Economic Perspectives

Volume 6 *An Electronic Journal of the U.S. Department of State* *Number 2*

THE FIGHT AGAINST MONEY LAUNDERING

- The Consequences of Money Laundering and Financial Crime
- International Standards and Cooperation in the Fight Against Money Laundering
- Money Laundering Enforcement: Following the Money
- Achieving a Sustained Response to Money Laundering

May 2001

ECONOMIC PERSPECTIVES

The Fight Against Money Laundering

U.S. DEPARTMENT OF STATE *ELECTRONIC JOURNAL* *VOLUME 6, NUMBER 2, MAY 2001*

Money laundering allows crime to pay by permitting criminals to hide and legitimize proceeds derived from illegal activities. According to one recent estimate, worldwide money laundering activity amounts to roughly $1 trillion a year. These illicit funds allow criminals to finance a range of additional criminal activities. Moreover, money laundering abets corruption, distorts economic decision-making, aggravates social ills, and threatens the integrity of financial institutions.

Money launderers now have access to the speed and ease of modern electronic finance. Given the staggering volume of this crime, broad international cooperation between law enforcement and regulatory agencies is essential in order to identify the source of illegal proceeds, trace the funds to specific criminal activities, and confiscate criminals' financial assets.

This issue of *Economic Perspectives* gives some idea of the scope of the problem as well as the way agencies of the U.S. government are cooperating with each other, the private sector, and foreign governments to contain this scourge.

-- Ambassador Wendy Chamberlin, Principal Deputy Assistant Secretary, Bureau for International Narcotics and Law Enforcement Affairs, U.S. Department of State

ECONOMIC PERSPECTIVES
An Electronic Journal of the U.S. Department of State

CONTENTS

THE FIGHT AGAINST MONEY LAUNDERING

❑ FACTS AND FIGURES

❑ INFORMATION RESOURCES

ECONOMIC PERSPECTIVES

An Electronic Journal of the U.S. Department of State — *Volume 6, Number 2, May 2001*

The Office of International Information Programs of the U.S. Department of State provides products and services that explain U.S. policies, society, and values to foreign audiences. The Office publishes five electronic journals that examine major issues facing the United States and the international community. The journals — *Economic Perspectives, Global Issues, Issues of Democracy, U.S. Foreign Policy Agenda,* and *U.S. Society and Values* — provide statements of U.S. policy together with analysis, commentary, and background information in their thematic areas.

All issues appear in English, French, Portuguese, and Spanish language versions, and selected issues also appear in Arabic and Russian. English-language issues appear at approximately a one-month interval. Translated versions normally follow the English original by two to four weeks.

Current or back issues of the journals, and the roster of upcoming journals, can be found on the Office of International Information Programs' International Home Page on the World Wide Web at http://usinfo.state.gov/journals/journals.htm. They are available in several electronic formats to facilitate viewing on-line, transferring, downloading, and printing.

Comments are welcome at your local U.S. Embassy or at the editorial offices:

Editor, Economic Perspectives
IIP/T/ES
U.S. Department of State
301 4th Street, S.W.
Washington, D.C. 20547
United States of America
E-mail: ejecon@usia.gov

U.S. Department of State
Office of International Information Programs
May 2001

❑ THE CONSEQUENCES OF MONEY LAUNDERING AND FINANCIAL CRIME

*By John McDowell, Senior Policy Adviser, and Gary Novis, Program Analyst,
Bureau of International Narcotics and Law Enforcement Affairs, U.S. Department of State*

Money laundering has a corrosive effect on a country's economy, government, and social well-being, two State Department officials say.

The officials — senior policy adviser John McDowell and program analyst Gary Novis of the Bureau of International Narcotics and Law Enforcement Affairs — say the practice distorts business decisions, increases the risk of bank failures, takes control of economic policy away from the government, harms a country's reputation, and exposes its people to drug trafficking, smuggling, and other criminal activity.

Given the technological advantages money launderers now employ, they say, a high level of international cooperation is necessary to keep them in check.

Money laundering is the criminal's way of trying to ensure that, in the end, crime pays. It is necessitated by the requirement that criminals — be they drug traffickers, organized criminals, terrorists, arms traffickers, blackmailers, or credit card swindlers — disguise the origin of their criminal money so they can avoid detection and the risk of prosecution when they use it.

Money laundering is critical to the effective operation of virtually every form of transnational and organized crime. Anti-money-laundering efforts, which are designed to prevent or limit the ability of criminals to use their ill-gotten gains, are both a critical and effective component of anti-crime programs.

Money laundering generally involves a series of multiple transactions used to disguise the source of financial assets so that those assets may be used without compromising the criminals who are seeking to use them. These transactions typically fall into three stages: (1) placement — the process of placing unlawful proceeds into financial institutions through deposits, wire transfers, or other means; (2) layering — the process of separating the proceeds of criminal activity from their origin through the use of layers of complex financial transactions; and (3) integration — the process of using an apparently legitimate transaction to disguise illicit proceeds. Through these processes, a criminal tries to transform the monetary proceeds derived from illicit activities into funds with an apparently legal source.

Money laundering has potentially devastating economic, security, and social consequences. It provides the fuel for drug dealers, terrorists, illegal arms dealers, corrupt public officials, and others to operate and expand their criminal enterprises. Crime has become increasingly international in scope, and the financial aspects of crime have become more complex due to rapid advances in technology and the globalization of the financial services industry.

Modern financial systems, in addition to facilitating legitimate commerce, also allow criminals to order the transfer of millions of dollars instantly using personal computers and satellite dishes. Because money laundering relies to some extent on existing financial systems and operations, the criminal's choice of money laundering vehicles is limited only by his or her creativity. Money is laundered through currency exchange houses, stock brokerage houses, gold dealers, casinos, automobile dealerships, insurance companies, and trading companies. Private banking facilities, offshore banking, shell corporations, free trade zones, wire systems, and trade financing all can mask illegal activities. In doing so, criminals manipulate financial systems in the United States and abroad.

Unchecked, money laundering can erode the integrity of a nation's financial institutions. Due to the high integration of capital markets, money laundering can also adversely affect currencies and interest rates. Ultimately, laundered money flows into global financial systems, where it can undermine national economies and currencies. Money laundering is thus not only a law enforcement problem; it poses a serious national and international security threat as well.

EXPOSED EMERGING MARKETS

Money laundering is a problem not only in the world's major financial markets and offshore centers, but also for emerging markets. Indeed, any country integrated into the international financial system is at risk. As emerging markets open their economies and financial sectors, they become increasingly viable targets for money laundering activity.

Increased efforts by authorities in the major financial markets and in many offshore financial centers to combat this activity provide further incentive for launderers to shift activities to emerging markets. There is evidence, for example, of increasing cross-border cash shipments to markets with loose arrangements for detecting and recording the placement of cash in the financial system and of growing investment by organized crime groups in real estate and businesses in emerging markets. Unfortunately, the negative impacts of money laundering tend to be magnified in emerging markets.

A closer examination of some of these negative impacts in both the micro- and macroeconomic realms helps explain why money laundering is such a complex threat, especially in emerging markets.

THE ECONOMIC EFFECTS OF MONEY LAUNDERING

Undermining the Legitimate Private Sector: One of the most serious microeconomic effects of money laundering is felt in the private sector. Money launderers often use front companies, which co-mingle the proceeds of illicit activity with legitimate funds, to hide the ill-gotten gains. In the United States, for example, organized crime has used pizza parlors to mask proceeds from heroin trafficking. These front companies have access to substantial illicit funds, allowing them to subsidize front company products and services at levels well below market rates.

In some cases, front companies are able to offer products at prices below what it costs the manufacturer to produce. Thus, front companies have a competitive advantage over legitimate firms that draw capital funds from financial markets. This makes it difficult, if not impossible, for legitimate business to compete against front companies with subsidized funding, a situation that can result in the crowding out of private sector business by criminal organizations.

Clearly, the management principles of these criminal enterprises are not consistent with traditional free market principles of legitimate business, which results in further negative macroeconomic effects.

Undermining the Integrity of Financial Markets: Financial institutions that rely on the proceeds of crime have additional challenges in adequately managing their assets, liabilities, and operations. For example, large sums of laundered money may arrive at a financial institution but then disappear suddenly, without notice, through wire transfers in response to non-market factors, such as law enforcement operations. This can result in liquidity problems and runs on banks.

Indeed, criminal activity has been associated with a number of bank failures around the globe, including the failure of the first Internet bank, the European Union Bank. Furthermore, some financial crises of the 1990s — such as the fraud, money laundering, and bribery scandal at BCCI and the 1995 collapse of Barings Bank as a risky derivatives scheme carried out by a trader at a subsidiary unit — had significant criminal or fraud components.

Loss of Control of Economic Policy: Michel Camdessus, the former managing director of the International Money Fund, has estimated that the magnitude of money laundering is between 2 and 5 percent of world gross domestic product, or at least $600,000 million. In some emerging market countries, these illicit proceeds may dwarf government budgets, resulting in a loss of control of economic policy by governments. Indeed, in some cases, the sheer magnitude of the accumulated asset base of laundered proceeds can be used to corner markets — or even small economies.

Money laundering can also adversely affect currencies and interest rates as launderers reinvest funds where their schemes are less likely to be detected, rather than where rates of return are higher. And money laundering can increase the threat of monetary instability due to the misallocation of resources from artificial distortions in asset and commodity prices.

In short, money laundering and financial crime may result in inexplicable changes in money demand and increased volatility of international capital flows, interest, and exchange rates. The unpredictable nature of money laundering, coupled with the attendant loss of policy control, may make sound economic policy difficult to achieve.

Economic Distortion and Instability: Money launderers are not interested in profit generation from their investments but rather in protecting their proceeds. Thus they "invest" their funds in activities that are not necessarily economically beneficial to the country where the funds are located. Furthermore, to the extent that money laundering and financial crime redirect funds from sound investments to low-quality investments that hide their proceeds, economic growth can suffer. In some countries, for example, entire industries, such as construction and hotels, have been financed not because of actual demand, but because of the short-term interests of money launderers. When these industries no longer suit the money launderers, they abandon them, causing a collapse of these sectors and immense damage to economies that could ill afford these losses.

Loss of Revenue: Money laundering diminishes government tax revenue and therefore indirectly harms honest taxpayers. It also makes government tax collection more difficult. This loss of revenue generally means higher tax rates than would normally be the case if the untaxed proceeds of crime were legitimate.

Risks to Privatization Efforts: Money laundering threatens the efforts of many states to introduce reforms into their economies through privatization. Criminal organizations have the financial wherewithal to outbid legitimate purchasers for formerly state-owned enterprises. Furthermore, while privatization initiatives are often economically beneficial, they can also serve as a vehicle to launder funds. In the past, criminals have been able to purchase marinas, resorts, casinos, and banks to hide their illicit proceeds and further their criminal activities.

Reputation Risk: Nations cannot afford to have their reputations and financial institutions tarnished by an association with money laundering, especially in today's global economy. Confidence in markets and in the signaling role of profits is eroded by money laundering and financial crimes such as the laundering of criminal proceeds, widespread financial fraud, insider trading of securities, and embezzlement. The negative reputation that results from these activities diminishes legitimate global opportunities and sustainable growth while attracting international criminal organizations with undesirable reputations and short-term goals. This can result in diminished development and economic growth. Furthermore, once a country's financial reputation is damaged, reviving it is very difficult and requires significant government resources to rectify a problem that could be prevented with proper anti-money-laundering controls.

SOCIAL COSTS

There are significant social costs and risks associated with money laundering. Money laundering is a process vital to making crime worthwhile. It allows drug traffickers, smugglers, and other criminals to expand their operations. This drives up the cost of government due to the need for increased law enforcement and health care expenditures (for example, for treatment of drug addicts) to combat the serious consequences that result.

