

# CHAPTER 1

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## Understanding the Process of Money Laundering

### What Is Money Laundering?

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People often see *money laundering* as an exotic process, an objective whose very name evokes some mysterious and nefarious financial crime. In reality, it is one of the most common—and commonly misunderstood—financial activities connected to illicit financial schemes, including fraud, tax evasion, narcotics, human smuggling, corporate fraud, government corruption, and terror financing. The beauty and danger of money laundering is that it touches them all.

Anti-fraud professionals, criminal investigators, tax auditors, government prosecutors, and corporate compliance professionals are all focused on different aspects of these actions, often-times missing the larger picture due to an incomplete understanding of what money laundering is, how it works, and who is involved. It is important to understand the meaning, role, and history of this kind of activity to see how it began and evolved to impact a wide range of business functions. Today money laundering is a criminal business, with the emphasis on the business aspect. To merely look at one statute or another, or focus on the criminal elements involved, significantly misses the point. Today the attraction to money laundering is profit—it

is a service-oriented business where readily available knowledge can position people to make significant profits with little perceived risk.

This chapter explores the origins and evolution of money laundering, tracing it to the current day, providing the foundation necessary to deter, detect, and document money laundering activities. With this foundation, the role and responsibilities of the money launderer can be explored as well as what makes money laundering so attractive to all kinds of people engaged in criminal activity. Understanding why something is done, as well as how it is accomplished, often provides the best path for defending against it. Simply calling something a “crime” is unlikely to make much of an impact where the financial benefits are often compelling.

## **Money Laundering Defined**

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What we now refer to as “money laundering” is popularly said to originate from Mafia ownership of laundries in the United States. Gangs generating illicit cash from extortion, prostitution, gambling, and other enterprises purchased legitimate businesses through which they funneled these illicit goods. True or not, the term stuck and for people seeking to legitimize cash, the laundry analogy is popularly accepted.

The reasons date back to Al Capone. Although reputed to be one of the biggest criminal leaders of his time, he was convicted of simple tax evasion. Seeing what happened to Capone forced gangsters to be more careful with the origin, accounting, and disbursement of their funds, and although the world is no longer the cash-based economy it was in the 1930s, the lessons they learned in trying to avoid criminal prosecution are still used today.

To protect the mob bosses’ money from government insight, Meyer Lansky is reputed to have developed the modern money laundering approach. He created a process whereby cash from

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crimes in the United States was taken to Switzerland and loaned back to entities owned or controlled by the various illegal gangs. The “loan-to-back” concept, which can obscure the real timing of the illicit funds, is still one of the more popular mechanisms for laundering cash. It allows the beneficiary to document, declare, and utilize cash while providing limited recourse for government investigators.

Money laundering has been defined in a variety of ways by a variety of sources. While the definitions used by various regulators, criminal codes, and law enforcement agencies are valid, they and others like them are mostly focused on the criminal aspects, the accounting aspects, or the illicit nature of the actions. For that reason, most are incomplete to a proper understanding of the laundering process. Traditional definitions have focused on the activities involved and are usually divided into three phases: (1) placement, (2) layering, and (3) integration, or some variation on those themes. While action oriented, these definitions also cover a lot of perfectly legitimate activities. Creating an adequate definition is challenging, since the basic roles and actions are often disputed, and the process is global where the lack of common practices and codes of conduct leave room for debate about the meaning of even the word illicit. This book uses a process similar to *zero-based budgeting* in that each step in the process is built from the ground up, creating a viable definition for the objectives and actions involved in money laundering.

You have to look no further than a criminal trial to see how diligently the standard definitions are disputed, as the prosecution attempts to corral the activities under this title and the defense argues they are merely common business activities. The problem with most standard definitions is that both the prosecution and the defense are correct. Money laundering in the criminal sense involves the use of criminal or illicit funds and assigns criminal liability to otherwise legitimate business practices. Thus

the first task in defining money laundering is to recognize that it is a business function. That is, *money laundering involves the use of traditional business practices to move funds and the people who engage in this activity are doing so to make money*. The mere fact that the activity has been criminalized does not change its underlying nature.

