



Corruption, KYC and the Cost of Compliance

Jarrad Hope

“According to some estimates, we cannot track \$2.3 trillion in transactions.”

— *Donald Rumsfeld,*
September 10, 2001





"The adversary is closer
to home, the Pentagon
Bureaucracy"

“We know it’s gone.
But we don’t know
what they spent it on”

Jim Minnery of the Defense
Finance and Accounting
Service traveled the country in
2002 looking for documents on
just \$300 million worth of
unrecorded spending.





\$6.5T

in unsupported
adjustments, 2015

54x

the spend authorized
by Congress (\$122B)

\$21T

avg \$1.2 T / year in
'undocumented adjustments'
between 1998-2015

— *Mark Skidmore, professor
of economics at Michigan
State University*



“The books are cooked routinely year after year”

— *Franklin C. Spinney,*
former defense analyst,
1983 military whistleblower





\$8.2 billion of "improperly valued" material to Ukraine



My News



United States | Ukraine and Russia at War

Pentagon finds another \$2 billion of accounting errors for Ukraine aid

By Mike Stone

July 25, 2024 5:12 PM EDT · Updated 2 months ago



Aa



"When it comes to catching fraud, DOD's internal controls are a complete failure. We've known it for decades."

— *Senator Chuck Grassley, 2024*

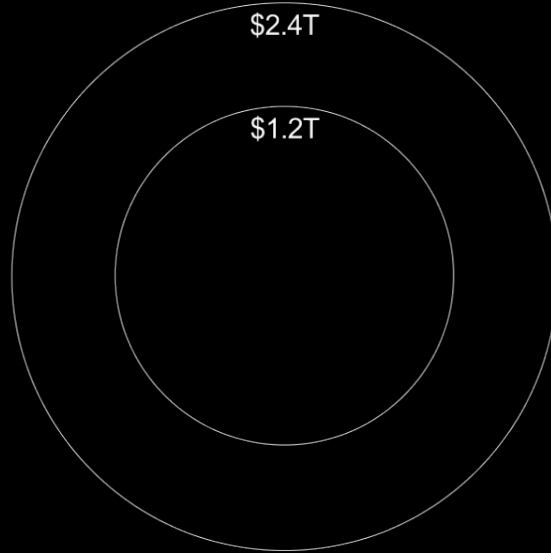




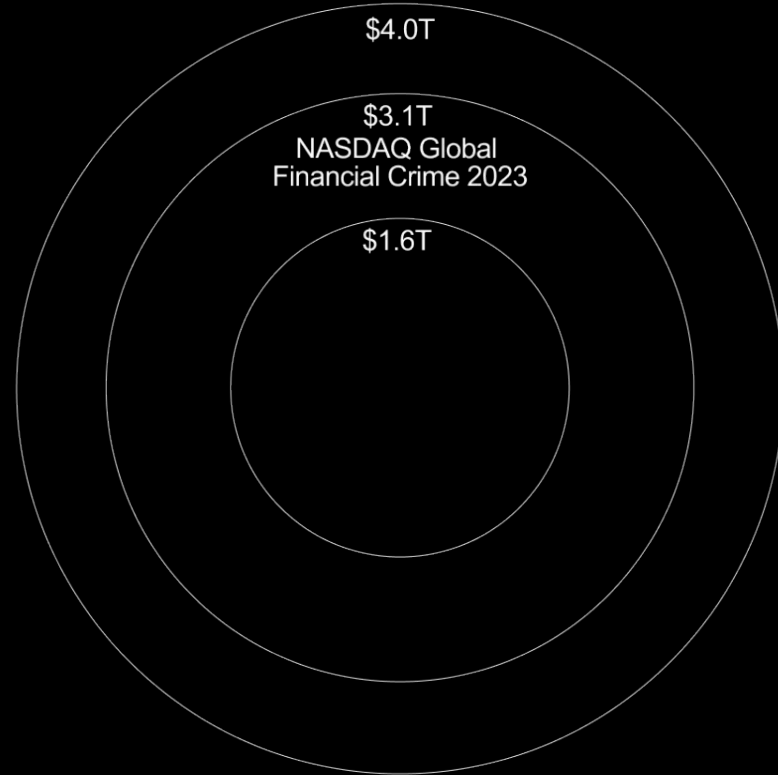
MOCAS: Mechanization of Contract Administration Services

It's illegal for any government agency to spend money appropriated for one purpose on a different program. But the military — either hilariously or horribly, depending on your perspective — created a program that algorithmically produced such violations of the law.