Among its other negative socioeconomic effects, money laundering transfers economic power from the market, government, and citizens to criminals. In short, it turns the old adage that crime doesn't pay on its head.

Furthermore, the sheer magnitude of the economic power that accrues to criminals from money laundering has a corrupting effect on all elements of society. In extreme cases, it can lead to the virtual take-over of legitimate government.

Overall, money laundering presents the world community with a complex and dynamic challenge. Indeed, the global nature of money laundering requires global standards and international cooperation if we are to reduce the ability of criminals to launder their proceeds and carry out their criminal activities. ❑

❑ INTERNATIONAL STANDARDS AND COOPERATION IN THE FIGHT AGAINST MONEY LAUNDERING

By Joseph Myers, Acting Deputy Assistant Secretary, Enforcement Policy, U.S. Department of the Treasury

Only sustained, vigorous international cooperation can keep money launderers in check, says Joseph Myers, acting deputy assistant secretary of the Treasury.

Already the 29-member Financial Action Task Force, similar regional organizations, and a group of national financial intelligence units have achieved a good level of cooperation, Myers says, but all of them need to do more.

Fighting money laundering is a cat-and-mouse game. The dirty money tends to find the darkspots, -- the countries having lax regulations, weak institutions, or an inability to enforce laws. These are good places to bank if you're a criminal.

While no amount of effort will ever eradicate money laundering or eliminate crime, international cooperation can arrest their corrosive effects on society, business, and government. Such cooperation against money laundering is improving, but requires more improvement.

One instrument of international cooperation, the Financial Action Task Force (FATF), has achieved some success. Never intended to have a long life at its founding in 1989, this informal group is still at work 12 years later, a tribute to its usefulness and renewed energy.

Most importantly, FATF set the international standards for money laundering controls — "The Forty Recommendations." Setting those standards meant that all participating governments committed to moving in the same direction at the same pace, a requirement for success. Through FATF's peer-review process, the participants have pushed each other into implementing the standards.

With expanded membership, FATF has now achieved agreement on money laundering standards and implementation among 29 governments. More than that, FATF has encouraged development of regional groups to adhere to the same standards. By the U.S. government's count, about 130 jurisdictions — representing about 85 percent of world population and about 90 to 95 percent of global economic output — have made political commitments to implementing "The Forty Recommendations."

In the United States, our financial industry's reputation for being well regulated has been good for our economy, good for investment. And some countries that recently converted to FATF standards have reported similarly good outcomes, especially in markets having many people working in professional businesses.

Another, more controversial initiative that FATF has developed to enhance international cooperation is publication of a list of non-cooperative countries and territories (NCCT) — jurisdictions that lack a commitment to fight money laundering. Following the June 2000 publication of the first such list, a number of the 15 NCCT jurisdictions have acted quickly to implement FATF standards.

While the NCCT initiative has produced good results, FATF participants need to address concerns from some jurisdictions on the list about the fairness of the process. FATF needs also, more generally, to take a more inclusive approach as it formulates policy. It is doing just that now by bringing in non-members to offer advice as FATF members review "The Forty Recommendations" for updating.

Another forum for international cooperation has developed among a number of national financial intelligence units (FIUs), such as the U.S. Financial Crimes Enforcement Network (FinCEN). Organically and spontaneously, several countries created these organizations around the same time to coordinate the activities of their law enforcement agencies fighting money laundering.

In the mid-1990s, people working in these FIUs began to realize the others were out there, and a small group of them started to meet to learn from each other. Quickly, they realized the potential of working with each other on operational matters. Such cooperation has already produced important results; more cooperation is in order.

Governments engaged in the fight against money laundering always need to figure out how they can do the job better. In months ahead FATF members will have to reach agreement on any proposed changes to "The Forty Recommendations" and consider next steps for the NCCT initiative. Meanwhile, the U.S. government is continuing to review the costs and benefits of the way we implement our national strategy against money laundering.

Whatever changes emerge, one fact won't change: only sustained, vigorous international cooperation can keep money laundering in check. ❑

❏ MONEY LAUNDERING ENFORCEMENT: FOLLOWING THE MONEY

By Lester M. Joseph, Assistant Chief, Asset Forfeiture and Money Laundering Section, U.S. Department of Justice

A number of U.S. investigations have successfully disrupted money laundering schemes, says Lester Joseph, assistant chief for asset forfeiture and money laundering in the U.S. Justice Department.

But just as often, he says, enforcement of U.S. law is frustrated by complexities of foreign jurisdictions and venues, as well as by outright lack of cooperation by foreign governments.

To promote cooperation, the United States shares the proceeds of successful forfeiture actions with countries that made possible or substantially facilitated the forfeiture of assets from money laundering, Joseph says.

Ever since the famous book about the Watergate scandal, *All the President's Men,* was written, it has become a mantra that, in order to solve a crime, one must "follow the money." This mantra has been adopted by law enforcement in the United States. Since the 1970s, we in the U.S. government have emphasized a three-pronged approach to fighting crime: prosecute the underlying crime, follow the money trail through money laundering investigations, and forfeit the proceeds and instrumentalities of the crime. Only by following the money can the full scope of a crime be discovered and a criminal organization be destroyed.

When the United States first enacted money laundering laws in 1986, they were designed to address what was primarily a domestic problem. Since 1986, money laundering has increasingly become a global problem, involving international financial transactions, the smuggling of currency across borders, and the laundering in one country of the proceeds of crimes committed in another. Currency, monetary instruments, and electronic funds flow easily across international borders, allowing criminals in foreign countries to hide their money in the United States and allowing criminals in this country to conceal their ill-gotten gains in any one of hundreds of countries around the world — with scant concern that their activities will be detected by law enforcement.

Yet despite the dynamic changes we are witnessing in the financial world, the basic problem for many money launderers, and especially those who launder the proceeds of illegal drug activity, remains the same — concealing and moving the enormous amounts of illicit cash. For this reason, even in the international context, the U.S. government's primary area of emphasis has been the placement stage of money laundering, the stage at which the money launderer first seeks to enter the illicit proceeds into the financial system.

As a result of our focusing on this placement stage, U.S. banks and other depository institutions have been and continue to be our first line of defense against the entry of illicit cash proceeds. Although some exceptions occur, we have largely succeeded in barring launderers from gaining direct access to U.S. banks. As a result, money launderers increasingly must look to international mechanisms and non-traditional financial institutions to launder their illegal proceeds. Some of the frequently utilized methods of money laundering include the bulk cash smuggling of currency; trade-based money laundering through the Colombian Black Market Peso Exchange system (BMPE); and the use of money service businesses such as wire remitters, casas de cambio, vendors of money orders and traveler's checks, and check cashers. Here, I would like to discuss several recent successful investigations that have disrupted schemes using these methods of money laundering.

OPERATION MULE TRAIN

On July 1, 1998, the chief financial officer, president, and vice president of Supermail, Inc., a check cashing company, were arrested on money laundering charges stemming from a two-year investigation conducted by the Los Angeles office of the Federal Bureau of Investigation (FBI) and the Los Angeles Police Department. According to corporate filings, the company was one of the largest check cashing enterprises operating in the western United States and purported to be one of the leading U.S. money transfer agents providing services to Mexico and Latin America.

The three executives, along with six other employees and associates, were arrested after a federal grand jury returned a 67-count indictment against 11 defendants, including the Supermail corporation, charging conspiracy, money laundering, the evasion of currency reporting requirements, and criminal forfeiture.

The initial target of the investigation was a company store in Reseda, California. Investigators, working in an undercover capacity, approached the manager, who agreed to launder purported "drug" money in exchange for a cash fee. Specifically, the manager converted large amounts of cash into money orders issued by the company. As larger sums were laundered, the manager sought the assistance of his associates working at other store locations. When a new manager took over operations at the Reseda store in April 1997, he brought in the company's corporate officers. The corporate officers authorized the issuance of money orders and the wire transfers of large sums of "drug" money to a secret bank account in Miami, while the cash was used to maintain operations at the company stores.

In total, the defendants laundered more than $3 million of "drug" money. The investigation is believed to be one of the largest money laundering "sting" operations targeting a check cashing business in U.S. history. The defendants in the case pled guilty to money laundering charges and received sentences ranging from 46 to 72 months in prison.

OPERATION RISKY BUSINESS

While most of the large-scale money laundering schemes involve the proceeds of drug trafficking, laundering the proceeds of white-collar crime is becoming an increasingly significant phenomenon. Operation Risky Business was launched by the U.S. Customs Service and the FBI in 1994 after scam artists began placing ads in major U.S. newspapers and business publications. The ads offered venture capital loans to entrepreneurs in exchange for "advance fees." Victims worldwide began paying advance fees, ranging from $50,000 to $2.2 million, to get access to the venture capital. After paying the fees, victims were asked to sign a contract requiring them to promptly obtain a letter of credit, ranging from $2 million to more than $20 million, as collateral for the loan. If victims were unable to obtain letters of credit for such amounts so quickly, the scam artists told them they had violated the terms of the contract and kept their advance fees. In fact, the perpetrators had set up the scheme knowing that the victims would be unable to meet the terms of the contract and thereby defrauding the victims of the advance fees.

To hide the money they had stolen, the scam artists created the Caribbean American Bank, Ltd., in Antigua and Barbuda in 1994. Customs and FBI agents found that the bank was nothing more than a storefront operation, one of 18 such operations under the control of American International Bank, Ltd., in Antigua. Both banks have since been closed in connection with the fraud. Using these banks and numerous front companies, the scam artists were able to buy airplanes, yachts, vehicles, real estate, and other assets with the fraud proceeds. Some of the defendants were issued major credit cards — in the names of the front companies — by the Antiguan banks so they could spend stolen money on credit anywhere in the world.

At least 400 people around the world lost money to the scheme. Far more were targeted. The total dollar amount of the fraud may never be known, but $60 million is considered a conservative estimate. To date, 19 people have been convicted in Operation Risky Business. The United States is seeking the extradition of a defendant in Antigua accused of establishing Caribbean American Bank for the use of scam artists, as well as the extradition of another defendant in Thailand.

BLACK MARKET PESO EXCHANGE SYSTEM CASES

Operation Skymaster: One example of a recent successful investigation attacking the BMPE was Operation Skymaster, an investigation conducted by the U.S. Customs Service. From March 1997 through May 1999, Operation Skymaster operatives were able to gain the trust of Colombian peso brokers working for Colombian narcotics traffickers, who directed the undercover operatives to retrieve bulk cash narcotics proceeds. The undercover operatives placed this drug cash into government-controlled accounts.

After each pick-up, the peso brokers instructed the operatives to wire-transfer the money to designated bank accounts. Using the Colombian BMPE, the peso brokers "exchanged" the dollars on deposit in the undercover bank accounts for Colombian pesos obtained from Colombian importers of U.S. goods. The peso brokers arranged to have the dollars wired to the bank accounts of U.S. exporters as payment for the goods received by the Colombian importers and also to other third parties involved in BMPE exchanges. To complete the laundering cycle, the importers received confirmation that the dollar wire transfers were sent and then paid the peso brokers the equivalent in pesos. Later, the peso brokers delivered the pesos to the Colombian drug trafficking groups.

Operation Skymaster has already resulted in 14 indictments against 29 defendants; 12 convictions on money laundering or drug conspiracy charges have already been secured. In addition, civil forfeiture actions have been instituted against the bank accounts that received the wire-transferred drug proceeds in the United States and in foreign jurisdictions.

Operation Juno: In a similar case, Operation Juno combined the talents of the Drug Enforcement Administration, the Internal Revenue Service Criminal Investigation Division, and the United States Attorney's Office in Atlanta in a task force anti-money-laundering investigation. In December 1999, a federal grand jury in Atlanta indicted five defendants from Colombia who were involved in a multimillion dollar scheme involving money laundering and drug distribution. At the request of the now-indicted defendants, undercover agents participating in Operation Juno picked up drug proceeds usually ranging between $100,000 and $500,000 in U.S. currency. The pickup of drug proceeds occurred in a variety of other U.S. cities, including Dallas, Houston, New York, Newark, Providence, and Chicago, as well as in Madrid and Rome.