### Why Do People Launder Money?

While it is possible given some psychopathic personalities, it is exceedingly rare that anyone gets involved in money laundering because he or she wanted to commit a crime. It is far more likely that the person would get involved because the activity is profitable. Treating the topic as a crime, however, misses the business realities that impact legitimate participants and financial transactions and, eventually, the investigation into the money laundering itself.

As a business activity, money laundering can further be divided among those “self-employed,” who launder funds for their own use, and “service providers,” who provide a commercial service to others. Again, the mere fact that these activities may or may not be legal in the jurisdiction has little bearing on the actions themselves. Thus a more complete definition has to encompass both the personal actions and the professional initiatives.

This leads to the motivations of the actors in money laundering. If the intent is to hide illicit funds, then the transactions will have no or limited legitimate business purposes. Here there is a clearly differentiating action. Where the process serves a legitimate business function, it will take the path of least resistance. In other words, people being people do things in the simplest and most straightforward way to accomplish the task. When laundering illicit funds, however, there is no legitimate business

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function being served and thus the actions often violate this rule of human nature. Since the aberration is due to the laundering objective, it provides support for an actionable definition of the process.

Thus far the definition includes a business process that provides a means for profit, either on an individual or service provider basis, whereby overly complicated mechanisms are used to mask the infusion of illicit funds into legitimate commerce. But is that complete? Or is there more to understanding exactly what is being done?

To test if there is more, look at the question of the origin of the funds. Are the actions taken related to the underlying illicit nature of the funds? Surprisingly, the answer is no. Tax evaders, spouses seeking to hide parts of the marital estate, corrupt politicians, embezzling employees, and terrorists all use astoundingly similar mechanisms to hide the movement of money.

People looking to hide the movement of funds are interested in two primary things: (1) safety and (2) secrecy. They are looking for mechanisms that will allow them to move the money with minimal risk of loss and keep the knowledge of those movements hidden from perceived adversaries. This is instructive into the thinking and mechanisms chosen.

Consider the lesson of Eliot Spitzer, the former New York governor who was involved in a prostitution ring. His long career as a prosecutor and politician should have given him the knowledge necessary to hide his actions (that is, allegedly paying a prostitute) from the government entities he served. Yet, despite his knowledge of how the government investigations were conducted, his actions fell squarely within their view. Why? Look at what he was trying to do. He was focused on hiding his alleged activities from his wife—she being the perceived adversary. He was not worried about hiding his actions from law enforcement per se because he was not hiding his financial transactions from an investigation. He did not care

that he was “Client no. 9”; he cared that his wife did not discover he was “Client no. 9.” Thus the perceived adversary is extremely important in differentiating and defining the money launderer’s actions.

When the money launderer identifies the perceived adversary, he can make all kinds of adjustments to the scheme and go undetected for years. This can be seen by looking back at the Barings Bank scandal of the 1990s. Nick Leeson, in his book *Rogue Trader* describes being caught several times over the course of his unauthorized speculative trading. He recounts how each time he was able to talk his way out of discovery because the people who caught him did not understand what he had done. So the structure of the transactions depends on who the likely discoverer could be and what they are likely to look at or for.

Another fraudster from the 1990s, Walt Pavlo, makes the same point in his published statements. He describes knowing what the auditors would look for and providing them with distractions to keep them away from what he was hiding. In other words, these overly complicated mechanisms described above are not incidental; they are required to conceal the activities from discovery.

## The Money Laundering Cycle

The definition of money laundering now needs to expand to encompass a series of actions where the money launderer conceals his actions from a perceived threat—but not from all possible lines of discovery. This leads him to create façades, illusions that can only prevent scrutiny from the perpetrator’s chosen direction or perspective.

Further, the actions are not only taken to hide, but they are taken to legitimize. An essential element in the process is the

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conversion of a wide range of illicit funds, including proceeds of street crime, narcotics trafficking, official corruption, corporate fraud, kickbacks, bribes, and even terror financing into apparently legitimate income. While a small portion of laundered funds are intended to be hidden for some period of time, the eventual purpose will be for the initiator to publicly use the funds. The mechanisms, therefore, must use otherwise legitimate types of transactions, otherwise legitimate entities, and involve otherwise legitimate intermediary purchases to create the appearance of legitimacy. This concept, *renting credibility*, is often why and how ordinary organizations are involved in money laundering transactions. And since they provide a vital service to the money launderer, they are often compensated for their roles, which is an incentive to ask limited questions or to look the other way entirely.