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Command ==>
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000100      IDENTIFICATION DIVISION.
000200      PROGRAM-ID. EDITCHAR.
000300      DATA DIVISION.
000400      WORKING-STORAGE SECTION.
000500      01 NUMZZ          PIC ZZZZ9.
000600      01 NUMDOLL        PIC $99999.
000700      01 NUMSTAR        PIC *99999.
000900      PROCEDURE DIVISION.
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Pentagon Average Annual
Unaccounted Adjustments



United Nations
Illicit Financial Flows

The Day After 9/11 FATF 8 of 9 Special Recommendations by October, 2001

PATRIOT ACT KYC/AML

Sections:

- 311 – Authority
- 326 – Standards
- 351 – Liability Immunity
- 352 – AML Programs

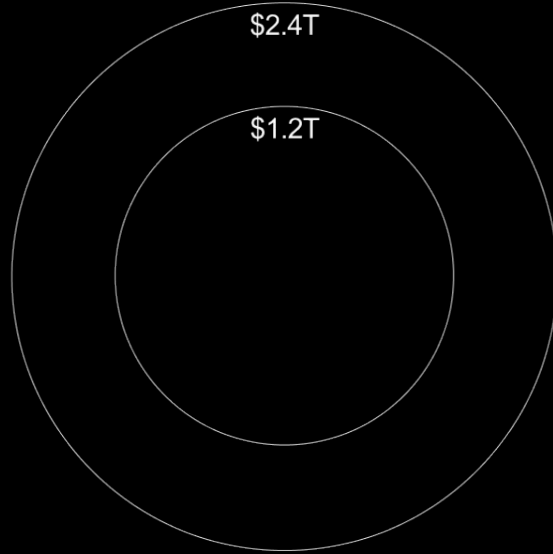




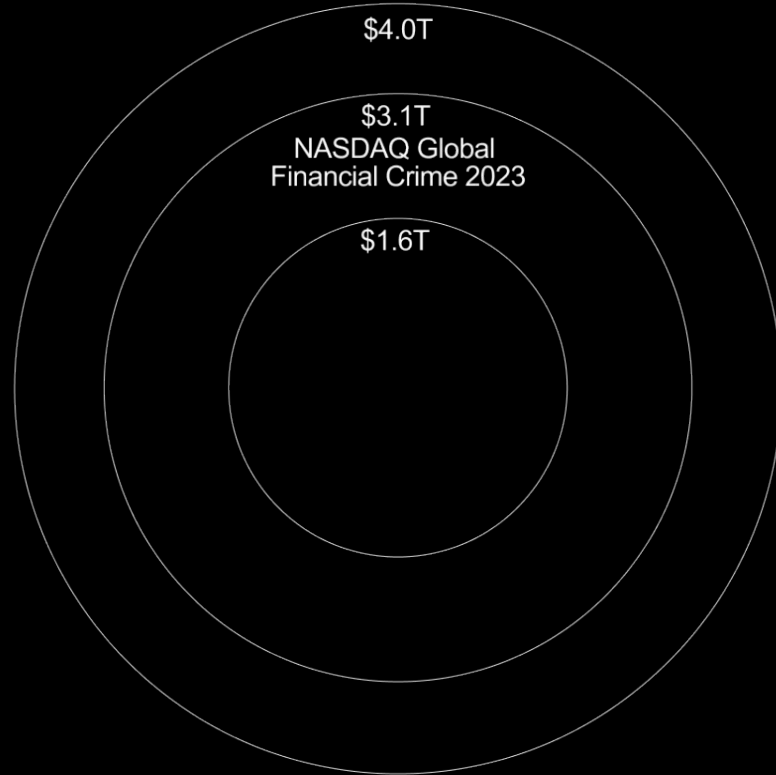
“AML compliance change being led by regulators within Asia, or by regulators in other regions? Local regulations were cited most frequently as having the greatest impact.

However US regulation, embodied in the PATRIOT Act, was cited most frequently overall by respondents, followed by European regulation.”

