illegal financing. In November 2001, governments had already frozen more than $43 million suspected of being linked to terrorist groups.

However, Islamic fundamentalists have found ways to use the financial system to their advantage. In Islamic countries, a money exchange system called the *hawala* is set up to provide channels to thousands of outlets around the world (Time). Using this

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system, transactions less than $1,000 can be sent all over the world instantly. The system is based on a fundamental principle of Islam. Donating money and helping the poor as a religious obligation have priority over government standards. The system itself is based on trust with little documentation, allowing widespread abuse of a system set up with good intentions. This is opposite from exchanges in most Western countries, and it is easy to see why it would be a preferred method. By recognizing this system as a valuable asset, terrorist groups are able to repeatedly send small amounts of money to other groups throughout the world.

Technology has also become a frighteningly efficient way to launder money. As in an earlier example, casinos again are targets, only this time they are online venues. The same rules apply here, with the money sitting in an account being used to play online. When the player decides to quit and cash out, new money is issued. Here, online casinos are also at risk when it comes to locations. Many popular online casinos are offshore, making it difficult to work with host governments to obtain records important for prosecution. The technological aspect is becoming more standard when looking at global commerce. According to an issue of the Journal of Money Laundering Control, a statistic concerning global e-commerce stands out: In Finland, 85% of transactions are completed online. In 2001, the last year info was available, the same journal estimated that cyber-laundering is running at around $50 billion a year and will probably continue to grow by leaps and bounds.10

There are several reasons for such unrestrained growth. First and foremost, the anonymity of the Internet protects perpetrators from casual inspection and creates a

tangled web for investigators to follow. With use of pseudonyms, it becomes difficult to track an individual throughout cyberspace. The longer a person can evade the authorities, the more he or she learns and can therefore work more effectively. While the learning curve is a detriment to investigators, they are also learning better tracking techniques and what to look for. In this instance, an investigation can be compared to a sweater. Once a thread is found, all it takes is for someone to keep pulling to reach the end.

Access is another benefit to using the Internet for laundering purposes. As was explained, identity is fairly easy to mask on the Internet. The next advantage comes from being able to get to accounts from almost anyplace. With computers everywhere, no one ever thinks twice about seeing someone using the Internet for financial transactions. A casual observer would be unable to tell whether someone is engaging in illegal activities or simply executing transfers. In America more than most other places, computers are often available throughout many parts of the country—in libraries, universities, and other public places. A personal computer is also always accessible but carries more risk than using a public one.

The ability to reach over national boundaries is also a beneficial element to a launderer and presents sticky issues to regulatory bodies. What country has primary responsibility? Is it the country where the launderer is located? How about where the money is going? What about where the server is located; do they have responsibility? The correct answer to these questions is that they all have equal responsibility to work together to prevent this crime from continuing.

However, how do countries trust each other to work together effectively before a trail disappears? One suggestion is that cases reaching across borders be turned over to
Interpol, the international police agency.\textsuperscript{11} This would allow countries to be “off the hook” as far as investigating is concerned. Also, Interpol would have more specialists in a field such as this than most developing and some developed countries. By allowing a “neutral” investigative agency into a country, Interpol might be able to delve deeper into surrounding areas than local governments cannot or will not. Another idea is that Internet Service Providers keep more detailed subscriber records that can be produced in a timely manner. In the United Kingdom, these suggestions are under attack from privacy advocates. Most people are not pleased with having their Internet surfing patterns on become an investigative matter. However, there must be some sense of regulation in order to keep money laundering under control.

How can someone spot cyber laundering? According to a 1999 report from the U.S. Office of the Comptroller, banks should be on the lookout for unusual requests or timings of transactions, incomplete online account applications, and potential customers who refuse to submit information for incomplete applications\textsuperscript{12}. Investigators must be very discreet due to the nature of the case. Because money can disappear in the blink of an eye, investigating laundering cases can be very frustrating. Most law enforcement officials try to find the money first and the criminal second. Without the money, there is no case against the criminal. Freezing assets often comes with a set of conditions, so care must be taken to satisfy them.

What are steps being taken now to combat money laundering? FATF is the main international body dealing with the problem; however, they have no real regulatory


power. Different areas of the world deal with the problem differently. According to the Journal of Money Laundering Control, money laundering is an international problem and must be combated as an international body.

Europe is an area that is ripe for money laundering, being connected closely to Africa, the Middle East, and Asia. The European Parliament is interested in expanding the regulation of industries not directly connected with the financial services industry, including lawyers, accountants, real estate managers, notaries, and auditors. Requirements would include new standards for keeping records of client identification and reporting suspicious transactions. In keeping with client confidentiality, lawyers would be given the option of reporting to a professional body rather than a financial intelligence unit.13

Similar legislation is being undertaken in the United States and Canada. Here at home, the Justice Department has been researching thresholds for financial institutions to report suspicious transactions. The first limit set was at $500 but was ultimately thrown out because it would present an undue burden on the financial industries. A limit of $2,000 was decided on in 2000 to be put in place in 2001.14 The U.S. has also decided to focus on using external accountants and auditors to look into suspicious businesses and to study the books of suspected companies. In addition, the Treasury Department has set up a study to examine how accountants in other countries deal with detecting financial fraud.


Canada has mimicked many practices put into effect by the United States after criticism from the FATF due to poor reporting practices.

New Zealand and Australia round out the regions of the world examined in the study. Both countries have expanded definitions of financial services to encompass those businesses previously overlooked. In Australia, the Financial Transactions Report Act of 1988 requires cash dealers to report suspicious transactions and transactions involving the exchange of more than $10,000 into a foreign currency. In addition, the act also requires that the dealers have identification of who owns accounts or becomes signatories on those accounts. Finally, the act also made owning an account in a false name a felony, a move that was a long time in coming.

