VISITING EXPERTS' PAPERS

COMPONENTS OF AN EFFECTIVE ANTI-MONEY LAUNDERING REGIME

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I. INTRODUCTION

Organized crime cannot be tackled effectively unless there is an efficient and effective partnership between the different bodies within a jurisdiction tasked with law enforcement - in its widest sense. Once the organized crime becomes transnational in nature, this partnership becomes both more important and more complex, necessitating co-operation not only between different law enforcement bodies but also between different jurisdictions. This is particularly so in perhaps the most transnational of all crimes today - money laundering.

This paper examines the individual components necessary to provide a jurisdiction with an effective money laundering regime. Effective, in this context, means a regime which allows for the confiscation of the proceeds of crime and the prosecution of those criminals who undertake money laundering, whether for themselves or on behalf of other criminals.

The paper will draw heavily on the experience gained by law enforcement bodies in the Hong Kong Special Administrative Region. Hong Kong passed its first anti-money laundering legislation in 1989, making it one of the first jurisdictions in Asia to do so. Since that time, the legislation has been continually developing as practical experience reveals its deficiencies. Both prosecutors and police in Hong Kong have gained experience, not only in enforcing the law and dealing with their overseas counterparts, but in dealing with private bodies and Government regulators which have a no less important role to play. Using this background, the paper will draw out some of the best practices which have been identified in both Hong Kong and other jurisdictions. Other practices will offer a contrast in approaches to certain problems. The best method to combat so called underground banks, for example, is still being debated and a number of different approaches have been or are being tried in various jurisdictions around the world.

To this end, the paper will examine the following areas:

- Legislation
- The role of a financial intelligence unit
- The role of regulators
- International co-operation
- Investigation of money laundering

Before examining any of these areas, however, it is necessary to look briefly at the size of the problem - how much money is being laundered and where is it coming from?

II. ESTIMATING THE MAGNITUDE OF MONEY LAUNDERING

It is almost impossible to put an accurate figure on the amount of money being laundered each year; criminals, after all, do not publish accounts. Estimates of the revenue generated from narcotics trafficking in the USA alone range from US$40 billion to US$100 billion[1].

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The Financial Action Task Force (FATF) estimates that narcotics trafficking is the single largest source of criminal proceeds, followed by the various types of fraud[2]. Smuggling, gambling and, increasingly nowadays, trafficking in human beings also generate significant amounts of criminal proceeds. Often overlooked, however, is the huge amounts of money generated by tax evasion. Many people do not think of tax evasion as being a source of criminal proceeds; indeed, in some jurisdictions tax evasion is not a crime *per se*. However one only has to consider the huge industry which has grown up around so called tax havens, or off-shore financial centres, to realise that tax evasion - and its legally ambiguous sibling, tax avoidance - is big business.

In summary, therefore, whilst it is not possible to accurately quantify the amount of money laundering going on in any one country or region, it is possible to conclude that the amount of money being laundered is huge.

III. REQUIREMENTS FOR EFFECTIVE LEGISLATION

Effective anti-money laundering legislation must address a number of points. The following are regarded as essential:

- Money laundering must be a criminal offence;
- The law must allow for the confiscation of a criminal's assets, and must allow for terms of imprisonment to be imposed where assets have been placed beyond the reach of the courts;
- Jurisdictions must be able to apply for the confiscation of assets held abroad and to reciprocate on similar requests from abroad;
- There must be some provision made for asset sharing between jurisdictions where there has been a successful joint prosecution and confiscation;
- There must be a system in place for the reporting of financial transactions, whether suspicion or threshold-based, to a financial intelligence unit (FIU);
- There must be regulation of financial service providers commonly used for money laundering such as banks, securities brokerages, remittance agents and company formation agents.

In addition to these, legislation may be considered to allow for the civil confiscation of assets.

A. The Money Laundering Offence

The money laundering offence should ideally consist of two elements - firstly, some form of dealing with the proceeds of crime and, secondly, the criminal intent with which it is done. It must also list the predicate offences which generate the proceeds of crime.