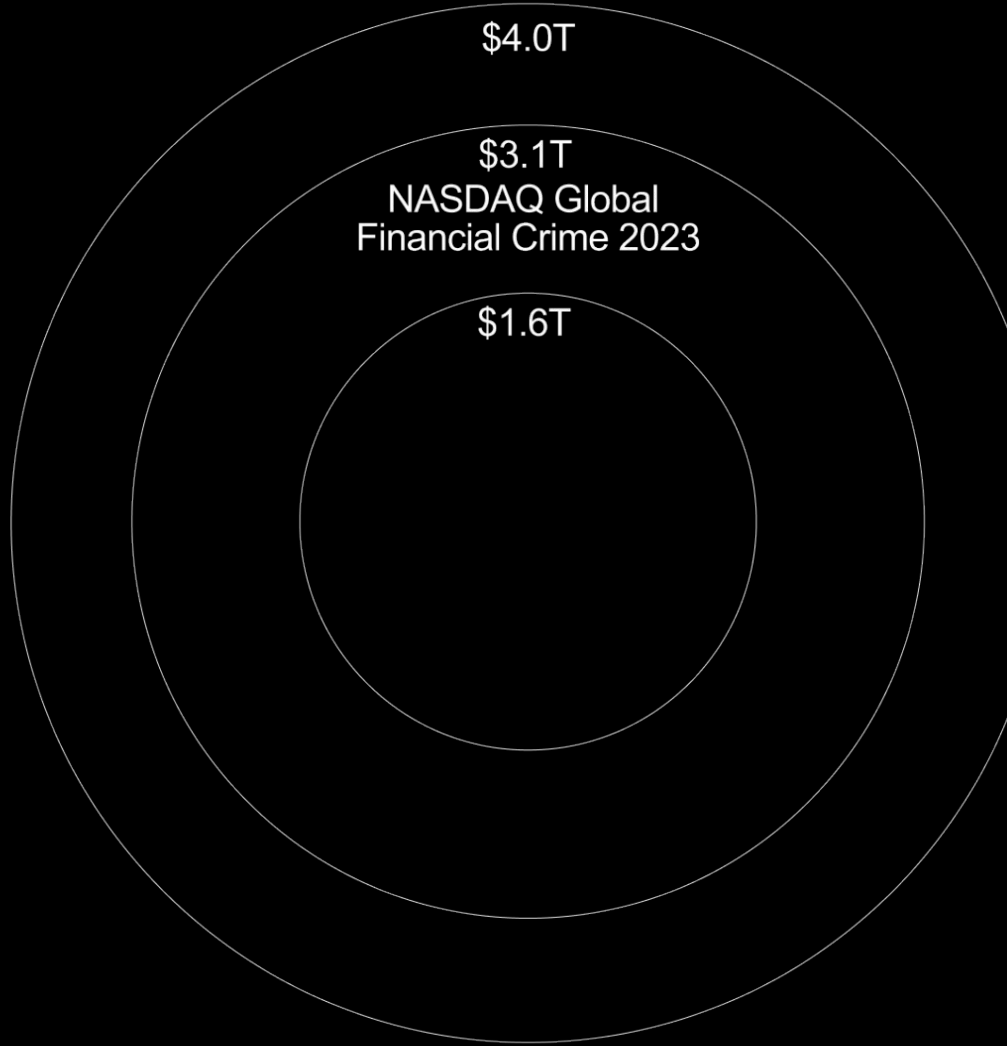
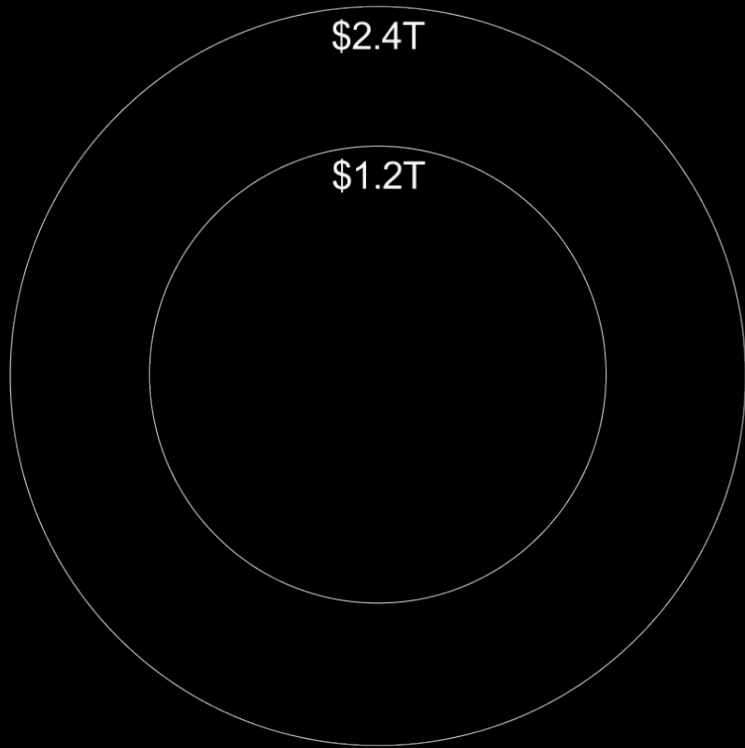
— LexisNexis® Risk Solutions, *The True Cost of Anti-Money Laundering Compliance survey, 2015*