This ability, and often willingness, to compensate people and organizations for their involvement creates a subtle encouragement for both participation and silence. Such entities may justify their involvement as saying that they did nothing different, but since they have accepted compensation for their role, their motives are clouded by at least the appearance of potential impropriety. Even when their actions appear otherwise ordinary, the fact that they have been compensated changes their motivation. As a for-profit enterprise, money laundering operators used compensation, coercion, bribery, and other forms of illicit pressure to induce otherwise law abiding citizens to become participants in the scheme. The use of ordinary individuals further produces the appearance of legitimacy and concealment for the money laundering operation. It also serves to decrease the likelihood that when found it will appear to be a criminal enterprise. Thus the definition must be expanded to include the attraction of individuals with no criminal objectives but purely financial objectives, who will become partners and promoters of the scheme.

So this yields a definition of money laundering that encompasses a range of otherwise ordinary business activities that are designed to hide the illicit source of funds, the illicit use of funds, the control of funds, or obscure the purpose of the funds from outside parties and provide privacy, access, and legitimacy to the end-user. The process appears harmless, enticing many people to actively consider participation and, when under stress, becomes an acceptable action. This creates a shared purpose, process, and role, where otherwise ordinary individuals and hardened criminals appear to act the same way. By hiding among the sheep, the wolves are much more successful. In laundering money, people seek to disguise the source origin or destination of cash, ending with the appearance of legitimate funds. Were the underlying funds legitimate, there would be no need for the time, risk, and expense of the laundering process. So money laundering, as the term is used today, indicates illegal conduct, but can involve any inappropriate financial behavior, including violent crimes such as extortion, drug trafficking, and arms smuggling; and nonviolent crimes, such as embezzlement, fraud, and corruption; and even personal motives, such as tax evasion and divorce. While resolving money laundering transactions is often like solving a puzzle, the model revolves around three related steps:

1. Placement
2. Layering
3. Integration

The first step, placement, generates the cash. This can consist of any activity that creates cash that the recipient wants to hide. It may involve the sales of legal or illegal products, the acceptance of improper payments, or the removal of company assets. Whatever the source, the result is money, usually cash, which could implicate the individual unless its origins can be



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disguised. Most commonly, the money will be deposited into a financial account with a bank, investment firm, or insurance company. To further obscure the path, money may be shipped to foreign financial organizations or used to buy works of art or other high-value items such as aircraft, boats, precious metals, and jewelry. Each possible path involves its own costs and risks, so it is clear that people would not use this process if the funds were legitimate.

The second step in money laundering, layering, involves stratifying the financial transaction. Since the objective is to hide the origins, the more layers that are added to the process, the harder it will be to prove the illicit basis for the funds. This can involve shifting the funds from account to account, or moving them from institution to institution. Once the funds are in the financial system, it is quite easy to move them around the world if necessary. Depending on the complexity of the movements, and the secrecy desired, these layers can become costly. Merely moving money from account to account is inexpensive but also easy to trace. Shifting the money through various asset types incurs costs for buying and selling, but is more effective at hiding the sources. Layers often include various financial accounts, high-value items, currency and equipment sales, and the purchase of real estate and legitimate businesses, particularly in the leisure and tourism industries. Some countries are structured to assist in these transactions and legal and accounting firms in these countries often assist in setting up shell companies to help layer the transactions. In these instances, working with a local attorney, various bank secrecy laws, and attorney–client privilege, enterprising money launderers can move huge sums of money around the globe.

The final step integrates the funds in the perpetrators life. Here the illicit income is returned in a form that appears legitimate and will withstand ordinary scrutiny. This integration is often as creative as the layering process, and a certain parity

should be expected here. For example, using front companies to “borrow” funds from the foreign financial institution holding the illicit funds because the “loans” are guaranteed by the deposits and the “lending” institution faces no risk. Another common approach is the over-invoicing of goods or services, again sold to either front companies or foreign institutions.

### **Money Laundering Is a Criminal Business**

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Outside of law enforcement circles, and the criminals who used the methodology, the term “money laundering” is actually relatively new. It appears to have come into the public eye during the Watergate scandal, where the methodology was used to obscure payments to criminals, and spawning the infamous “follow the money” mantra of financial investigations. One court case, *United States v. \$4,255,625.39* (551 F. Supp 314 (1982)), found the term reaching acceptance throughout the U.S. judiciary.