However, as mentioned before, it is in more developing countries that most laundering takes place. India, steadily becoming an industrialized nation, was one of the first to pass money laundering laws. In 1939, before the outbreak of World War II, India enacted a set of rules to limit capital flight.\footnote{Kumar, B.V. "The Prevention of Money Laundering in India." \textit{Journal of Money Laundering Control.} Autumn 2003. Vol.7 Issue 2.} While its main purpose was to preserve capital, it was an effective deterrent to financial crime. More recently, India has passed the Money Laundering Prevention Act of 2002. Some of the more important parts of the act include:

- "Declaration of laundering of monies earned through serious crimes, a criminal offense."
- Additions to disclosures that financial institutions must issue
- "confiscations of the proceeds of a crime"
- "declaring money laundering to be an extraditable offense."
- Promote international cooperation in stemming the flow of money laundering.\footnote{Kumar, B.V. "The Prevention of Money Laundering in India." \textit{Journal of Money Laundering Control.} Autumn 2003. Vol.7 Issue 2.}
These standards will increase the amount of power that India's government will be able to wield in financial crimes. The ability to extradite criminals will also help strengthen international cooperation since India can no longer be seen as a haven for operating across national borders. India is a crucial point for cutting off funds from illegal operations. In addition, as a growing superpower, India must be able to show the international coalition that it is ready to shoulder responsibility as a global leader.

As discussed, countries all over the world deal with the problem of money laundering in different ways. However, there needs to be a united front against this and other financial crimes. The FATF needs to be given real power in order to enforce "recommendations" and the United Nations needs to take a more active role in getting infrastructure in place to uphold these standards. As a first proposal, I would recommend something that the United Kingdom has had in place since 2003. The Money Laundering Regulations of 2003 have five pertinent points from which most countries would benefit if they included them in their by-laws.¹⁷ In the United Kingdom, failure of any of these points is a criminal offense.

The first point involves the appointment of a government nominated officer. This officer would be head over an agency's records, ultimately in charge of signing off on records of interest as genuine or not. Although an opportunity of corruption exists, there are still four other crucial points to this legislation.

The next part of the act includes the training of a knowledgeable, competent internal staff. These positions would be mainly clerical albeit highly sensitive. Jobs would include fact-checking, appropriate filing, following up with investigative agencies,

keeping duplicate records to reduce the risk of altering of primary documents, and generally supporting the head officer.

The third part of the regulatory act would be one of the most crucial. The identity of clients is becoming critical to investigating cases of money laundering. The internal staff would be concerned with keeping documents valid by determining the correct identity of clients. Since most people who launder money use false identities, this would be one of the more difficult jobs to work with. That is another reason why the internal staff must operate independently and work closely with police agencies to follow up with names and other confidential information.

The fourth aspect of the regulatory laws would be the timely keeping of records. As mentioned before, ideally the staff could operate independently to keep it free of corruption from other agencies or the chief officer.

The final aspect of the British law is the placement of reporting procedures. As the most important part of the bill, this deserves the most attention. It also is highly dependent on the other parts of the bill being done correctly. Many times illegal activities are not caught because information is not reported correctly. I propose that this bill is something that could be emulated and copied in other countries. However, there are problems with this bill as well.

The United States has a bill currently in effect for its own fight against money laundering. According the Office of the Comptroller of the Currency in 2002, The Money Laundering Control Act of 1986 gave the government more strength in dealing
with money laundering by making the crime a federal one. Later laws, particularly the Patriot Act have strengthened penalties dealing with money laundering. The Patriot Act has extended anti-money laundering legislation to all financial industries and has significantly increased the penalties for individuals and institutions. Jail terms can come in all lengths from 6 months to 15 years or so.

As the financial industry is highly competitive, it also has the disadvantage of being highly dependent on trust. In many countries, especially in developing ones, corrupt

Bills designed to halt money laundering also would be seen as disadvantageous to countries whose revenues come from the criminal underworld or lax financial laws that attract criminal elements. As such bills are dependent on a large degree of trust, it would not work without significant international involvement and assistance in such countries. As an additional proposal, I believe that the United Nations should play a significant role in setting this up. However, the United States and European countries must be able to invest large sums of money into this venture. This is due to these countries already having a large, established network set up and the ability to train potential officers in places like Africa, Eastern Europe, the Middle East, and Russia. Also, bills always need the support of their strongest members. Without assistance from larger countries, these bills would surely flounder and fail. However, if such a proposal came to the floor, I would see no real reason not to support it. As I have already pointed out, money laundering is a crime that does not recognize national borders. It has the ability to affect every country in the world, and each and

every country has the responsibility to do what it can to halt it. However, time can only tell if this action would produce the desired results.

The world needs to recognize money laundering for the serious crime that it is. Currently, white collar crime is generally overlooked or downplayed compared to other felonies. However, it is still a felony and therefore must be punished. As this financial crime gives terrorists and other criminals the ability to carry out more heinous plots against society, it is time that more serious action is taken. Jail sentences of a few months do nothing to stop people from trying to partake in the action. Money laundering is done in addition to other criminal activity. If stricter penalties can be enforced for money laundering AND committing other crimes, it may be enough to discourage some people from attempting it. As technology continues to improve, new methods must be discovered to cut off weak points that can be exploited in the financial sector. Once that occurs, society can properly punish those who commit these crimes so that all people can live safely with more criminals behind bars.
References