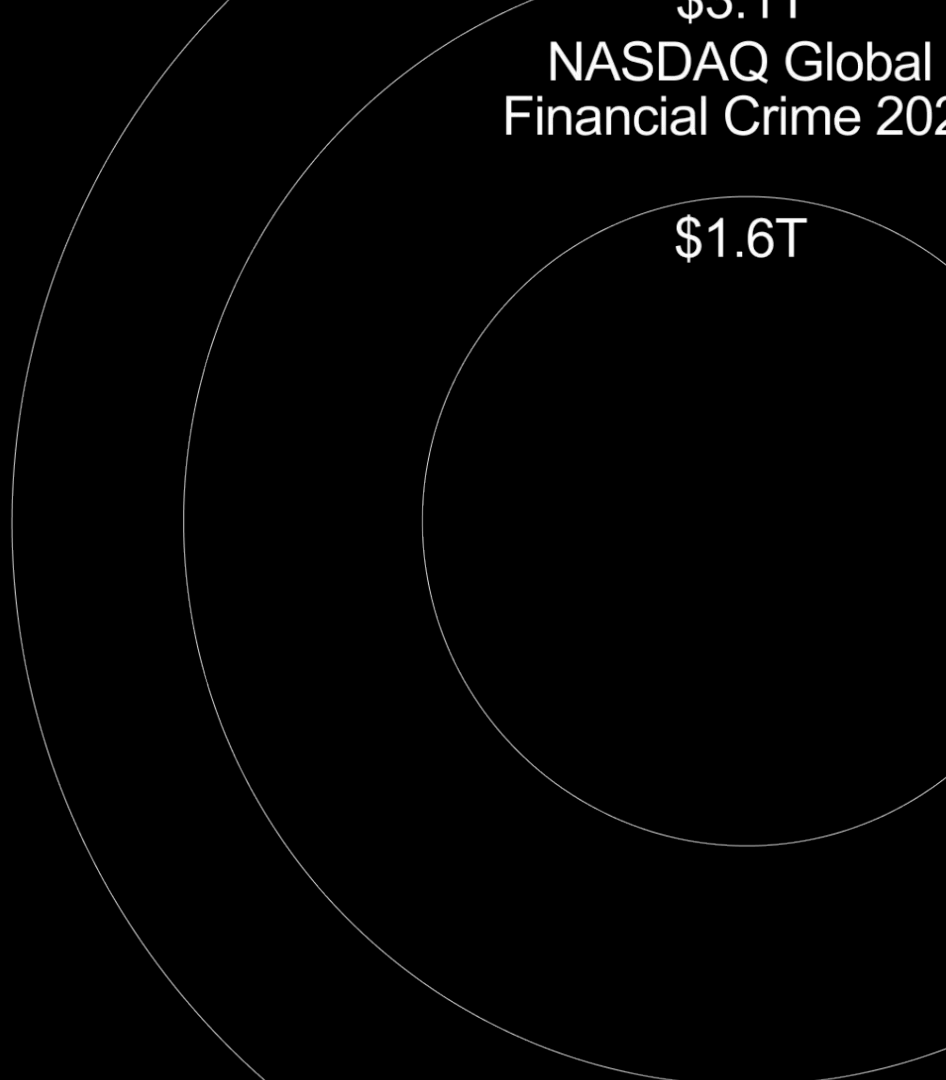
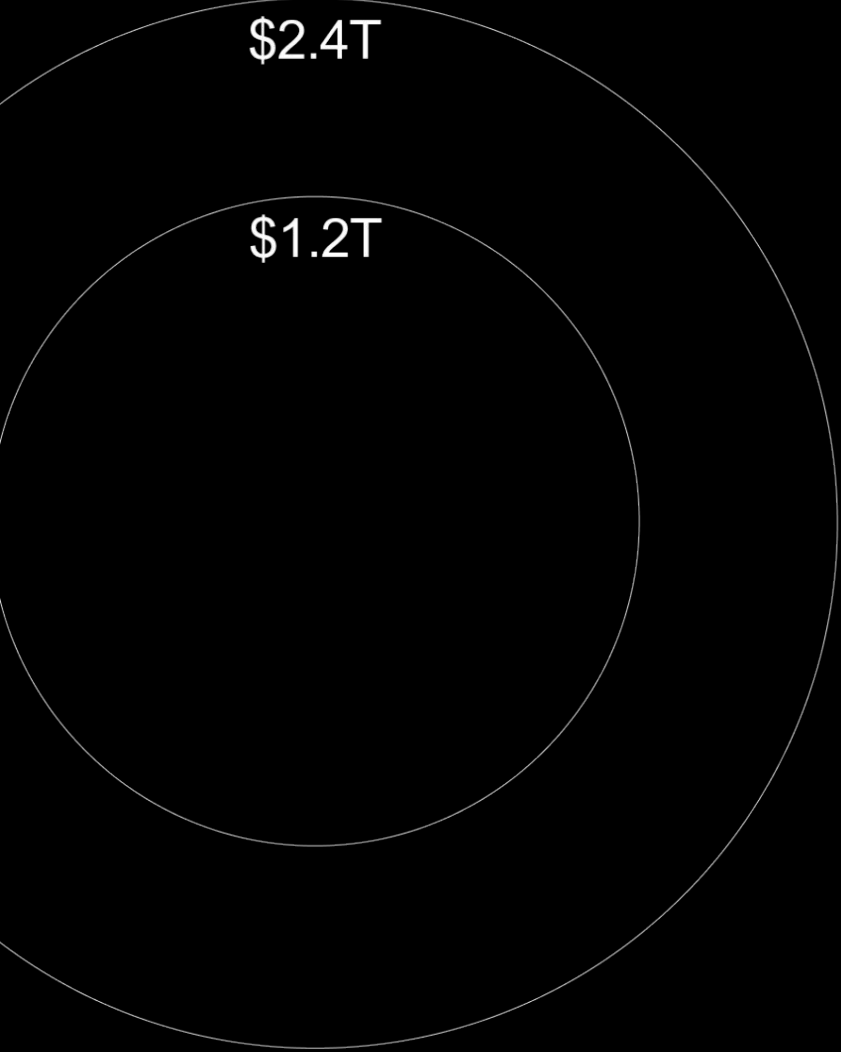