Operation Juno later wire-transferred the money from the collection city to an undercover bank account in Atlanta. At the direction of the now-indicted individuals, the money was then distributed to various accounts in the United States and around the world. As in Operation Skymaster, the drug proceeds in Operation Juno were laundered through the Colombian Black Market Peso Exchange, as peso brokers "exchanged" the dollars on deposit in the undercover bank accounts for Colombian pesos obtained from Colombian importers of U.S. goods. Again, civil forfeiture actions were filed to recoup the funds that were wire-transferred into the domestic and foreign accounts.

DIFFICULTIES IN INTERNATIONAL MONEY LAUNDERING CASES: OPERATION CASABLANCA

Operations Skymaster and Juno succeeded not merely in terms of criminal investigations, indictments, convictions, and forfeitures of assets, but also by exposing and destroying parts of the Colombian Black Market Peso Exchange. Yet the forfeiture cases spawned by Operations Skymaster and Juno investigations underscore the difficulties in forfeiting illegal proceeds sent outside of the United States, especially when those proceeds are transferred through correspondent bank accounts.

First, due to the existence of offshore banks with representative offices in other foreign countries, U.S. law enforcement officials often encounter difficulty trying to determine the actual location of the funds and in which jurisdiction to focus forfeiture efforts. Even where U.S. law enforcement requests the assistance of the correct foreign jurisdiction, our ability to forfeit these funds depends upon the strength of the forfeiture laws in that jurisdiction, which, if available, are frequently incompatible with U.S. law, and upon the cooperation of the foreign government.

Moreover, limitations of domestic U.S. forfeiture law can lead to complex, time-consuming legal issues with respect to jurisdiction and venue for the forfeiture case. This is particularly true in cases in which U.S. law enforcement does not know initially the final destination or beneficiary of the funds sent through a correspondent account and only determines this fact at a later point in time.

Problems presented by correspondent bank accounts in forfeiture cases have arisen not only in Operations Skymaster and Juno, but in other cases as well. For example, in Operation Casablanca, a money laundering prosecution based in Los Angeles involving foreign banks and their correspondent accounts, prosecutors in Washington, D.C., filed civil forfeiture complaints in the District of Columbia against the funds wire-transferred to foreign accounts. Our efforts to have these funds frozen and forfeited met with a variety of results, depending on the jurisdiction to which they were transmitted. In some cases, we received cooperation from our foreign counterparts, and in others we did not. In some cases where there was cooperation, challenges and questions were raised as to the appropriate venue and jurisdiction for the action, as well as to the actual location of the funds.

For example, in one instance funds had been wire-transferred to a bank account in a foreign location. After filing a civil forfeiture complaint, the Justice Department requested assistance from the foreign government in freezing these funds, pursuant to the 1988 Vienna Convention. As a result, our foreign counterparts interviewed employees of the bank and determined that the bank, as well as the account to which the funds had been transferred, was actually located in another jurisdiction.

Pursuant to a mutual legal assistance treaty with the second country, the department advised authorities that we had information concerning the transfer of drug proceeds to bank accounts within its jurisdiction. Because the laws of this second country only recognized criminal forfeiture and did not allow for assistance to the United States in a civil forfeiture action, the government of the second country opened its own investigation based on the information we provided, and subsequently froze the accounts. However, because the defendants were not then before that court, it was unclear whether the funds could be forfeited criminally. In addition, the bank did not appear to have any actual buildings or branches within the court's jurisdiction, and the assets securing the bank's obligations were not located in the country. Finally, having come almost full circle, it was determined that the assets we were pursuing were likely located in the foreign bank's correspondent account in a U.S. bank in New York City.

Indeed, there remains a great deal of uncertainty today as to the prospects for success in the U.S. civil forfeiture action because there is a potential claim that the assets in question were actually "located" in the foreign bank's correspondent account in New York — thereby drawing into question whether the District of Columbia is the appropriate jurisdiction for purposes of the underlying civil forfeiture action. This scenario illustrates the difficulties we face in tracing, seizing, and forfeiting assets held in correspondent accounts of foreign banks.

It should be noted that the above examples describe a situation where the foreign governments were cooperative with the U.S. requests. In many cases, such cooperation cannot be obtained, and the difficulties are further exacerbated if we are dealing with a non-cooperative bank secrecy jurisdiction.

INTERNATIONAL COOPERATION AND ASSET SHARING

To defeat international money launderers, it is imperative that the nations of the world work together to exchange information and provide cooperation in investigations and asset forfeiture cases. It is the policy and practice of the United States, pursuant to statutory authority, to share the proceeds of successful forfeiture actions with countries that made possible or substantially facilitated the forfeiture of assets under U.S. law. As of July 2000, the Department of Justice, with the concurrence of the U.S. secretary of state, has transferred approximately $169 million to 26 countries in recognition of their forfeiture assistance. We believe that asset sharing among countries enhances international forfeiture cooperation by creating an incentive for countries to work together, regardless of where the assets are located or which jurisdiction will ultimately enforce the forfeiture order. The most important issue is to take the criminal proceeds away from the criminals.

A complete strategy against drug trafficking and organized criminal activity must focus on the financial aspect of the criminal activity. In order to accomplish this, there must be a comprehensive set of laws that criminalize money laundering, provide for asset seizure and forfeiture, and facilitate international cooperation. In addition, a full range of regulatory measures, such as comprehensive bank supervision and a system of suspicious activity reporting, are necessary to deter and detect money laundering. Only by working together on the interagency and international levels will we be able to stem the flow of criminal proceeds and cripple criminal organizations. ❑

❑ ACHIEVING A SUSTAINED RESPONSE TO MONEY LAUNDERING

By Steven L. Peterson, Acting Office Director, Crime Programs,
Bureau of International Narcotics and Crime Affairs, U.S. Department of State

A country attempting to attack money laundering needs to have legal, financial, and law enforcement infrastructure in place, says Steven L. Peterson of the State Department's Bureau of International Narcotics and Crime Affairs. He says cooperation between the country's public and private sectors is crucial, as is cooperation with other countries.

Training for all the agencies enlisted in the fight against money laundering is important, too, and several U.S. government agencies provide that training, Peterson says.

Fighting money launderers not only reduces financial crime; it also deprives criminals and terrorists of the means to commit other serious crimes. To successfully combat money laundering, a country must address several important conditions:

• First, national officials should ensure that they have the necessary legal, financial, and law enforcement structures in place to combat money laundering. "The Forty Recommendations" of the Financial Action Task Force (FATF), the accepted international standard in this regard, outline the steps that countries must take to protect themselves from money laundering abuse. (For additional information on FATF and the forty recommendations, see the article "The Financial Action Task Force on Money Laundering" in this issue.) Each country must ensure that its own law enforcement agencies, regulators, and judicial systems are communicating, sharing vital information, and working together.

• Second, it is necessary to involve business leaders in the private sector, especially in financial services, to support government initiatives against money laundering and financial crime.

• Third, countries should actively participate in international and regional forums to increase knowledge and cooperation against money laundering.

• Fourth, countries need the ability through cooperative agreements to share important information about money laundering and financial crime rapidly so that globalization works against the money launderer instead of being his ally.

TRAINING AND TECHNICAL ADVICE

Properly structured training and technical assistance programs are critical to building institutions capable of a sustained approach to the problem of money laundering. Under such an approach, countries eventually are able to increase their own anti-money-laundering capabilities to the point where they become effective partners in global efforts to combat money laundering.

The U.S. Department of State's Bureau for International Narcotics and Law Enforcement Affairs (INL) develops assistance programs to combat global money laundering. INL participates in and supports international anti-money-laundering bodies and provides policy recommendations regarding international money laundering activities.

The State Department has developed a programmatic approach to assist jurisdictions in developing anti-money-laundering regimes to protect their economies and governments from abuse by financial criminals and stem the growth of international money laundering. This approach integrates training, technical assistance, and money laundering assessments on specific money laundering problems or deficiencies to achieve concrete, operational, institution-building objectives.

For example, with this approach, operational and policy planners may determine that a critical deficiency exists in a given country because it lacks a financial intelligence unit (FIU) that can serve as the focal point for national anti-money-laundering programs. FIUs provide the possibility of rapidly exchanging information (between financial institutions and law enforcement/prosecutorial authorities, as well as between jurisdictions), while protecting the interests of the innocent individuals contained in their data.

Since the reasons for the lack of an FIU can vary by country, these programs are tailored to meet the needs of each country. If, for instance, the critical problem is lack of regulations, the State Department may fund a regulator from the U.S. Federal Reserve System to assist the country in drafting appropriate regulations or guidelines and then provide a series of training courses so that regulators, compliance officers, and other officials can learn how to implement these regulations effectively. If it is a problem of hardware or analysis, the department may fund experts from the U.S. financial intelligence unit, called FinCEN, to assist this country.

During 2000, as part of this programmatic approach, the State Department funded various U.S. law enforcement and bank regulatory agencies to provide training and technical assistance on money laundering countermeasures and financial investigations to their counterparts around the globe. These courses give financial investigators, bank regulators, and prosecutors the necessary tools to recognize, investigate, and prosecute money laundering, financial crimes, and related criminal activity. Courses have been provided both in the United States and in the jurisdictions where the programs are focused.

INL funded over 60 programs in 2000 to combat international financial crimes and money laundering in 35 countries. Nearly every U.S. law enforcement agency assisted in this effort by providing basic and advanced training in all aspects of financial criminal activity. In addition, INL made funds available for intermittent posting of technical advisers at selected overseas locations. These advisers work directly with a host government in the creation, implementation, and enforcement of anti-money-laundering and financial crime legislation and the development of financial intelligence units. Further, INL provided funding to several federal agencies to conduct multi-agency financial crime training assessments and developed specialized training in specific jurisdictions to combat money laundering.

TRAINING PARTNERS

Among the federal agencies providing anti-money-laundering training and technical assistance components of these programs through INL funds are the following:

Financial Crimes Enforcement Network (FinCEN): FinCEN, the U.S. financial intelligence unit led by the Department of the Treasury, provides training and technical assistance to a broad spectrum of foreign government officials, financial regulators, law enforcement personnel, and bankers. This training covers a variety of topics, including money laundering typologies, the creation and operation of FIUs, the establishment of comprehensive anti-money-laundering regimes, computer systems architecture and operations, and country-specific anti-money-laundering regimes and regulations. FinCEN also works closely with the informal Egmont Group of more than 50 FIUs to assist various jurisdictions in establishing and operating their own FIUs.

Additionally, FinCEN has provided FIU and money laundering briefings and training in many jurisdictions, including Argentina, Armenia, Australia, the Bahamas, Brazil, Canada, China, Costa Rica, Dominican Republic, El Salvador, Germany, Greece, Hong Kong, India, Indonesia, Isle of Man, Jamaica, Jersey, Kazakhstan, Lebanon, Italy, Liechtenstein, Nauru, Nigeria, Netherlands, Palau, Paraguay, Russia, Seychelles, South Africa, Switzerland, St. Vincent and the Grenadines, Taiwan, Tanzania, Thailand, Tonga, and the United Kingdom. FinCEN has also conducted personnel exchanges with the Korean and Belgian FIUs.

Internal Revenue Service (IRS): The Treasury Department's Internal Revenue Service focuses its training on investigative techniques involving financial crime and money laundering. The goal of this training is to assist foreign governments in establishing or enhancing anti-money-laundering, criminal, tax, and asset forfeiture laws. In addition, the IRS provides assistance in the investigation of violations of these laws and promotes enhanced anti-money-laundering regimes that conform to international standards.