Money laundering can be viewed in two ways. What may be termed the 'traditional' definition of money laundering involves some form of complicated and sophisticated process by which the proceeds of crime are hidden, disguised or made to appear as if they were generated by legitimate means. Using this definition in law, however, would cause immense problems in trying to prove the criminal's intent to, say, disguise the proceeds; if police subsequently find the proceeds, would that then mean that they were not disguised and therefore the offence was not committed? Obviously this

[1] Financial Action Task Force Annual Report 1999-2000

[2] Financial Action Task Force Annual Report 1999-2000

possibility must be avoided.

The 'legal' definition of money laundering used in Hong Kong is far wider and simpler than the 'traditional' definition. It means, simply, any transaction involving the proceeds of crime. This is inclusive of both the 'traditional' definition and also of any transaction involving the proceeds of crime in which there has been no attempt to hide or disguise its source. Thus the drug dealer who receives money and deposits it in his/her own bank account is money laundering, as he/she is carrying out transactions knowing they involve the proceeds of crime.

Experience in Hong Kong has shown that the most difficult part of a money laundering case is in proving the criminal intent of the money launderer. Clearly, a person who deals with the proceeds of crime without knowing, or at least suspecting, the illegal origin of those proceeds should not be guilty of an offence. Setting the level of criminal intent at too high a level, however, can cause problems for the investigator. For example, a law that requires proof that the money launderer *knew* the property with which he/she was dealing was the proceeds of crime will result in very few prosecutions as evidence of such knowledge is difficult to come by in the absence of a confession. It can be argued that there is very little point in having a law which is almost impossible to use in practice. The net result is that the criminals continue money laundering as the law is unable to prosecute them or even act as a deterrent. The relevant section of the Hong Kong law is worded as follows:

> "...a person commits an offence if, *knowing or having reasonable grounds to believe* that any property, in whole or in part directly or indirectly represents any person's proceeds of an indictable offence, he deals with that property.[3] [italics added]

Judicial decisions on this section of the law have construed *having reasonable grounds to believe* as meaning that a reasonable person, knowing the circumstances which the defendant knew, would have believed that the property was the proceeds of crime. This is an advance on having to prove the defendant's actual knowledge or belief as it allows for the prosecution of someone who had turned a wilful blind eye to the possible origins of the property in question.

It has been proposed that a further offence be created under Hong Kong law to deal with those people who deal with the proceeds of crime, *suspecting* them to be such but falling short of having a reasonable person's *belief*. If the proposal is passed into law, this lower mental element would be reflected by a lower sentence than that imposed on those with reasonable grounds to believe.

A final consideration when drafting an effective money laundering law is the need for the law to apply to as wide a range of predicate offences as possible. Obviously the law must apply to all serious crimes such as drug trafficking, fraud, kidnapping etc., which generate substantial criminal proceeds. Additionally, in recent years there has been a growing awareness that tax evasion should be included as a predicate offence. If it is not included, the problem then arises of money launderers claiming that they handled crime proceeds in the belief that they were dealing in the proceeds of tax evasion - and are therefore not guilty of the offence of money laundering.

[3] S.25A, Organized & Serious Crimes Ordinance, Chapter 455, Laws of Hong Kong

B. Restraint & Confiscation of Assets

In addition to a money laundering offence, effective legislation must also provide for the restraint and confiscation of a criminal's assets. The provisions for restraining assets must allow for restraint without the suspect becoming aware of it - in the common law system, this is done by way of an ex parte application, without the presence of a defence representative. This allows for the restraint order to be served on financial institutions as soon as the investigation turns overt, thus depriving the suspect or his associates of an opportunity to dispose of the assets. Knowingly failing to comply with a restraint order should be a criminal offence.

The provisions for confiscating assets should ideally allow not just for the confiscation of the assets which investigators find, but also those assets which the defendant may have successfully hidden. Thus a defendant with only US$2 million in located assets, but whom it can be proved has benefited from crime by over US$10 million, can be ordered to pay back the full amount of his/her profits. If the balance is not subsequently paid, the law should allow for a custodial sentence to be imposed in lieu of payment.