Pentagon Average Annual
Unaccounted Adjustments



United Nations
Illicit Financial Flows





\$1.2T

o
\$11.5B in Terrorism Financing
2023 NASDAQ Global Financial
Crime Report 2024



\$11.5B in Terrorism Financing
2023 NASDAQ Global Financial
Crime Report 2024



In 2001, the World Bank and IMF estimated that the annual flow of funds to terrorist organizations was between **\$300 million and \$500 million.**

A 2005 RAND study estimated that al-Qaeda's annual budget was between **\$30 million and \$50 million.**

In 2015, the U.S. Department of Treasury estimated that ISIS generated approximately **\$1 billion** annually from various sources, including oil sales, taxation, and extortion.

In 2016, Europol reported that ISIS had an annual budget of around **\$2 billion.**



Counterterrorism-related spending
from 2002-2017 came to \$2.8 trillion, or
\$186 billion average per year

— *Stimson Study Group, On Counterterrorism Spending*

Illicit Financial Flows (IFFs)

No single, agreed-on definition

IFFs generally comprise:

- tax evasion
- multinational tax avoidance
- the theft of state assets
- the laundering of the proceeds of crime

And cover a broad range of market and regulatory abuses, including:

- corruption,
- drug smuggling
- human trafficking





Addressing IFFs is Important

In the Research Handbook on Money Laundering, Donato Masciandaro describes the societal costs of money laundering by criminals - outlining how every dollar of criminal proceeds reinvested, can lead to more crime. Brigitte Unger summarises “Since money laundering can lead to an explosion of crime rates, it is a ticking time bomb and therefore create(s) a serious problem that has to be fought.”