Training led by IRS Financial Crime Training in support of INL programs during 2000 included financial investigative techniques training in Nigeria, Russia, and Hungary; anti-money-laundering training in Russia, China, and Mexico; and advanced anti-money-laundering training in Mexico and complex financial investigations training in Thailand (taught jointly with the U.S. Customs Service).

Secret Service: The Treasury Department's Secret Service is extensively involved in training foreign government officials and law enforcement personnel about financial fraud schemes and counterfeit U.S. currency investigations and crimes involving electronic commerce.

During 2000, the Secret Service supported INL programs by training foreign law enforcement and financial institutions in China, Nigeria, Bulgaria, and Lithuania. Additional presentations were made at training academies in Hungary and Thailand, and the Secret Service provided independent classes in Bulgaria, Colombia, Greece, Italy, Mexico, and Romania, and at the Interpol conference in Lyon, France.

U.S. Customs Service (USCS): The Treasury Department's Customs Service, Office of Investigations, Financial Investigations Division, draws on its expertise in undercover drug money laundering and traditional money laundering investigations to impart its considerable experience to law enforcement, regulatory, and banking officials identified in INL programs.

As host or co-host with other federal agencies, the USCS conducted anti-money-laundering and financial crime seminars domestically and abroad for some 725 officials from 16 nations in 2000.

Office of Technical Assistance (OTA): The Treasury Department's Office of Technical Assistance delivers interactive, adviser-based assistance to senior-level representatives in various ministries and central banks in the areas of tax reform, government debt issuance and management, budget policy and management, financial institution reform, and law enforcement reforms related to money laundering and other financial crimes. OTA works with embassy staff and host country clients on long-term projects designed to promote systemic changes and new organizational structures. The program has provided technical assistance to more than a dozen countries worldwide.

During 2000, projects were conducted in a number of countries, including Armenia (technical assistance in the areas of financial crimes, organized crime, gaming crimes, and insurance fraud); El Salvador (drafting and implementing an anti-money-laundering law and helping to design, staff, and build the El Salvador Financial Investigation Unit); Georgia (in cooperation with the U.S. Agency for International Development, the Justice Department, and the U.S. Securities and Exchange Commission, completing a report on the enforcement authorities of the National Securities Exchange); Indonesia (training programs designed to enhance the forensic accounting abilities of Indonesian Bank Restructuring Agency personnel and to provide knowledge relating to financial investigations and asset recovery); and Moldova (technical assistance to the drafters of the economic and financial crime section of the criminal procedure code currently under consideration in Parliament, assistance to the Finance Ministry in organizing a tax evasion enforcement unit and a bank fraud working group, and forensic training and assistance in combating credit card fraud and document fraud and in developing the capabilities of the government's forensic laboratories). Advisers from the Enforcement Team also assisted Peru and Malaysia in drafting and discussing proposed anti-money-laundering legislation.

Overseas Prosecutor Development and Training Section (OPDAT): The Department of Justice's OPDAT group within the Criminal Division is Justice's primary source for the training of foreign prosecutors, judges, and law enforcement. During 2000, OPDAT sponsored 13 seminars throughout the world that dealt with money laundering and asset forfeiture issues. Some 800 students received training in transnational money laundering, international asset forfeiture, and asset sharing.

Additionally, the department's Asset Forfeiture and Money Laundering Section conducted a regional Asset Forfeiture and Money Laundering conference in Buenos Aires, which included 200 prosecutors and law enforcement officials from Argentina, Brazil, Paraguay, Uruguay, and Bolivia.

Drug Enforcement Administration (DEA): The Drug Enforcement Administration's Office of Training, International Training Section, as part of the U.S. Department of Justice Asset Forfeiture Program, conducts seminars on international asset forfeiture and money laundering. These seminars share, compare, and contrast U.S. legislation with that of other countries, building relationships and fostering communications with foreign narcotics enforcement and prosecutorial personnel on money laundering and asset forfeiture issues. DEA offers a number of other anti-money-laundering courses, including specialized training for foreign central bank regulators, police and customs officials, and prosecutors. During 2000, seminars were conducted in Hungary, Panama, Peru, Singapore, South Africa and Spain, plus a regional anti-money-laundering training session in Brazil.

Federal Bureau of Investigation (FBI): The FBI Money Laundering Unit within the Justice Department trains international law enforcement personnel to investigate various methods of money laundering. The training emphasizes the techniques that money launderers use to conceal or disguise the nature of illicit cash proceeds and provides law enforcement with the ability to trace the location, source, or ownership of these proceeds. The FBI has also provided experts for advanced training in traditional and emerging technologies, such as digital cash, smart cards, and Internet banking.

During 2000, the FBI participated in money laundering and financial crimes training courses in Moldova, Pakistan, Panama, Poland, Russia, Slovakia, Ukraine, and Vietnam. In addition, the FBI has offered independent money laundering training and briefings at the FBI Academy in Quantico, Virginia, and at FBI headquarters in Washington, D.C.

Board of Governors of the Federal Reserve System: Staff of the Federal Reserve, the U.S. central bank, provides training in anti-money-laundering procedures to foreign law enforcement officials and central bank supervisory personnel in dozens of jurisdictions each year. These have included Argentina, Brazil, Caribbean jurisdictions, Chile, Czech Republic, Ecuador, Poland, Russia, South Pacific jurisdictions, United Arab Emirates, and Uruguay.

MULTILATERAL ASSISTANCE INITIATIVES

As part of its anti-money-laundering program, INL recognizes the need for regional-based, long-term training programs. For example, INL, along with the European Union and the United Kingdom, funds the Caribbean Anti-Money-Laundering Programme (CALP), which aims to reduce the incidence of the laundering of the proceeds of all serious crime by facilitating the prevention, investigation, and prosecution of money laundering. CALP also seeks to develop a sustainable institutional capacity in the Caribbean to address the issues related to anti-money-laundering efforts at the local, regional, and international levels.

INL also participates in and provides significant financial support for many of the anti-money-laundering bodies around the globe. During 2000, support was furnished to the Asia/Pacific Group on Money Laundering (APG), the Caribbean Financial Action Task Force, the Financial Action Task Force, and the Council of Europe (COE); additional support was provided to the APG and COE to conduct mutual evaluation training programs for their members.

These INL training programs follow an the interagency approach, bringing together, where possible, foreign law enforcement, judicial, and central bank authorities in assessments and training programs. This allows for an extensive dialogue and exchange of information. This approach has been used successfully in Asia, Central and South America, Russia, the Newly Independent States, and Central Europe.

INL also provides funding for many of the regional training and technical assistance programs offered by the various law enforcement agencies, including those at international law enforcement academies (ILEAs). The ILEAs were organized and are funded by INL to conduct a variety of law enforcement courses to mid-level managers. Core law enforcement training includes modules on financial crime and money laundering, and seminars on these subjects were conducted for senior law enforcement officials at some of the ILEAs.

The ILEA's initiative is regionally based. The first ILEA for Europe was established in Budapest and is focused primarily on training the police and criminal justice services of Central Europe and the Newly Independent States. An ILEA for Southeast Asia opened in March 1999 in Bangkok, and more than 1,000 officials from 10 Southeast Asian nations have attended courses. An ILEA has also been established for the Western Hemisphere, but a permanent location for this ILEA is still being considered. In addition, an ILEA for Southern Africa, located in Gaborone, Botswana, opened on April 23, 2001. ❑

❑ UNDERSTANDING THE WASH CYCLE

By Paul Bauer, Economic Adviser and Rhoda Ullmann, Research Assistant, Federal Reserve Bank of Cleveland

Money laundering has gone on since the first crime was committed for profit, but it has been explicitly illegal in the United States only since 1986, say Paul Bauer and Rhoda Ullman of the Federal Reserve Bank of Cleveland.

This article describes the money laundering process, summarizes the evolving statutes, and describes the role of the Federal Reserve System, the U.S. central bank, in assisting in their enforcement.

Bauer is an economic adviser and Ullman is a research assistant at the bank.

"Follow the money."

This was the advice of "Deep Throat," the key informant to *Washington Post* reporter Bob Woodward, in his investigation of the Watergate scandal.

Although the phrase "money laundering" did not even appear in print until the Watergate scandal, criminal investigators have long adhered to Deep Throat's sound advice. While not officially outlawed until 1986, money laundering — or failure to do it well — has figured in many prominent cases. Two of America's most notorious criminals in the 20th century were undone by failure to cover their financial tracks. Gangster Al Capone was finally convicted of tax evasion, not racketeering. Bruno Richard Hauptmann, who kidnapped the son of famed aviator Charles Lindbergh in 1932, was caught because he failed to launder the ransom money successfully. And, as we saw in 1999, when concerns arose about funds that may have been obtained illegally in Russia possibly entering the U.S. banking system, the problem of "dirty money" has not gone away.

Because criminals have a strong incentive to disguise their activities, the amount of money laundered is not known precisely, but the International Monetary Fund has estimated that the annual total is equivalent to around 3 to 5 percent of the world's output. Alternatively, the Group of Seven (G-7) nations' Financial Action Task Force puts the figure at $300,000 million to $500,000 million worldwide. According to *Business Week* magazine, more than $2,000,000 million courses daily through the U.S. economy alone, so law enforcement is necessarily a needle-in-a-haystack effort.

WASH-CYCLE BASICS

Money laundering involves three steps that sometimes overlap: placement, layering, and integration. During the placement stage, the form of the funds must be converted to hide their illicit origins. For example, the proceeds of the illegal drug trade are mostly small-denomination bills, bulkier and heavier than the drugs themselves. Converting these bills to larger denominations, cashier's checks, or other negotiable monetary instruments is often accomplished using cash-intensive businesses (like restaurants, hotels, vending machine companies, casinos, and car washes) as fronts.

In the layering stage, the launderer tries to obscure further the trail linking the funds with the criminal activity by conducting layers of complex financial transactions. For example, sophisticated criminals with large sums to launder set up shell companies in countries known either for strong bank secrecy laws or for lax enforcement of money laundering statutes. The tainted funds are then transferred among these shells until they appear clean.

These transactions must be disguised to blend in with the trillions of dollars of legitimate transactions that occur every day. Variations of "loan-backs" and "double invoicing" are common techniques. With a loan-back, the criminal puts the funds in an offshore entity that he secretly controls and then "loans" them back to himself. This technique works because it is hard to determine who actually controls offshore accounts in some nations. In double invoicing — a scam for moving funds into or out of a country — an offshore entity keeps the proverbial two sets of books. To move "clean" funds into the United States, a U.S. entity overcharges for some good or service.

To move funds out (say, to avoid taxes), the U.S. entity is overcharged.

Other layering techniques involve buying big-ticket items — securities, cars, planes, travel tickets — that are often registered in a friend's name to further distance the criminal from the funds. Casinos are sometimes used because they readily take cash. Once converted into chips, the funds appear to be winnings, redeemable by a check drawn on the casino's bank. The integration stage is the big payoff for the criminal. At this stage, he moves the funds into mainstream economic activities — typically business investments, real estate, or luxury goods purchases.

KEY U.S. LEGISLATION

Law enforcement agencies are fond of money laundering legislation because it may be more effective than a direct attack on criminal activity. In the illicit drug trade, for example, profit rates can reach 1,000 percent — tempting enough to ensure that a steady supply of criminals will replace those carted off to jail. However, if its rewards can be reduced through legislation and enforcement, then so can its appeal.

The foundation of U.S. money laundering laws is the Bank Secrecy Act (BSA) of 1970, which does not criminalize the activity but does require financial institutions to create and preserve a "paper trail" for various types of transactions. The BSA has been challenged repeatedly. Some criticize the compliance costs it imposes. Others claim it infringes on the Fourth Amendment protection of the U.S. Constitution against unreasonable search and seizure and Fifth Amendment guarantees against self-incrimination. Although it has been upheld repeatedly, the BSA remains controversial in some quarters. In one case that went all the way to the U.S. Supreme Court, the forceful dissenting opinion written by Justice Douglas said, "I am not yet ready to agree that America is so possessed with evil that we must level all constitutional barriers to give our civil authorities the tools to catch criminals."