Since then, the term has achieved common acceptance around the world. While early U.S. efforts to criminalize this pattern of international activity were cautiously reviewed, a substantial change in cooperation occurred after 2001. The clear connection between terror financing methodology and money laundering techniques ushered in a much greater level of cooperation among the world’s governments.

Big business can become involved in combating money laundering. Large companies, especially financial institutions, are very attractive to money launderers, so, through regulations and evolving business practices, governments have established comprehensive anti-money-laundering (AML) systems. These systems aim to raise awareness of the place—both in government and on the part of the business—and then provide the necessary legal or regulatory devices to help resolve money laundering issues.

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From a criminal investigation standpoint, the approach has been to use fines and forfeiture statutes to fund AML efforts. Law enforcement agencies find, seize, and ultimately draw their resources from the confiscation of criminal assets. Legal changes have allowed the exchange of data among public and private entities, making enforcement efforts more productive. These structural approaches have been reproduced in other countries as well.

This is extremely important in the development of the global AML programs. They model the benefits of aligning the regulatory and administrative law enforcement processes with the financial regulations, while giving consideration to the problems faced by responsible financial institutions. This requires that these institutions forgo certain types of transactions, establishing AML programs, customer identification requirements, record beneficial holders, and verify compliance with applicable regulatory requirements.

## **Money Laundering Is Global**

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So, given the renewed focus and move toward greater global integration on money laundering crimes, how is that impacting the overall process? Unfortunately, there is no evidence that money laundering is being impacted by these changes. The wide range of diverse legal and regulatory requirements means that enterprising criminals can find more opportunities to exploit these differences. Any national plan should be compatible with global standards and flexible enough to respond to new money laundering schemes.

In many countries, criminals can respond to the new regulations much faster than the authorities are able to review and revise the regulations. This means that the authorities are often forced to proceed to the financial component of the assessment

in an environment that may be either too weak or legally ineffective to deal with this problem. For these reasons, governments must continue to revise their standards toward greater levels of transparency and cooperation to limit these exploitable differences.

The design of large-scale money laundering nearly always includes cross-border elements, since money laundering is a worldwide, global cooperation. The number of programs that have been established include those sponsored by international organizations such as the United Nations or the Bank for International Settlements, and at least 80 such agreements were made in the late twentieth century. Following the Financial Action Task Force, created in 1989, various governmental and cooperative entities (e.g., the European Union, the European Commission, and the Organization of American States) created regional working groups to establish AML measures based on the legal and regulatory requirement of their members. The Caribbean, Asia, Europe, and South Africa have also created regional AML task force–like organizations. Countries in West Africa and Latin America have also done the same.

Since money laundering is illegal, those criminals involved mask their transactions, blending them in with larger accounts with higher activity in the legitimate economy. This makes their individual transactions much more difficult to find. As technology has increased, it has simplified both the mechanisms for moving money and the incentive to use the global financial network for both individuals and organizations involved in crimes that involve the crime of money laundering as well.

Making use of jurisdictional differences as well as differences in laws and treaties around the globe, criminals moving money internationally present unique challenges to the investigation. The combination, too, of changing language, changing time zone, and rapidly moving money all combine to hamper

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recovery and regulatory enforcement. And coordination of regulatory bodies is countered by less cooperative or less observant jurisdictions, some of which facilitate money laundering.

## **Money Launderers Adapt Technology**

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This development exploits new technologies, system projects, and personnel actions, as well as other places where boundaries may be weakened to expand worldwide movement of illicit funds. The willingness to spend money to hide the origin of the funds attracts the assistance of professional intermediaries, most commonly lawyers, accountants, and bankers (every profession has its ethically challenged members), who have appeared in significant numbers to provide their services. Experts who have the ability to cover up the source of funds maintain public offices, and often times high-profile positions, creating and supporting the purported legitimacy of their methods. This comfortable existence, and the profits generated by these activities, has enabled illicit funds to gradually infiltrate the legitimate financial and economic markets.