In the book "Prioritizing Development: A Cost Benefit Analysis of the United Nations' Sustainable Development Goals", Bjorn Lomborg, along with the top economists rank UN Sustainable Development Goals (SDGs) \$1 for \$1 spent and finds mitigating Illicit Financial Flows to be a top priority



Why is Addressing IFFs Important?

IFFs of all types are associated with:

- ineffective state functioning
- illegitimate use of state power
- international problems

Lost GDP = Lost Tax Revenue = Poor Governance

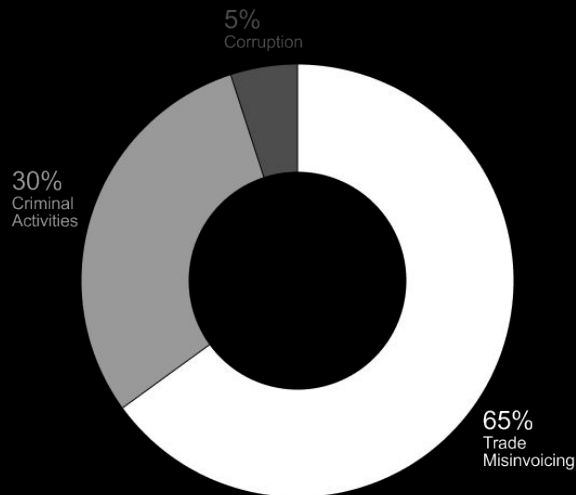


What exactly are Illicit Financial Flows?

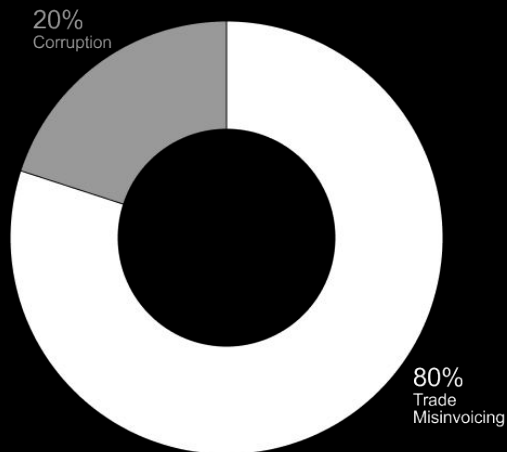
....Well, that depends.



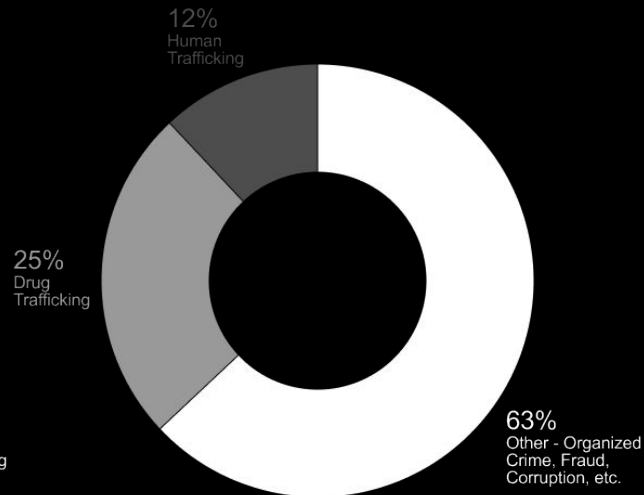
IFF Methodologies & Composition



— Raymond W. Baker, *Capitalism's Achilles heel: Dirty money and how to renew the free-market system*, 2005



— Cardamone Kar, *Post-2015 Consensus: IFF Perspective*



— NASDAQ Global Financial Crime Report 2023



“The issue of illicit financial flows came to prominence as a public policy issue with the publication of Raymond Baker’s *Capitalism’s Achilles Heel* in 2005, but it is striking that today we know little more about the issue.

Moreover, all the current estimates of such flows are based on those of Global Financial Integrity, set up by Baker after his book was published, and use a single methodology. The state of the art on IFFs is essentially prescience, with no empirical basis for assessing the effectiveness of proposed policies.”

— *Peter Reuter, Post-2015 Consensus: IFF Perspective*



“Although different measures and models are used to estimate money laundering, no model to quantify money laundering is globally acceptable.

The absence of an accurate measurement of costs incurred and the difficulty in linking benefits to AML efforts pose challenges in assessing the effectiveness of AML policy.”