C. Overseas Confiscation Orders

The trans-national nature of organized crime is reflected in the fact that criminals will often keep their assets in different countries. It is essential, therefore, that legislation provides for this by allowing for confiscation orders issued in overseas jurisdictions to be enforced domestically. In this regard, the FATF recommends:

> "There should be authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate proceeds or other property of corresponding value to such proceeds, based on money laundering or the crimes underlying the laundering activity."[4]

D. Asset Sharing

Once an overseas confiscation order is enforced domestically, fairness dictates that the overseas jurisdiction be allowed to share the confiscated assets. Provision must therefore be made, both by law and by policy, for assets to be shared between jurisdictions. This may not always be practicable where only a small amount of property has been confiscated, as the administrative costs involved would outweigh the value of the assets to be shared. Government policy, therefore, should set a realistic threshold over and above which foreign governments may be allowed to apply for and receive a share of the assets commensurate with the work done by each side in that particular case.

E. Reporting of Financial Transactions

Most jurisdictions which have enacted money laundering legislation have incorporated a requirement for some form of reporting of financial transactions to a central body - usually a financial intelligence unit (see Part IV below). The reporting requirement can take one of three forms:

- Mandatory reporting of certain transactions over a particular value threshold - for example, cash transactions and international remittances over US10,000;
- Suspicious transaction reporting;
- Both threshold and suspicious transaction reporting.

Both threshold and suspicion based reporting have pros and cons; the former

[4] FATF Recommendation No. 38

picks up a wealth of detail about an individual's spending habits which can be useful to an investigator conducting a financial profile or asset tracing on a suspect. It also, however, results in a great many reports which, because of the sheer volume, are rarely examined in any detail and present administrative problems due to the large numbers received. Suspicious transaction reporting does not provide the vast database of financial transactions which threshold reporting provides but can allow investigators to better concentrate their resources on genuinely suspicious activity.

Another factor to consider are the categories of people or institutions which are required to report financial transactions. Reporting of transactions over a certain threshold would entail all businesses being required to make such reports if their customers exceed the threshold. Suspicious transaction reporting can be more selective - although Hong Kong law requires all persons to report suspicious transactions, other jurisdictions require only banks and other financial institutions to make such reports.

F. Regulation of Financial Services Providers

An effective law must also provide for the regulation of those companies which provide financial services to the public. Most jurisdictions will have comprehensive laws and regulations to govern the operation of financial institutions such as banks, insurance companies and stock brokers. Less well regulated, but equally important in the battle against money laundering, are what may be termed intermediaries.

An 'intermediary' is a person or company which introduces a third party's money to the regulated financial system. The most widely recognised form of intermediary is the company formation agency, which will allow a customer to purchase a 'shell' or 'shelf' company and will then operate the company - and, more importantly, its bank account - on the customer's behalf. Often the identity of the beneficial owner of the shelf company is not disclosed to the bank and, as the signatories to the shelf company's bank account are the staff of the company formation agency, the bank has no record of the real owner of the bank account. Not surprisingly, this arrangement has proved attractive to money launderers the world over as it allows for effective anonymity on the part of the beneficial owner of the shelf company and its bank account.

Some of the more responsible off-shore tax havens, where the bulk of company formation agents operate, are considering legislation to regulate the activities of such agents. Usually this legislation takes the form of a licensing regime under which company formation agents are only allowed to operate if they demonstrate that they apply basic anti-money laundering measures to their business practices.

Another form of intermediary is the remittance agent - also known as underground banks. Different jurisdictions around the world have approached the problem of remittance agents in different ways. In some jurisdictions their activities are completely illegal; in others they are left completely unregulated. Hong Kong has recently passed legislation requiring remittance agents to register with the Government, verify the identity of certain customers and make and retain records of certain transactions. It is hoped that the new law will, at the least, ensure that remittance agents will keep records which will allow investigators to trace an audit trail and identify the persons involved. The new law is also expected to act as a deterrent as it will make the remittance

sector less attractive to money launderers.