As the drug trade grew, the U.S. Congress became increasingly concerned with money laundering and moved to outlaw it in 1984 by making BSA violations predicate acts under the Racketeer Influenced and Corrupt Organizations Act. Finally, the Money Laundering Act (1986) made money laundering a federal crime. It added three new offenses to the criminal code: knowingly helping to launder money from criminal activity, knowingly engaging in a transaction of more than $10,000 involving property from criminal activity, and structuring transactions to avoid BSA reporting requirements. This last element targeted "smurfs," people hired by launderers to make multiple deposits or purchases of cashiers' checks in amounts just under the $10,000 threshold.

This legislation has been amended several times. The Anti-Drug Abuse Act (1988) significantly increased the penalties and, required strict identification and record keeping for cash purchases of certain monetary instruments. (Most of the requirements related to keeping records of cash purchases of monetary instruments have since been repealed.) In addition, the legislation permitted the U.S. Department of the Treasury to force financial institutions to file additional geographically targeted currency transaction reports. The secretary of the treasury can issue an order requiring financial institutions in a specific geographic area to file currency transaction reports for less than the $10,000 threshold. The act also directed the Treasury to negotiate bilateral international agreements for recording large transactions of U.S. currency and sharing this information.

The Annunzio-Wylie Anti-Money Laundering Act (1992) enlarged the BSA's definition of "financial transactions," added a conspiracy provision, and outlawed the operation of "illegal money transmitting businesses." Annunzio-Wylie is best known for establishing what has become known as the "death penalty," which provides that if a bank is convicted of money laundering, the appropriate federal bank supervisor must begin a proceeding to either terminate its charter or revoke its insurance, depending on the bank's primary supervisor. Annunzio-Wylie also created the BSA Advisory Group (of which the Federal Reserve is a founding member) to suggest methods for increasing the effectiveness and efficiency of the Treasury Department's anti-laundering programs.

The Money Laundering Suppression Act (1994) tinkered with the law's conspiracy and structuring provisions while the Terrorism Prevention Act (1996) added terrorist crimes as predicate acts to money laundering violations, and the Health Insurance Portability and Accountability Act (1996) made "federal health care offenses" predicate acts as well.

Criminal penalties include prison terms as long as 20 years and fines up to $500,000 or twice the value of the monetary instruments involved, whichever is greater. On top of the criminal penalties, violators may face civil penalties up to the value of the property, funds, or monetary interests involved in a transaction. The U.S. Congress intended these punishments to be harsh. Before the 1986 Money Laundering Act, defendants had to be prosecuted under other statutes related to the underlying unlawful activities that had induced the money laundering, such as tax evasion, conspiracy, BSA, bribery, and fraud. Generally, these statutes have far less severe penalties.

But from a monetary perspective, life for accused violators gets really nasty when the forfeiture laws kick in. Forfeiture is intended to prevent criminals from keeping either the fruits of their crimes or the tools used to commit them. Under the Civil Asset Forfeiture Reform Act of 2000, the U.S. government must now clear a slightly higher hurdle to seize and forfeit assets. To seize assets, it must show probable cause that the property is from criminal activity. To win civil forfeiture, it must prove its case by a preponderance of the evidence, and to win criminal forfeiture, it must prove its case beyond a reasonable doubt. Forfeited assets may be shared with all law enforcement agencies involved in obtaining a conviction, a policy that has been particularly effective in obtaining cooperation from some foreign law enforcement agencies.

Legally, money laundering is defined as any attempt to engage in a monetary transaction that involves criminally derived property. To convict, prosecutors must show that the defendant engaged in financial transactions or international transportation that involved funds from a "specified unlawful activity." The list of such activities is extremely long and includes bribery, counterfeiting, drug trafficking, espionage, extortion, fraud, murder, kidnapping, racketeering, and certain banking practices.

THE PAPER TRAIL

Prosecutors consider the paper trail mandated by the BSA and its amendments to be a crucial tool in the investigation and prosecution of money laundering offenses. They use five kinds of reports to track financial transactions:

• Currency transaction report: filed when a financial institution receives or dispenses more than $10,000 in currency. The report includes the name and address of the person who presents the transaction and the identity, account number, and Social Security number of anyone for whom a transaction is made. (Currency transaction reports need not be filed for every large cash transaction. Banks can exempt certain customers from this obligation, thereby reducing the number of currency transaction report filings.)

• Suspicious activity report: filed when any bank employee has reason to suspect a person of money laundering, regardless of the transaction size.

• IRS Form 8300: filed by any person involved in a business that receives cash payments in exchange for goods or services exceeding $10,000 in a single transaction or a series of related ones.

• Currency and monetary instruments report: filed by anyone entering or leaving the United States with currency or monetary instruments in excess of $10,000. Carrying more than this amount is perfectly legal, but failure to file the report can lead to fines, up to five years in prison, or forfeiture.

• Foreign bank account form: filed by anyone controlling more than $10,000 in a foreign account during the year.

All these reports help investigators "follow the money." The Financial Crimes Enforcement Network (FinCEN), which was created by Treasury Department order in 1990 to give law enforcement agencies analytical support, is now charged with maintaining these reports as well. On occasion, the reporting requirements have been adjusted so that useful information is gathered without generating a flood of unnecessary reports.

By filing these forms, financial institutions aid law enforcement authorities in the fight against money laundering. The forms also impose real costs on these institutions and on legitimate customers. FinCEN estimated that reporting and record-keeping costs associated with BSA compliance in 1999 totaled $109 million, which does not include the costs of training and monitoring personnel, modifying computer programs to enable compliance, and inconveniencing legitimate customers. There is also concern that a disproportionate share of these costs may fall on smaller institutions.

In addition, the forms' effectiveness has been questioned. Former Federal Reserve Governor Larry Lindsey observed that between 1987 and 1996, banks filed 77 million currency transaction reports; these led to only 3,000 money laundering cases, in which 7,300 defendants were charged but only 580 were convicted. To be fair, in addition to 580 guilty verdicts, the U.S. Department of Justice obtained 2,295 guilty pleas, for a 40 percent sentencing rate. Bank regulators and law enforcement representatives defend the BSA applications, countering that currency transaction reports were never designed to generate prosecutions, and the Federal Reserve Board continues to support them.

THE GLOBAL SPIN CYCLE

In the evolving global financial system, funds can be moved instantaneously from one country to another, making international cooperation even more important in combating money laundering. In 1989, the G-7 nations established a Financial Action Task Force (FATF) to develop anti-laundering strategies. The next year, the task force drafted "The Forty Recommendations," which requires member countries to assist each other in money laundering investigations, avoid enacting secrecy laws that hamper such investigations, criminalize money laundering, and report suspicious transactions.

Although the task force involves the major financial centers in North America, Europe, and Asia, many countries are not yet FATF participants. In June 2000, the task force released a list of 15 countries with "serious systemic problems." In July, finance ministers from the G-7 nations followed up with a plan to persuade these countries to cooperate by threatening to cut off their access to the international banking system — as well as International Monetary Fund and World Bank loans — unless they combat money laundering more aggressively. In addition, private financial institutions in G-7 countries will be warned that transactions with target countries will draw intense scrutiny.

THE FEDERAL RESERVE'S ROLE

Although the Federal Reserve is not a law enforcement agency, it works actively to deter the use of financial institutions for laundering. The Federal Reserve's activities include conducting BSA exams, developing anti-laundering guidelines, and providing expertise to U.S. law enforcement officers and various foreign central banks and government agencies. Financial organizations and their employees are considered the strongest defense against money laundering, and the Federal Reserve emphasizes the banks' importance in establishing controls to protect themselves and their customers from illicit activities. In every examination the Fed supervises, it verifies the bank's BSA compliance. Any indication of deficiencies, such as inadequate internal controls or training, results in a second-stage examination that is even more rigorous.

The Federal Reserve has been promoting the concept of "enhanced due diligence." Under this policy, banks that have experienced problems will be required to enter agreements to ensure future compliance. These agreements are designed to reasonably ensure the identification and timely, accurate, and complete reporting of known or suspected criminal activity against or involving the bank to law enforcement and supervisory authorities.

FUTURE CONSIDERATIONS

Two developments warrant close monitoring. First, Internet-based payment systems are being developed to facilitate electronic transactions. Some of these systems seek to give users as much anonymity as currency provides.

The speed of electronic transfers, combined with the anonymity of cash, would appeal strongly to launderers. While this is a potential law enforcement concern, today's e-money lacks the large volume of legitimate transactions essential to provide cover for criminal ones. Moreover, launderers are not drawn to most current electronic purse schemes, in which balance limits are low and transactions can be audited.

Second, proposed legislation would grant the Treasury Department sweeping new powers to fight money laundering, the centerpiece being an ability to ban financial transactions between offshore financial centers and U.S. banks or brokerage houses. The Treasury now has no power to prevent U.S. financial entities from transacting business in countries that allegedly tolerate money laundering, short of asking Congress to declare emergency sanctions against nations deemed security threats. The Treasury issues advisories warning banks against money from foreign institutions that repeatedly violate accepted standards, but these advisories lack the force of law.

In sum, over the last 30 years, U.S. lawmakers have enacted a broad array of domestic legislation, striving to forge the enforcement tools they need to combat money launderers' ingenious and continuously evolving techniques for circumventing the previous piece of legislation. As a bank regulator, the Federal Reserve has an important supporting role in the struggle against money laundering. Because launderers' operations are global, the recent increase in international cooperation is a promising development. Of course, in our zeal to catch criminals, we must weigh the benefits of legislation and regulation against the costs they impose on financial institutions and their customers. ❑

Note: The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government, the Federal Reserve Bank of Cleveland, or the Board of Governors of the Federal Reserve System.

❑ U.S. BANKING: AN INDUSTRY'S VIEW ON MONEY LAUNDERING

By Ann T. Vitale, Esq.

Both to protect their own reputations and to adhere to the requirements of laws and regulations, U.S. banks conduct vigorous programs to prevent money laundering abuse of their business, says Anne Vitale, former managing director and deputy general counsel of the Republic National Bank of New York, where she directed the global anti-money-laundering program.

Most important for the success of such programs, she says, is the demonstration of commitment from senior management.

In the United States, actions by banks to prevent money laundering are not only a regulatory requirement, but also an act of self-interest. All financial institutions, both banks and non-banks, are susceptible to money laundering activities. However, banks have taken the lead in developing programs to prevent and detect money laundering, which their non-bank counterparts would do well to emulate. Money laundering as well as the underlying criminal activity — fraud, counterfeiting, narcotics trafficking, and corruption — weaken the reputation and standing of any financial institution. A bank tainted by money laundering accusations from regulators, law enforcement agencies, or the press faces serious challenges to its reputation.

As a result, over the past decade U.S. banks have developed comprehensive programs to prevent their activities from being abused for money laundering.

To implement effective anti-money-laundering procedures, banks must understand the laundering process. Basically, that process has three stages, each of which involves interaction with a financial institution:

• Placement — physically disposing of cash proceeds derived from illegal activity.

• Layering — separating illicit proceeds from their source by creating complex layers of financial transactions designed to hamper the audit trail, disguise the origin of such funds, and provide anonymity to their owners.

• Integration — placing the laundered proceeds back into the economy in such a way as to appear as resulting from legitimate business activity.

Law enforcement agencies and regulators require financial institutions to adopt procedures to guard against and report suspicious transactions that occur at each of these stages. Accordingly, U.S. banks strive to conduct due diligence in order to prevent the use of its institution for criminal purposes.

Due diligence increases the likelihood that the bank complies with established laws and regulations and decreases the likelihood that the bank will become a victim of money laundering, fraud, or other illegal activities. Moreover, it protects the bank's good name without interfering with good customer relationships.