Over time, this service industry has grown and matured, with the involved professionals assisting in the maintenance of individual criminals and expansion of corruption through their activities. Coordination of money movements with legitimate proceeds, in particular, is organized by these service providers to further limit the likelihood of discovery and recovery. These service providers use careful management of the financial balances and the changing jurisdictional rules to prevent or avoid the attention of the regulatory system—sometimes using multiple roundtrip financial transactions to reduce the possibility of detection.

As facilitators of money laundering, service providers in concert with criminals seek countries that demonstrate less respect for the global AML legislation. They use or create shelters, which

are often in offshore banking centers that provide both banking services and commercial secrecy. They also supply the human face of trust, which is used to cover large-scale coordination of assets controlled by and for the benefit of the criminal money launderer. Since 1996, the International Monetary Fund (IMF) has seen a continuing increase in the flow of illicit funds coming from drugs and related money laundering, corruption, and tax evasion as compared to global economic growth. Given the pace of technological change and the ever increasing ease of complex financial movements, it is likely that an even higher share of the world's financial transactions will be used to mask the flow of illicit funds.

## **The Role of Technology**

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A growing number of Web sites to attract overseas transfers of funds, for online gambling or virtual banking, provide additional means to move money globally with limited or no restrictions. In addition, encryption technologies provide better means for hiding transactions and anonymity for those involved. All that is required is a computer. The use of technology and its impact on laundering money cannot be overstated. Technology did not create money laundering, but it did bring about a new dimension in remote destinations such as Vanuatu, Nauru, and the Marshall Islands, which might be hard to reach in person but are only a click away online.

Virtual banking, as well as online access to traditional banks, has enabled these locales to increase their financial posture, attracting capital as well as illicit funds. By layering transactions carefully through entities in these countries, money launderers are able to mask themselves and thus secure their funds in mainstream banking centers without detection.

Technology has also had an impact on the prosecution aspect. Where transactions used to be relatively slow and

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documentation took time to process, the pace of investigation and prosecution seemed appropriate. But the pace of transactions had increased dramatically. Today, it is possible that a defendant will learn he is a target and have time to electronically transfer funds around the globe before the legal mechanisms can be used to stop him. While some countries, such as the United States, have faster mechanisms, these are not universal. Further, most legal systems require sufficient proof before acting, and getting this level of proof requires the cooperation of the source country. Where the money is connected to political leaders or close connections, the needed law enforcement cooperation will never materialize. In many countries, only specific activities constitute a basis for money laundering, leaving the door open to safely move illicit funds through.

### **The Role of Banks**

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Simply put, what is today called money laundering was once simply called “banking.” The secure handling and movement of funds is banking and, for most of history, banks were not concerned with their customers’ source of funds. As regulatory environments have modernized, more and more activities have been proscribed. But this places financial institutions in a difficult place. When regulations are used to prohibit natural *and* profitable behavior, the temptation to bend and break the regulations increases. The globalization of the banking sector also means that where one bank is prohibited but another is not, the competitive pressure can also influence the choices. Offshore banks have jumped into the service environment, as affluent individuals demand confidentiality and are willing to pay for specialized services. By the end of 1997, international financial institutions held more than half of all global cross-border assets.

The exceptions to this trend have been financial institutions in the United States and Switzerland. However, the various government actions to freeze and confiscate illegal funds have been ineffective in curbing the total market for illicit funds. In the most important other financial centers, such as in the United Kingdom and Germany, there has been a huge increase in potentially suspicious transactions, yet no accompanying increase in individual criminal prosecution or confiscation of assets. Thus, while there are more regulations and more interest in terror financing and narcotics smuggling, there have been proportionally fewer financial crime arrests, indicating the relative safety of money laundering activities in these countries. More and more of these transactions occur in offshore banking centers, such as Grand Cayman, the Isle of Man, Malta, Cyprus, and other jurisdictions.

It is important to note that not all offshore banking is money laundering. Yet because of the huge growth in legitimate offshore transactions, money launderers are able to hide their transactions. Global business efforts, combined with unstable political environments, rapidly changing currency valuations, and competitive tax structures, all encourage the movement of legitimate funds along the same channels. Thus on a daily basis huge sums of money are moved around the world, providing, in essence, a river of money to hide the illicit transactions. For the most flagrant abusers, there is no economic infrastructure or meaningful regulatory process to monitor the financial transactions. In these countries, businesses are taking advantage of the bank secrecy these locales offer. Many countries in the Caribbean have established large legitimate banking services, which provide legitimate services to large enterprise customers around the world. This combination of high volumes of legitimate financial transactions with high levels of secrecy and protection become magnets for money launderers.