G. Civil Confiscation of Assets

The confiscation of assets described above concerns the assets of convicted criminals. Some jurisdictions, however, have also incorporated a form of civil confiscation into their legislation. Civil confiscation allows for the confiscation of property where it can be shown *on the balance of probabilities*, that is, a lesser standard of proof than the criminal standard of *beyond reasonable doubt*, that the property was the proceeds of, or was used in connection with, or was intended to be used in connection with, a crime. Confiscation is not dependant upon anyone being convicted of any crime.

IV. THE ROLE OF A FINANCIAL INTELLIGENCE UNIT

Financial Intelligence Units (FIUs) can be part of a police force or customs agency, a separate Government agency or a department of a central bank. Whichever form they take, their role should at least include the following:-

- Collection, collation and dissemination of transaction reports (whether they be threshold or suspicion based);
- Provision of feedback and training to makers of suspicious transactions reports.

Collection, collation and dissemination of reports can be done in a number of different ways and will not be discussed here.

The provision of feedback and training is an often overlooked, but vital, part of an FIU's duties. The effectiveness of a suspicious transaction reporting system relies on both the quantity and quality of the reports made. This in turn depends on how well staff of financial institutions (which in practice make the vast majority of reports) can identify transactions which are genuinely suspicious. Without proper training, both the quantity and quality of the reports will remain at a low level. Although banks and other financial institutions provide basic training to their staff, input from the FIU is vital if they are to be kept up to date on the latest trends and methodologies for laundering money. The following practices can be considered when planning training and feedback:

- Lectures to bank compliance officers and front line staff;
- Provision of training material or vetting of a bank's training material to ensure it is up to date and covers all relevant legislation;
- Provision of real life sanitised cases to illustrate particular methods of money laundering and highlight suspicious activity indicators;
- Working groups consisting of members of both financial institutions and the FIU to highlight best practices;
- An FIU web site to increase public awareness of the legal requirements to report suspicious transactions;
- Qualitative and quantitative analyses of suspicious transaction reports made by individual institutions.

In addition, makers of suspicious transaction reports should be informed, whenever practical, of the progress and ultimate outcome of the investigation generated by their report, particularly where the report has led to a successful case.

V. THE ROLE OF REGULATORS

Banks and other financial institutions recognise the dangers which money

laundering can present to the financial system. More importantly, they are aware of the damage which could be caused to their reputations if they were to be found laundering money due to their own negligence or lax procedures; the recent Bank of New York scandal illustrates this point. Whilst most financial institutions are very responsible, not all of them devote sufficient time, effort or resources to combating money laundering. This is where regulators of financial institutions have a vital role to play.

The role of a regulator, in an anti-money laundering context, is three-fold. Firstly, to draw up anti-money laundering guidelines for financial institutions to follow. These guidelines should include such matters as establishing the true identity of account holders, record keeping, training and reporting of suspicious transactions (if required by law). Secondly, the regulator should ensure that the financial institutions have appropriate policies and practices in place which conform with the guidelines. Thirdly, the regulator should check that the guidelines are being adhered to through regular visits to the financial institutions and spot checks. Prior to visiting a financial institution, the regulator should also liaise with the financial intelligence unit to check that the institution's rate of suspicious transaction reporting is in line with expectations, bearing in mind the type and size of the financial institution.

A range of measures should be available to the regulator to sanction those financial institutions which fail to comply fully with the regulator's guidelines.

VI. INTERNATIONAL CO-OPERATION

International co-operation, in the form of enforcement of external confiscation orders and asset sharing, has already been touched upon in Part III above. This form of co-operation relates to cases where a suspect has already been arrested and his or her assets restrained. Equally, if not more important, is international co-operation during the investigation phase.

FATF Recommendation no. 32 states:

> "Each country should make efforts to improve a spontaneous or "upon request" international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities".