U.S. banks have typically adopted procedures to apply scrutiny at the time a client opens an account and to monitor ongoing activity through the account. What follows is a summary description of what comprises a successful anti-money-laundering program.

Identification Procedures: A bank must develop and implement comprehensive procedures for opening accounts, establishing loan and other business relationships, and conducting transactions with non-account holders. The bank must know the true identity of a customer, including the beneficial owner, requesting any of its services. Identification must be verified to prevent establishment of accounts for fictitious beneficiaries.

In addition, the bank must know the customer's business or professional activities; sources of the customer's income, wealth, or assets; and the specific source of the money subject to transactions at the bank. The purpose of the account should be noted. The bank should develop a sense of the types of transactions in which the customer normally engages. When opening a client account, bank personnel should know whether the client may be included in a high-risk category, indicating the need for enhanced monitoring.

Monitoring Procedures: Internal systems must be in place for identifying and monitoring transactions that appear to be suspicious. Suspicious activity includes transactions for which no legitimate activity can be ascertained. It also may include transactions that fall outside the parameters that the bank establishes. What is important to note is that, given the huge number of transactions banks process each day, banks cannot monitor every single transaction. Banks must therefore assess the risk inherent in doing business with a specific type of account, with a specific geographic area, and with a specific type of transaction.

A bank should review any single transactions or series of transactions that exceed a money threshold set for its typical services: opening deposits; monthly wire transfers; transactions in cash, traveler's checks, money orders, bank checks, third party checks, cashier's checks; internal transfers; credit facilities', and trading — including the buying and selling of currencies, options, and precious metals.

Additionally, significant increases in activity should be monitored. Accounts that may have a high risk for suspicious transactions — such as accounts of non-bank financial institutions, offshore accounts, personal investment company accounts, correspondent accounts, accounts subject to subpoena or other legal process, accounts of politicians, accounts from high-risk jurisdictions lacking effective anti-money-laundering controls — should receive greater scrutiny. A bank should set thresholds and change them from time to time to check whether they remain adequate. Once a bank system has identified possible suspicious activity, trained personnel must investigate whether the transactions represent legitimate business activity. If no information can substantiate such legitimate activity, the bank has the duty to file a suspicious activity report.

Training Procedures: Banks should conduct ongoing education programs for bank staff to review money laundering techniques, anti-money-laundering procedures, changes in applicable laws and regulations, and the kind of transactions that may warrant investigation. Regular training should include how to identify and follow up on unusual or suspicious activities. The bank should train not only all personnel who have account relationships but also appropriate back office personnel. All new employees should be provided with guidelines concerning anti-money-laundering procedures.

Auditing and Accountability: A bank should conduct annual audits of each department's compliance with due diligence policies and procedures. Each employee should receive a copy of the written anti-money-laundering procedures and sign an attestation that he or she has read them, understands them, and will abide by them. Evaluations of personnel should include how well each employee adheres to the bank's anti-money-laundering policy.

Anti-Money-Laundering Unit: Banks should establish adequately staffed and trained independent departments responsible for the development and enforcement of the bank's anti-money-laundering policy and procedures. It is important that these units be independent of business units — sometimes they are a part of the compliance, control, or legal departments. In addition to developing and enforcing the bank's procedures, the units should investigate transactions referred to them that may be suspicious. Instances of suspicious activity must be communicated to the anti-money-laundering unit in order to file reports of suspicious activity as required by law.

What perhaps is the most important element of a successful anti-money-laundering program is the commitment of senior management, including the chief executive officer and the board of directors, to the development and enforcement of the anti-money-laundering objectives. Senior management must send the signal that the corporate culture is as concerned about its reputation as it is about profits, marketing, and customer service.

It is important to realize that no anti-money-laundering program is going to be 100 percent successful. Money launderers employ increasingly sophisticated techniques to avoid banks' detection programs. Nonetheless, a program like the one outlined above greatly improves a bank's ability to prevent and detect money laundering and to satisfy government requirements that it has been duly diligent in preventing access to those who would conduct illegitimate transactions. In short, such a program enhances the bank's ability to preserve its reputation for integrity and risk-adverse practices. ❑

Note: The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

❑ CORRESPONDENT BANKING: A GATEWAY FOR MONEY LAUNDERING

By Linda Gustitus, Elise Bean, and Robert Roach, Democratic Staff, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

The Democratic staff of the U.S. Senate Permanent Subcommittee on Investigations, under the leadership of Senator Carl Levin, conducted a year-long investigation of correspondent banking and its use as a tool for laundering money. The staff's investigation led them to conclude that allowing high-risk foreign banks and their criminal clients access to U.S. correspondent bank accounts, among several negative impacts, "facilitates crime" and "undermines the U.S. financial system." In their view: "It is time for U.S. banks to shut the door to high-risk foreign banks and eliminate other abuses of the U.S. correspondent banking system."

During a series of hearings held in February and March, Senator Susan Collins, the Republican chairwoman of the subcommittee, expressed her concern about the lapses in the banking indusry revealed in the report. The hearings represented an early step in a long process where the proposals contained here, and others yet to be submitted, may be the basis for future legislative remedy and self-corrective action by the banking industry.

The staff's findings are summarized in the report "Correspondent Banking: A Gateway for Money Laundering," which was issued in February 2001 and is adapted here.

U.S. banks, through the correspondent accounts they provide to foreign banks, have become conduits for "dirty money" flowing into the American financial system and have, as a result, facilitated illicit enterprises, including drug trafficking and financial frauds. Correspondent banking involves one bank's providing services to another bank to move funds, exchange currencies, or carry out other financial transactions. Foreign banks can establish U.S. correspondent accounts with any bank that is authorized to conduct banking activity in the United States, whether or not the bank's parent company is domiciled here. These accounts give the owners and clients of poorly regulated, poorly managed, sometimes corrupt, foreign banks that have weak or no anti-money-laundering controls direct access to the U.S. financial system and the freedom to move money within the United States and around the world.

Many banks in the United States have established correspondent relationships with high-risk foreign banks. These foreign banks can be: (1) shell banks with no physical presence in any country for conducting business with their clients, (2) offshore banks with licenses limited to transacting business with persons outside the licensing jurisdiction, or (3) banks licensed and regulated by jurisdictions with weak anti-money-laundering controls that invite banking abuses and criminal misconduct. Some of these foreign banks are engaged in criminal behavior, some have clients who are engaged in criminal behavior, and some have such poor anti-money-laundering controls that they do not know whether or not their clients are engaged in criminal behavior.

These high-risk foreign banks typically have limited resources and staff, and they use their correspondent bank accounts to conduct operations, provide client services, and move funds. Many of the banks reviewed by the subcommittee deposit all of their funds in, and complete virtually all transactions through, their correspondent accounts, making correspondent banking integral to their operations. Once a correspondent account is open in a U.S. bank, not only the foreign bank but also its clients can transact business through the U.S. bank.

THE PITFALLS OF CORRESPONDENT RELATIONSHIPS

The industry norm today is for U.S. banks to have dozens, hundreds, or even thousands of correspondent relationships, including a number of relationships with high-risk foreign banks. Virtually every U.S. bank examined in the minority staff investigation had accounts with offshore banks, and some had relationships with shell banks.

In many cases, high-risk foreign banks have been able to open correspondent accounts at U.S. banks and conduct their operations through these accounts because U.S. banks fail to adequately screen and monitor foreign banks as clients.

The prevailing principle among U.S. banks has been that any bank holding a valid license issued by a foreign jurisdiction qualifies for a correspondent account because U.S. banks should be able to rely on the foreign banking license as proof of the foreign bank's good standing. U.S. banks have too often failed to conduct careful due diligence reviews of their foreign bank clients, including obtaining information on the foreign bank's management, finances, reputation, regulatory environment, and anti-money-laundering efforts.

The frequency of U.S. correspondent relationships with high-risk banks, as well as a host of troubling case histories uncovered by the minority staff investigation, belie banking industry assertions that existing policies and practices are sufficient to prevent money laundering in the correspondent banking field. For example, several U.S. banks were unaware that they were servicing foreign banks that had no office in any location, were operating in a jurisdiction where the bank had no license to operate, had never undergone a bank examination by a regulator, or were using U.S. correspondent accounts to facilitate crime.

In other cases, U.S. banks did not know that their client banks lacked basic fiscal controls and procedures and would open accounts without any account-opening documentation, would accept deposits directed to persons unknown to the bank, or would operate without written anti-money-laundering procedures. There are still other cases in which U.S. banks lacked information about the extent to which respondent banks had been named in criminal or civil proceedings involving money laundering or other wrongdoing.

U.S. banks' ongoing anti-money-laundering oversight of their correspondent accounts is often weak or ineffective. A few large banks have developed automated monitoring systems that detect and report suspicious account patterns and wire-transfer activity, but they appear to be the exception rather than the rule. Most U.S. banks appear to rely on manual reviews of account activity and to conduct limited oversight of wire transfers, even though the majority of correspondent bank transactions consist of incoming and outgoing wire transfers. And even when suspicious transactions or negative press reports about a respondent bank come to the attention of a U.S. correspondent bank, in too many cases the information does not result in a serious review of the relationship or concrete actions to prevent money laundering.

FAILURES OF DUE DILIGENCE REVIEWS

Two due diligence failures by U.S. banks are particularly noteworthy. The first is the failure of U.S. banks to determine the extent to which their foreign bank clients are allowing other foreign banks to use their U.S. accounts. On numerous occasions, high-risk foreign banks gained access to the U.S. financial system not by opening their own U.S. correspondent accounts, but by operating through U.S. correspondent accounts belonging to other foreign banks.

U.S. banks rarely ask their client banks about their correspondent practices and, in almost all cases, remain unaware of their respondent bank's own correspondent accounts. In several instances, U.S. banks were surprised to learn from minority staff investigators that they were providing wire-transfer services or handling Internet gambling deposits for foreign banks they had never heard of and with whom they had no direct relationship. In one instance, an offshore bank was allowing at least a half dozen offshore shell banks to use its U.S. accounts. In another, a U.S. bank discovered by chance that a high-risk foreign bank it would not have accepted as a client was using a correspondent account the U.S. bank had opened for another foreign bank.

The second failure is the distinction U.S. banks make in their due diligence practices between foreign banks that have few assets and no credit relationship, and foreign banks that seek or obtain credit from the U.S. bank. If a U.S. bank extends credit to a foreign bank, it usually will evaluate the foreign bank's management, finances, business activities, reputation, regulatory environment, and operating procedures. The same evaluation usually does not occur where there are only fee-based services, such as wire transfers or check clearing. Since U.S. banks usually provide cash management services on a fee-for-service basis to high-risk foreign banks and infrequently extend credit, U.S. banks have routinely opened and maintained correspondent accounts for these banks based on inadequate due diligence reviews. Yet these are the very banks that should be carefully scrutinized. Under current practice in the United States, high-risk foreign banks in non-credit relationships seem to fly under the radar screen of most U.S. banks' anti-money-laundering programs.

These due diligence failures have made the U.S. correspondent banking system a conduit for criminal proceeds and money laundering for both high-risk foreign banks and their criminal clients. Of the 10 case histories investigated by the minority staff, numerous instances of money laundering through foreign banks' U.S. bank accounts were documented, including:

• Laundering illicit proceeds and facilitating crime by accepting deposits or processing wire transfers involving funds that the high-risk foreign bank knew or should have known were associated with drug trafficking, financial fraud, or other wrongdoing.

• Conducting high-yield investment scams by convincing investors to wire-transfer funds to the correspondent account to earn high returns, and then refusing to return any monies to the defrauded investors.

• Conducting advance-fee-for-loan scams by requiring loan applicants to wire-transfer large fees to the correspondent account, retaining the fees, and then failing to issue the loans.