## **The Role of Nations**

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Money laundering is also aided by the historical strength of the U.S. dollar. Because of the devaluation of so many other currencies, there has been a strong demand for the dollar as well as other strong currencies across the globe and sometimes a correspondingly lesser inclination by countries seeking the security of stronger currencies to question the source. They become offshore havens, where capital is tax free and the emphasis is more about the collection of funds than the development of monitoring systems. Money launderers, seeking to conduct business with strong currencies, have found willing takers in developed and developing governments who have also become willing service providers in the movement and cleaning of illicit funds for mutual benefit.

One need only look at the rapid evolution of electronic financial transactions among large banks, offshore banking and financial organizations, currency exchanges, brokerage houses, gold dealers, casinos, and cash protection and processing companies to see the market that exists between money launderers and their service providers. And proficiency has become important. As with all smuggling activities, knowing what to do and how to do it correctly achieves a degree of success. Since these same activities appeal to the narcotics dealer, the corrupt politician, the employee thief, the tax evader, and so on, a large number of people have the incentive to push further developments in this area. The perception of limited risk for money laundering and, specifically, to the professionals, whether business people or government bureaucrats, who help run the processes further encourages participation from ever more otherwise law-abiding people. Many organizations have historically chosen to look away from these activities because they profit from them and/or view them as a cost of doing business internationally. The efforts that the Organisation for Economic Co-operation and

Development (OECD) has sponsored to reduce global tolerance and to limit and restrict foreign places to hide money have not yet led to any significant reduction in the volume of funds being laundered.

When government officials take a bribe, they will often seek to expatiate it to protect the funds from discovery. Since money laundering laws rely on an underlying crime, the key to reduced attention then becomes *geographically* separating the crimes from the proceeds. For many years it was hard to get foreign governments to focus on money laundering proceeds in their jurisdictions because the perpetrators went to great lengths to ensure they did not commit any crimes in those countries. Even today, in an atmosphere of greater cooperation, unless a clear reason can be made for one country to act on the behalf of another in its attempts to counter terror financing, prosecute international criminals, and the like, enforcing another country's financial laws is often a low priority. This gray area, where cooperation doesn't exist, results in a "safe zone" where individuals can manipulate the system and remain protected, not by the legal framework but rather by the "structural" inhibitors to money laundering investigations.

## **Regional Hotspots**

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Money laundering is a growing concern in a number of Latin American countries of the MERCOSUR (*Mercado Común del Sur*, or Southern Common Market) and generating increasing challenges for regulators and law enforcement, despite improved AML tools and technology. This is partly related to the drug lords in Colombia and Mexico who need to clean their own money and larger facilities to enable them to administer the flow of funds in their own countries and regionally. In addition, it is due to foreign banks in Latin America and the Caribbean,

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which now includes 43 percent of the total global increase. The most visible manifestation of the money has been funneled into construction projects in tourist destinations, such as Cancun. The resulting hotel business is used to launder money. This is not limited to Mexico, as similar models have been found in other tourist areas and in luxury developments in Argentina. Stronger notification and regulations are being instituted across the Southern Common Market, focusing on potential money laundering through products, companies, and currency exchange brokers.

In Brazil, the largest economy in South America, funds from white collar crime, narcotics, and weapons smuggling are routinely laundered. Taking advantage of both regional rivalries and political differences, Brazil has become a popular banking center.

Paraguay, which is one of the most important money laundering centers in Latin America, chose to exacerbate the problem by actively pursuing banking business. By promoting policies that ensure secrecy, countries attract illicit funds. Estimates are that 20 percent of the drug-related money laundering is in Paraguay.

Until recently it has been difficult to perceive money laundering as an important issue and has resulted in the existing cumbersome means of a global legal compliance. In addition, the regulation of these areas has been resisted by financial institutions, as it is highly profitable for them. All organizations are resistant to rules that limit their profits. In this case, competing economic needs have made either covert or overt acceptance of funds, no matter the source, acceptable in many places. Money always seeks shelter, protection, and secrecy. Between dictators seeking to expatriate their stolen funds, the global narcotics trade, and the global weapons trade, there has been an ever-expanding interest in safe and secure financial transactions. This is met by increasing governmental regulation and technology for

tracing transactions, resulting in ever increasingly complex money movement mechanisms.