Recommendation No. 37 goes on to state:

> "There should be procedures for mutual assistance in criminal matters regarding the use of compulsory measures including the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in money laundering investigations and prosecutions and in related actions in foreign jurisdictions."

There is a distinction to be made here between the exchange of *intelligence* in money laundering matters and the rendering of assistance to another jurisdiction in obtaining *evidence*. The swift exchange of intelligence between enforcement agencies and FIU's of different jurisdictions at the investigation phase is vital if trans-national money laundering is to be tackled effectively. Treaties governing mutual legal assistance in criminal matters are designed primarily for collecting evidence for use in a court of law, not the swift exchange of intelligence.

VII. INVESTIGATION OF MONEY LAUNDERING

Experience in Hong Kong has shown that whilst confiscating the assets of a criminal is usually a relatively straightforward, albeit time consuming process, proving a case of money laundering is a good deal harder. Although the exact wording of money laundering laws varies from jurisdiction to jurisdiction, there will generally be two elements to the offence which have to be proved:-

- Dealing in property;
- Knowing or believing the property to be the proceeds of crime.

The first element, dealing in property, is normally the easiest to prove, although investigators should be aware that just because someone's bank account is being used does not mean that person is conducting the transactions - a 'stooge' is a person paid to open an account and then hand over the account books to a second person for their use. This MO is common in loan sharking syndicates. ATM cards and telephone banking are other examples of banking facilities which can be used by persons who are not the account holder.

It is, however, the second element, *knowing or believing*, that presents most problems. A money launderer will seldom admit that he or she knows or believes the property was the proceeds of crime. However, skilful investigation and the use of circumstantial evidence can negate a defence of ignorance as to the illicit origin of the property.

A. Investigation Techniques

1. Surveillance

Surveillance can be useful to prove that a suspect had no apparent legitimate source of income. For example, he/she was never seen going to work in a company, factory, etc. Surveillance can also be useful in identifying where a suspect keeps his/her assets - financial transactions that the suspect performs whilst under surveillance, such as visiting a bank or an ATM, may identify which bank the suspect has an account with.

2. Telephone Intercepts

Lawfully obtained telephone intercepts which can be used in evidence can provide invaluable assistance to the investigator in proving that a suspect was aware of the criminal nature of the funds with which he/she was dealing.

3. Undercover Operations

As with telephone intercepts, use of undercover agents can provide direct evidence of a suspect's knowledge or belief as to the illicit source of the money. These operations can be relatively simple ones, targeting remittance agents or company formation agents, or they can be as sophisticated as setting up a 'shop front' operation to launder money on behalf of criminals.

4. Controlled Deliveries

The use of controlled deliveries in drug operations, whereby a drug shipment is delivered from one country to another under the control of the authorities, is a well established tactic. Controlled deliveries of money is less common but can be similarly effective when combined with other resources such as surveillance and telephone intercepts.

B. Circumstantial Evidence

Circumstantial evidence, whereby proof of guilt can be inferred from indirect evidence, can also be crucial in proving a money laundering case. The investigator may be able to show, for example, that a defendant had no legitimate income, that he/she often performed his/her transactions using cash, that his/her banking habits

were not those to be expected from a normal person and that he/she was associated with people he/she knew to be criminals. None of these facts on their own would be enough to establish guilt, but if they are put together and presented to a court, the jury may feel that the inescapable inference is that the defendant was guilty of money laundering.

VIII. CONCLUSION

Tackling money laundering will never be easy. The ease with which money can be moved around the world, the ingenuity of money launderers in finding new ways to disguise their ill gotten gains, the prevalence of tax havens and shelf companies and the excessive secrecy of certain jurisdictions all combine to ensure that tracing the flow of dirty money and prosecuting the money launderer will remain one of the hardest tasks in criminal investigation. This task will be made somewhat easier, however, if the various anti-money laundering components mentioned above are welded together to form a cohesive anti-money laundering strategy. A workable and comprehensive law, close international co-operation, an effective FIU and strong regulation of the financial sector, combined with imaginative and thorough investigation, are vital if money laundering and its inherent dangers to society are to be effectively combated.