— *H. C. Choo, M. S. Amirrudin, Nur Adelina Ahmad Noruddin, R. Othman, Anti-money Laundering And Its Effectiveness, 2014*

The “FATF Methodology for assessing compliance with the FATF Recommendations and the effectiveness of AML/CFT systems” itself lacks hard data, instead relying in the use of general crime statistics, anecdotal evidence and subjective conclusions.



UNCTAG Pilot

First-ever official data on illicit
financial flows now available
June 2023



Official estimates reported on the [Global SDG Indicators Database](#)

Crime-related IFFs

Mexico 🇲🇽
North America

The **trafficking in drugs** (heroin, cocaine, methamphetamine) was estimated to have generated **inward IFFs** in Mexico for **\$12 084 million** on average per year, between 2015 and 2018. In addition, the **smuggling of migrants** generated **\$1 116 million in inward IFFs** and **\$13.8 million in outward IFFs** on average per year between 2016 and 2018.

Colombia 🇨🇴
South America

Cocaine trafficking was estimated to have generated **inward IFFs between \$1 152 and \$8 619 million** annually between 2015 and 2019. **Cocaine trafficking** was estimated also to have generated value of **outward IFFs** from the import of inputs used in cocaine production **between \$197 million and \$267 million** per year, between 2015 and 2019.

Ecuador 🇪🇨
South America

The **smuggling of migrants** was estimated to have generated **outward IFFs** for an average of **\$13.6 million** per year, between 2016 and 2018.

Peru 🇵🇪
South America

Cocaine trafficking inward IFFs were estimated at an annual average of **\$1 482 million** between 2015 and 2017.

Bangladesh 🇬🇧
Asia

Drug trafficking is estimated to have generated an annual average of **\$481 million in outward IFFs** between 2017 and 2021. This estimate includes the trafficking in methamphetamine tablets, heroin and synthetic opioids such as buprenorphine and phensidyl.

Maldives 🇲🇻
Asia

Drug trafficking is estimated to have generated **outward IFFs** from the Maldives estimated at **\$16.4 million** on average per year, between 2020 and 2021. The estimate includes the trafficking in cannabis, heroin, cocaine and ecstasy.

Nepal 🇳🇵
Asia

Heroin trafficking was estimated to have generated **outward IFFs** from Nepal at annual average of **\$4.6 million** between 2019 and 2021. In addition, the recruitment of Nepali migrants exploited in **forced labour** abroad was estimated to have generated **inward IFFs** for **\$3.3 million** in 2021.

Afghanistan 🇦🇫
Asia

The potential **exports of opiates** from Afghanistan were estimated to have generated **between \$1 300 and \$2 233 million in inward IFFs** on average between 2018, 2019 and 2021.

Myanmar 🇲🇲
Asia

The potential **exports of opiates** from Myanmar were estimated to have generated between **\$508 and \$1 347 million in inward IFFs** on average between 2018 and 2022.



Are Follow the Money Methods Effective?

“Less than 1% of global illicit financial flows is recovered”

— *FATF, 2023*

"Anti-money laundering policy intervention has **less than 0.1% impact** on criminal finances"

— *Ronald F. Pol, Anti-money laundering: The world's least effective policy experiment? Together, we can fix it*

~0.2% illicit funds intercepted

— *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes, UNODC*



In other words, 99.8% of criminal
proceeds are unaffected.

Direct costs to Banks

Lexis Nexis Risk Solutions assessed the cost to U.S. banks as **\$26.4 billion annually**, more than double global Terrorism Financing.



"Compliance costs exceed recovered criminal funds more than a **hundred times** over, and banks, taxpayers and ordinary citizens are penalized more than criminal enterprises."

— *Ronald F. Pol, Anti-money laundering: The world's least effective policy experiment? Together, we can fix it*



“Challenges with unintended consequences of financial regulation have been highlighted by Business at OECD and the B20 for several years.”

“The typical cost-to-income ratio in traditional trade finance is 50-60%, meaning that **more than half of the price** charged to clients for trade is used to cover operational expenses, even before covering the costs of risk, liquidity and capital.”