As an example, with the end of the Cold War, large sums of money began flowing in and out of former Soviet bloc countries. Due to political instability, many business transactions are conducted through offshore business centers. These huge money flows masked the rise and impact of organized crime in these countries, allowing them the ability to launder money through the most important economic centers and offshore locations. The new focus on corruption and its impact on the money laundering process is an attempt to reverse this trend.

### **The Birth of the Financial Action Task Force (FATF)**

In 1989, the Financial Action Task Force (FATF) was established at the G-7 Summit in Paris to develop and aid in the implementation of AML policies and practices on a national and international level and to coordinate solutions and make money laundering more difficult. The following year the FATF 40 Recommendations provided a framework that was subsequently amended in 1996. FATF grew to include 36 members and helped to set global standards for processes, procedures, regulation, and monitoring of money laundering activities. The first efforts were aimed at setting standard legal definitions and urging countries to adopt more uniform legal regulations. While this was generally successful, there are still wide differences in the underlying crimes for the basis for money laundering. Laws against narcotics trafficking are nearly universal. But other crimes such as human trafficking, tax evasion, official corruption, and white collar crime are treated differently in regard to the money laundering statutes of different countries. The FATF provides guidelines for a consistent global model, but its implementation is not uniform and this allows money launderers

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to still take advantage of variations in different countries' legal frameworks.

By creating coordinated processes and definitions, even with some differentiation, the objective of the FATF is to enhance the effectiveness and efficiency of global AML efforts. This includes the confiscation of identified illicit funds, the identity of account holders, the retention of records, and the creation of reporting procedures, all tools for tracking financial transactions through the global financial community.

Financial institutions are required to monitor and report large and suspicious transactions—albeit this does not imply that competent authorities will investigate or track suspicious transactions to final recipients. These guidelines further extend to all financial products, including personal and business banking, private banking, and investments. (Similar guidelines apply to insurance companies.) These guidelines extend beyond the named account holder to reasonable beneficiaries' known associates (as is characteristic of business—and criminal—enterprises). They also encourage regulators to take a close look at laws to provide appropriate mechanisms for international cooperation regarding suspicious transactions and in confiscation, mutual assistance, and extradition.

FATF issues annual reports on compliance, effectiveness, and recommended enhancements. Over time, these reports have helped encourage countries to adopt many of the FATF guidelines. As of late 2010, there were only two countries listed as not being in compliance—Iran and North Korea. However, there were 31 countries with significant deficiencies. Analysis of these countries indicates that money laundering has a strong financial impact. Were the benefits of allowing these activities not in their interests, these countries would more fully implement AML policies. Since money laundering can be highly profitable, however, these countries permit it and there is considerable pressure against any real compliance.

Agreement is, nevertheless, continuing to increase in the development of AML policies in many countries. This agreement is related, in large part, to the degree that money laundering activities impact their financial situation. This is largely a diplomatic effort to enhance the regulatory processes because the past practices have proven ineffective. Now the focus is not legitimate tax avoidance, but the cost and impact of international criminal activity, terror financing, the risk of official corruption, and, most recently, the impact on national economies. As an aggregate, it is the scale of illicit financial transactions that seems to have motivated countries to view the risks more seriously.

## **Conclusion**

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By using overseas accounts, individuals and business entities seek to protect themselves from the volatility of banking institutions while protecting their ability to access the funds anywhere in the world. Unfortunately, this same process works to help corrupt persons and entities avoid legal authorities and secure their ill-gotten gains. The primary challenge of money laundering is that its activities often appear perfectly normal, unless one knows the illicit origins of the funds. This is why money laundering is so successful.

AML efforts such as FATF require the coordination of all financial institutions and regulators across national borders to identify the origin and recipients of financial transactions. As these efforts improve, the perpetrators work to add layers, making compliance ever more difficult to achieve. Between economic priorities and technology, the race to keep up can outpace the capabilities of many countries willing to combat money laundering.