• Facilitating tax evasion by accepting client deposits, co-mingling them with other funds in the foreign bank's correspondent account, and encouraging clients to rely on bank and corporate secrecy laws in the foreign bank's home jurisdiction to shield the funds from U.S. tax authorities.

• Facilitating Internet gambling, illegal under U.S. law, by using the correspondent account to accept and transfer gambling proceeds.

Allowing high-risk foreign banks and their criminal clients access to U.S. correspondent bank accounts facilitates crime, undermines the U.S. financial system, burdens U.S. taxpayers and consumers, and fills U.S. court dockets with criminal prosecutions and civil litigation by wronged parties. It is time for U.S. banks to shut the door to high-risk foreign banks and eliminate other abuses of the U.S. correspondent banking system.

SUMMARY OF CONCLUSIONS

The minority staff investigation of international correspondent banking for money laundering led to several conclusions:

• U.S. correspondent banking provides a significant gateway for rogue foreign banks and their criminal clients to carry on money laundering and other criminal activity in the United States and to benefit from the protections afforded by the safety and soundness of the U.S. banking industry.

• Shell banks, offshore banks, and banks in jurisdictions with weak anti-money-laundering controls carry high money laundering risks. Because these high-risk foreign banks typically have limited resources and staff and operate outside their licensing jurisdiction, they use their correspondent banking accounts to conduct their banking operations.

• Most U.S. banks do not have adequate anti-money-laundering safeguards in place to screen and monitor foreign banks that carry high money laundering risks. This problem is longstanding, widespread, and ongoing.

• U.S. banks are often unaware of legal actions related to money laundering, fraud, and drug trafficking that involve their current or prospective respondent banks.

• U.S. banks have particularly inadequate anti-money-laundering safeguards when a correspondent relationship does not involve credit-related services.

• High-risk foreign banks that are denied their own correspondent accounts at U.S. banks can obtain the same access to the U.S. financial system by opening correspondent accounts at a foreign bank that already has a U.S. bank account. U.S. banks have largely ignored or failed to address the money laundering risks associated with "nested" correspondent banking.

• In the last two years, some U.S. banks have begun to show concern about the vulnerability of their correspondent banking to money laundering and are taking steps to reduce the money laundering risks, but the steps are slow, incomplete, and not industry-wide.

• Foreign banks with U.S. correspondent accounts have special forfeiture protections in U.S. law that are not available to other U.S. bank accounts and that present additional legal barriers to efforts by U.S. law enforcement to seize illicit funds. In some instances, money launderers appear to be deliberately using correspondent accounts to hinder seizures by law enforcement, while foreign banks may be using the "innocent bank" doctrine to shield themselves from the consequences of lax anti-money-laundering oversight.

• If U.S. correspondent banks were to close their doors to rogue foreign banks and to adequately screen and monitor high-risk foreign banks, the United States would reap significant benefits by eliminating a major money laundering mechanism, frustrating ongoing criminal activity, reducing illicit income fueling offshore banking, and denying criminals the ability to deposit illicit proceeds in U.S. banks with impunity and profit from the safety and soundness of the U.S. financial system.

RECOMMENDATIONS

The minority staff makes the following recommendations to reduce the use of U.S. correspondent banks for money laundering:

• U.S. banks should be barred from opening correspondent accounts with foreign banks that are shell operations with no physical presence in any country.

• U.S. banks should be required to use enhanced due diligence and heightened anti-money-laundering safeguards, as specified in guidance or regulations issued by the U.S. Treasury Department, before opening correspondent accounts with foreign banks that have offshore licenses or are licensed in jurisdictions identified by the United States as non-cooperative with international anti-money-laundering efforts.

• U.S. banks should conduct a systematic review of their correspondent accounts with foreign banks to identify high-risk banks and close accounts with problem banks. They should also strengthen their anti-money-laundering oversight, including by providing regular reviews of wire-transfer activity and providing training to correspondent bankers to recognize misconduct by foreign banks.

• U.S. banks should be required to identify a respondent bank's correspondent banking clients, and refuse to open accounts for respondent banks that would allow shell foreign banks or bearer share corporations to use their U.S. accounts.

• U.S. bank regulators and law enforcement officials should offer improved assistance to U.S. banks in identifying and evaluating high-risk foreign banks.

• The forfeiture protections in U.S. law should be amended to allow U.S. law enforcement officials to seize and extinguish claims to laundered funds in a foreign bank's U.S. correspondent account on the same basis as funds seized from other U.S. accounts.

Banking and anti-money-laundering experts repeatedly advised the minority staff during the investigation that U.S. banks should terminate their correspondent relationships with certain high-risk foreign banks, in particular, shell banks. They also advised that offshore banks and banks in countries with poor bank supervision, weak anti-money-laundering controls, and strict bank secrecy laws should be carefully scrutinized.

The minority staff believes that if U.S. banks terminate relationships with the small percentage of high-risk foreign banks that cause the greatest problems and tighten their anti-money-laundering controls in the correspondent banking area, they can eliminate the bulk of the correspondent banking problem at minimal cost. ❑

Note: The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. Department of State.

❑ THE FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING

Efforts by the United States and international organizations to measure the magnitude of money laundering have proved difficult. In congressional testimony and reports, officials have cited problems concerning data and methodology that must be resolved before reliable, detailed statistics can be generated. Meanwhile, some available estimates provide a rough measure of international money laundering operations. Michel Camdessus, former International Monetary Fund managing director, has estimated that the volume of worldwide money laundering is between 2 and 5 percent of the world's gross domestic product — some $600,000 million even at the low end of the range.

Several initiatives to curtail this massive criminal activity have been under way since the late 1980s. The body that has most successfully coordinated international anti-money-laundering initiatives is the Financial Action Task Force on Money Laundering, or FATF (see FATF*GAFI at http://www.oecd.org/fatf/).

In 1989, growing concern about money laundering's threat to the international banking system and financial institutions prompted the leaders of the Group of Seven (comprising the heads of state of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) to convene FATF. This new intergovernmental policy-making task force was assigned responsibility for examining money laundering techniques and trends, reviewing prior national and international action, and determining additional anti-money-laundering measures.

Currently, FATF membership consists of two regional organizations — the European Commission and the Gulf Cooperation Council — and 29 countries and territories: Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

THE FORTY RECOMMENDATIONS

To establish a global framework for anti-money-laundering efforts, FATF issued "The Forty Recommendations" in 1990. Today this comprehensive set of measures is the leading international anti-money-laundering standard. "The Forty Recommendations" and "Interpretative Notes" cover the criminal justice system and law enforcement, the financial system and its regulation, and international cooperation. The recommendations, set out principles for action and allow countries flexibility in implementing these principles in accord with their particular circumstances and laws. Many countries have made a political commitment to combat money laundering by implementing the recommendations even though they are not binding agreements (see The Forty Recommendations at http://www.oecd.org/fatf/40Recs_en.htm).

In 2000, FATF launched a comprehensive review to determine whether the recommendations, last revised in 1996, are up to date and provide effective countermeasures. This review exercise is expected to continue into 2001-2002. The recommendations' relevancy is also monitored through the annual "typologies" meeting. At this forum, law enforcement and regulatory experts from FATF member countries and other international organizations discuss prevailing money laundering methods, emerging threats, and any effective countermeasures that have been developed.

A recent FATF brochure summarized some of the recommendations' basic obligations that countries need to implement. These are:

- Criminalizing the laundering of the proceeds of serious crimes (Recommendation 4) and enacting measures to seize and confiscate the proceeds of crime (Recommendation 7).

• Requiring financial institutions to identify all clients, including any beneficial owners of property, and to keep appropriate records (Recommendations 10 to 12).

• Requiring financial institutions to report suspicious transactions to the competent national authorities (Recommendation 15) and to implement a comprehensive range of internal control measures (Recommendation 19).

• Ensuring adequate systems for the control and supervision of financial institutions (Recommendations 26 to 29).

• Establishing international treaties or agreements and to pass national legislation that will allow countries to provide prompt and effective international cooperation at all levels (Recommendations 32 to 40).

FATF gauges member governments' progress in implementing the forty recommendations through a yearly self-assessment exercise and a mutual evaluation procedure. In the self-assessment, each member country answers a standard questionnaire about the status of its implementation work. In the mutual evaluation process, each country is examined by a team of four legal, financial, and law enforcement experts, selected from FATF member countries.

When a member country is found to be out of compliance with the forty recommendations, FATF applies a series of measures to press the member country to tighten its anti-money-laundering system. As a first step, the non-complying member must deliver a progress report at the FATF plenary meeting. If subsequent measures are required, the FATF president will send a letter or a high-level mission to the country. In addition, FATF can issue a statement requiring financial institutions to pay special attention to business relations and transactions with individuals, companies, and financial institutions based in the non-complying country. As a last resort, the country's FATF membership can be suspended.

NON-COOPERATIVE COUNTRIES AND TERRITORIES

To encourage non-member countries with deficient anti-money-laundering provisions to implement new laws, FATF introduced a major project in 1999 known as the Non-Cooperative Countries and Territories (NCCT) initiative. The initiative's first major report, published in June 2000, set forth the criteria for defining non-cooperative countries and territories and identified the specific NCCTs. The 15 jurisdictions with serious, systemic money laundering problems placed on the FATF list were: the Bahamas, the Cayman Islands, the Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, the Marshall Islands, Nauru, Niue, Panama, the Philippines, Russia, St. Kitts and Nevis, and St. Vincent and the Grenadines (see Review to Identify Non Cooperative Countries or Territories at http://www.oecd.org/fatf/pdf/NCCT2000_en.pdf).

The report strongly urged these jurisdictions to adopt legislation and improve their rules and practices as expeditiously as possible. It emphasized that FATF would continue its dialogue with the NCCTs and would provide technical assistance, where appropriate, to help the NCCTs design and implement anti-money-laundering systems. In cases where NCCTs maintain their detrimental rules and practices, FATF could employ a host of countermeasures ranging from requiring its FATF members to provide closer scrutiny of transactions with NCCTs to prohibiting financial transactions with non-cooperative jurisdictions.

At each of its plenary meetings — held in September/October, February, and June — FATF discusses developments related to its NCCT initiative. At its February 2001 meeting, FATF issued a progress report on the 15 NCCTs. The report states that while none of the 15 jurisdictions has both enacted and implemented all necessary reforms, several of them have taken impressive strides toward improving their counter-money-laundering regimes (see Progress Report on Non-Cooperative Countries and Territories at http://www.oecd.org/fatf/pdf/PR-20010201_en.pdf).

The report noted that the Bahamas, the Cayman Islands, the Cook Islands, Israel, Liechtenstein, the Marshall Islands, and Panama have enacted most, if not all, of the necessary remedial legislation. As a follow-up, FATF has asked these jurisdictions to submit legislative implementation plans. At its next plenary meeting, in June 2001, FAFT will review implementation plans and will discuss a timetable for removing jurisdictions' names from the NCCT list. Also scheduled for this meeting is consideration of countermeasures for those jurisdictions that have not made adequate progress since they were identified as non-cooperative in June 2000.

REGIONAL AND INTERNATIONAL COOPERATION

To foster the global implementation of international anti-money-laundering standards, FATF promotes the establishment of regional groups. These groups have observer status with FATF. The regional FATF-style bodies perform functions for their members similar to those performed by FATF for its own membership. Regional groups, for instance, carry out mutual evaluations of their members and review regional money-laundering trends.

Efforts by FATF to advance regional groups and initiatives in Africa and South America have led to the establishment of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) and the Financial Action Task Force on Money Laundering in South America (GAFISUD). Other prominent regional FATF-style bodies are the Asia/Pacific Group on Money Laundering (APG), the Caribbean Financial Action Task Force (CFATF), and the Council of Europe PC-R-EV Committee (see Observer Bodies and Organisations at http://www.oecd.org//fatf/Members_en.htm).

Close cooperation with international organizations is another means by which FATF is constructing a worldwide anti-money-laundering network. Organizations involved in combating money laundering that have observer status with the FATF include the Asia Development Bank, the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the International Monetary Fund (IMF), the Offshore Group of Banking Supervisors (OGBS), and the United Nations Office for Drug Control and Crime Prevention (UNODCCP). Many of these international organizations have formulated major anti-money-laundering initiatives (see Other International Anti-Money Laundering Initiatives at http://www.oecd.org//fatf/Initiatives_en.htm). ❑

❑ MONEY LAUNDERING COMPARATIVE TABLE

Excerpts from State Department's 2001 report, "Money Laundering and Financial Crimes"

Each year, U.S. officials from agencies with anti-money-laundering responsibilities meet to assess the money laundering situations in more than 175 jurisdictions. The review includes an assessment of the significance of financial transactions in the country's financial institutions that involve proceeds of serious crime, steps taken or not taken to address financial crime and money laundering, each jurisdiction's vulnerability to money laundering, the conformance of its laws and policies to international standards, the effectiveness with which the government has acted, and the government's political will to take needed actions.

The 2000 INCSR [International Narcotics Control Strategy Report] assigned priorities to jurisdictions using a classification system consisting of three categories titled Jurisdictions of Primary Concern, Jurisdictions of Concern, and Other Jurisdictions Monitored.

INCSR priorities draw upon a number of factors, which include: (1) whether the country's financial institutions engage in transactions involving significant amounts of proceeds from serious crime; (2) the extent to which the jurisdiction is or remains vulnerable to money laundering, notwithstanding its money laundering countermeasures, if any; (3) the nature and extent of the money laundering situation in each jurisdiction (for example, whether it involves drugs or other contraband); (4) the ways in which the United States regards the situation as having international ramifications; (5) the situation's impact on U.S. interests; (6) whether the jurisdiction has taken appropriate legislative actions to address specific problems; (7) whether there is a lack of licensing and oversight of offshore financial centers and businesses; (8) whether the jurisdiction's laws are being effectively implemented; and (9) where U.S. interests are involved, the degree of cooperation between the foreign government and U.S. government agencies. There are approximately two dozen sub-factors that are also considered.

(text continued pg. 35)

Countries/Jurisdictions of Primary Concern

Antigua and Barbuda
Australia
Austria
Bahamas
Brazil
Burma
Canada
Cayman Islands
China
Colombia
Cyprus
Dominica
Dominican Republic
France
Germany
Greece
Grenada
Guernsey
Hong Kong
Hungary
India
Indonesia
Isle of Man
Israel
Italy
Japan
Jersey
Lebanon
Liechtenstein
Luxembourg
Mexico
Nauru
Netherlands
Nigeria
Pakistan
Panama
Paraguay
Philippines
Russia
Singapore
Spain
St. Kitts and Nevis
St. Vincent
Switzerland
Taiwan
Thailand
Turkey
United Arab Emirates
United Kingdom
United States
Uruguay
Venezuela

Countries/Jurisdictions of Concern

Albania
Argentina
Aruba
Bahrain
Barbados
Belgium
Belize
Bolivia
British Virgin Islands
Bulgaria
Cambodia
Chile
Cook Islands
Costa Rica
Czech Republic
Ecuador
Egypt
El Salvador
Gibraltar
Guatemala
Haiti
Honduras
Ireland
Jamaica
Korea
Korea, North
Latvia
Macau
Malaysia
Marshall Islands
Monaco
Netherlands Antilles
Nicaragua
Niue
Palau
Peru
Poland
Portugal
Romania
Samoa
Seychelles
Slovakia
South Africa
St. Lucia
Turks and Caicos
Ukraine
Vanuatu
Vietnam
Yugoslavia

Other Countries/Jurisdictions Monitored

Afghanistan
Algeria
Angola
Anguilla
Armenia
Azerbaijan
Bangladesh
Belarus
Benin
Bermuda
Bosnia and Herzegovina
Botswana
Brunei
Cameroon
Cote d'Ivoire
Croatia
Cuba
Denmark
Eritrea
Estonia
Ethiopia
Fiji
Finland
Georgia
Ghana
Guyana
Iran
Jordan
Kazakhstan
Kenya
Kuwait
Kyrgyzstan
Laos
Liberia
Lithuania
Macedonia
Madagascar
Malawi
Maldives
Mali
Malta
Mauritius
Micronesia FS
Moldova
Mongolia
Montserrat
Morocco
Mozambique
Namibia
Nepal
New Zealand
Niger
Norway
Oman
Papua New Guinea
Qatar
Saudi Arabia
Senegal
Slovenia
Solomon Islands
Sri Lanka
Suriname
Swaziland
Sweden
Tajikistan
Tanzania
Togo
Tonga
Trinidad and Tobago
Tunisia
Turkmenistan
Uganda
Uzbekistan
Yemen
Zambia
Zimbabwe

A government (e.g., the United States or the United Kingdom) can have comprehensive laws on its books and conduct aggressive anti-money-laundering enforcement efforts but still be classified a "Primary Concern" jurisdiction. In some cases, this classification may simply or largely be a function of the size of the jurisdiction's economy. In such jurisdictions, the volume of money laundering is likely to be substantial, necessitating quick, continuous, and effective anti-money-laundering efforts by the government. Primary Concern jurisdictions will therefore likely receive priority attention from the United States. While the threat from jurisdictions classified under "Concern" is not as acute, they too must undertake efforts to develop or enhance their anti-money-laundering regimes. Finally, while jurisdictions in the "Other" category do not pose an immediate concern, it will nevertheless be important to monitor their money laundering situations because, under the right circumstances, virtually any jurisdiction of any size can develop into a significant money laundering center. ❑

KEY CONTACTS AND INTERNET SITES

UNITED STATES GOVERNMENT

U.S. Department of the Treasury
Financial Crimes Enforcement Network (FinCEN)
Office of Communications
2070 Chain Bridge Road
Suite 200
Vienna, Virginia 22182 U.S.A.
Telephone: (800) SOS-BUCK
http://www.ustreas.gov/fincen/border.html

U.S. Customs Service
Money Laundry Coordination Center
Money Laundering Enforcement
http://www.customs.treas.gov/enforcem/monlaund.htm

U.S. Department of Justice
Criminal Division
Asset Forfeiture and Money Laundering Section
950 Pennsylvania Avenue, N.W.
Washington, DC 20530-0001 U.S.A.
Telephone: (202) 514-1263
http://www.usdoj.gov/criminal/afmls.html

Drug Enforcement Administration
Financial Investigations Section
Money Laundering
2401 Jefferson Davis Highway
Alexandria, Virginia 22301 U.S.A.
http://www.dea.gov/programs/money.htm

U.S. Department of State
Bureau of International Narcotics and
Law Enforcement Affairs
Room 7333
2201 C Street, N.W.
Washington, DC 20520 U.S.A.
Telephone: (202) 647-8464
http://www.state.gov/g/inl

NON-U.S. GOVERNMENT

Financial Action Task Force on Money Laundering
FATF Secretariat - FATF/OECD
2, rue Andre-Pascal
75775 Paris CEDEX 16
France
Telephone: (33) 01.45.24.82.00
Fax: (33) 01.45.24.85.00
E-mail: fatf.contact@oecd.org
http://www.oecd.org/fatf

Caribbean Financial Action Task Force
http://www.cfatf.org/eng/

Organization of American States/Inter-American Drug Abuse Control Commission (OAS/CICAD)
http://www.cicad.oas.org/es/Lavado/Principal.htm (Spanish)

Royal Canadian Mounted Police
http://www.rcmp-grc.gc.ca/html/launder.htm

ADDITIONAL READINGS ON MONEY LAUNDERING

Baker, Raymond W. "*The Biggest Loophole in the Free-Market System.*" *Washington Quarterly, vol.* 22, no. 4, Autumn 1999: pp. 29-46.

Bentham, Mandy. *The Politics of Drug Control.* London: Macmillan; New York: St. Martin's Press, 1998.

Blunden, Bob. *The Money Launderers: How They Do It, and How to Catch Them at It.* Chalford, England: Management Books 2000, 2001.

International Monetary Fund. *Enhancing Contributions to Combating Money Laundering: Policy Paper.* Prepared by the staffs of the International Monetary Fund and the World Bank. Washington D.C.: IMF, 2001. http://www.imf.org/external/np/ml/2001/eng/042601.htm

International Monetary Fund. *Financial System Abuse, Financial Crime and Money Laundering: Background Paper.* Washington D.C., IMF, 2001. http://www.imf.org/external/np/ml/2001/eng/021201.htm

Lilley, Peter. *Dirty Dealing: The Untold Truth About Global Money Laundering.* London: Kogan Page, 2000.

Money Laundering Alert [periodical]
Publisher: Alert Global Media.
http://www.moneylaundering.com,
http://www.lavadodinero.com (Spanish)

Morris-Cotterill, Nigel. "Money Laundering." *Foreign Policy,* May/June 2001 pp. 16-20, 22.

The National Money Laundering Strategy for 2000. Washington, D.C.: U.S. Department of the Treasury and U.S. Department of Justice, 2000. http://www.treas.gov/press/releases/docs/ml2000.pdf

Robinson, Jeffrey. *The Laundrymen: Inside Money Laundering, the World's Third Largest Business.* Rev. ed. London and New York: Pocket Books, 1998.

Savla, Sandeep. *Money Laundering and Financial Intermediaries.* The Hague: Kluwer Law International, 2001.

Stessens, Guy. *Money Laundering: A New International Law Enforcement Model.* Cambridge, England: Cambridge University Press, 2000.

U.S. Congress. House. Committee on Banking and Financial Services. *Money Laundering.* Hearing, 106th Congress, 2d Session, Washington, D.C.: Government Printing Office, 2000.

U.S. Congress. House. Committee on Banking and Financial Services. *Money Laundering and Financial Crimes Strategy Act of 1998.* Report to Accompany H.R. 1756, 105th Congress, 2d Session, Washington, D.C.: Government Printing Office, 1998.

U.S. Congress. House. Committee on Banking and Financial Services. *Russian Money Laundering.* Hearing, 106th Congress, 1st Session, Washington, D.C.: Government Printing Office, 1999.

U.S. Congress. Senate. Committee on Governmental Affairs. Permanent Subcommittee on Investigations. *Report on Correspondent Banking and Money Laundering: A Gateway to Money Laundering.* Report prepared by the Minority Staff, 107th Congress, 1st Session, Washington, D.C.: Government Printing Office, 2001. http://www.senate.gov/~gov_affairs/020501_psi_minority _report.htm

U.S. Department of State. *Money Laundering and Financial Crimes.* Washington, D.C.: Bureau of International Narcotics and Law Enforcement, 2001. http://www.state.gov/g/inl/rls/nrcrpt/2000/ index.cfm?docid=959

U.S. General Accounting Office. *Money Laundering: Observations on Private Banking and Related Oversight of Selected Offshore Jurisdictions.* Washington, D.C.: GAO, 1999.

U.S. General Accounting Office. *Suspicious Bank Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities.* Washington, D.C.: GAO, 2000.

U.S. General Accounting Office. *Money Laundering: Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers.* Washington, D.C.: GAO, 2001.

Williams, B. Frederic and Frank D. Whitney. *Federal Money Laundering: Crimes and Forfeitures.* Charlottesville, Virginia: Lexis Law Publishing, 1999.

Woods, Brett F. *The Art and Science of Money Laundering: Inside the Commerce of the International Narcotics Traffickers.* Boulder, Colorado: Paladin Press, 1998.

Economic Perspectives

Volume 6 An Electronic Journal of the U.S. Department of State Number 2

THE FIGHT AGAINST MONEY LAUNDERING

• The Consequences of Money Laundering and Financial Crime

• International Standards and Cooperation in the Fight Against Money Laundering

• Money Laundering Enforcement: Following the Money

• Achieving a Sustained Response to Money Laundering

May 2001