“The requirements to merely participate in trade are typically too onerous for most SMEs to trade safely and/or efficiently,”

— *Yousef Abdullah Al-Benyan & Phil O'Reilly B20 & OECD, “GVC Passport” on financial compliance, a pragmatic concept to strengthen Inclusive and Sustainable Growth*

“Our estimates highlight negative and robust relationship between transaction costs generated by legal institutions and cross-country economic growth. The evidence suggests strong effects of rising transaction costs on economic growth.

For a country with 10 basis points higher extent of transaction costs relative to those that do not increase the costs, according to our measurement, we expect it to be between 3.12-fold and 4.66-times poorer which roughly corresponds to the per capita **output gap between Switzerland and Argentina.**”

— *Institutional development, transaction costs and economic growth: evidence from a cross-country investigation, 2016*



“No-one could rationally think that AML controls in general or financial investigation in particular will 'solve' organised crime completely or eliminate high-level offending: for there even to be a chance to achieve that, there would need to be a step change in transparency and effective action against high-level corruption along all possible supply chains”

— *Michael Levi, "Money for Crime and Money from Crime", 2015*

WEAPONIZING COUNTERTERRORISM

INDIA'S EXPLOITATION OF TERRORISM FINANCING ASSESSMENTS TO TARGET CIVIL SOCIETY

“The Indian government has exploited the 2010 and 2013 Financial Action Task Force (FATF) assessment reports to supplement its arsenal of counterterrorism and money laundering laws, many of which are routinely used to target civil society organizations and human rights defenders.

The briefing paper analyses the Foreign Contribution (Regulation) Act, Unlawful Activities (Prevention) Act and Prevention of Money Laundering Act and highlights the emblematic cases of the crackdown suffered by journalists, academics, human rights activists, and students under these laws since 2010.”

AMNESTY
INTERNATIONAL





Royal United Services Institute (RUSI) FATF Weaponisation Tactics:

1. Intelligence fishing and scraping
2. Strategic bank account freezing
3. Harassment and prosecution of organisations
4. Politically motivated (pre-trial) detention
5. Lawfare for transnational repression

www.rusi.org



Special Resource

Weaponisation of the FATF Standards A Guide for Global Civil Society

Stephen Reimer





“IFFs are likely, by and large, to be an elite phenomenon

because this is where the incidence of direct taxation will overwhelmingly lie and because political and corporate power in many cases will facilitate IFFs. If tax systems are in theory progressive, then

incentives for abuse are likely to be strongest at the top of the income distribution and opportunities will also be concentrated here,

for those with access to foreign bank accounts, or for businesses operating internationally. Lost taxation on high (individual and corporate) income makes the system less progressive and increases inequality.”

— Alex Cobham, *Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda Assessment Paper*

Crypto was a tool for
“criminals, drug traffickers,
money laundering, and tax
avoidance,” adding, “if I
were the government, I’d
close it down”

— *Jamie Dimon, CEO, JP Morgan Chase,*
Dec. 6, 2023





The irony is that just a few weeks after Dimon's congressional testimony, JP Morgan Chase was fined \$348 million for 'inadequate trade reporting'...

And that fine, in turn, followed over 80 regulatory fines against JP Morgan Chase for banking violations and other crimes dating back to 2003, with a total amount paid of over \$39 billion.



FINCEN Files

“Secret U.S. government documents reveal that JP Morgan Chase, HSBC, and other big banks have defied money laundering crackdowns by moving staggering sums of illicit cash for shadowy characters and criminal networks that have spread chaos and undermined democracy around the world.”

JP Morgan Chase, HSBC, Standard Chartered Bank, Deutsche Bank, and Bank of New York Mellon – “kept profiting from powerful and dangerous players even after US authorities fined these financial institutions for earlier failures to stem flows of dirty money”

— *The International Consortium of Investigative Journalists (ICIJ)*

Financial Secrecy Index

1. United States

FSI Value:
1,951



Secrecy Score:



Global Scale Weight:



FSI Share:



2. Switzerland

FSI Value:
1,167



Secrecy Score:



Global Scale Weight:



FSI Share:



3. Singapore

FSI Value:
1,167



Secrecy Score:



Global Scale Weight:



FSI Share:





“Asking a kleptocratic state to create an effective AML system is to ask the fox to create a better henhouse; it is the governing political elite that benefits most substantially from the weakness of the existing system of controls.”

— *Peter Reuter, Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda Perspective Paper*

Trust in Most US Institutions Has Withered

Percentage of respondents who have a “great deal” or “fair amount” of confidence

Lower confidence in 2024 relative to first poll Higher confidence

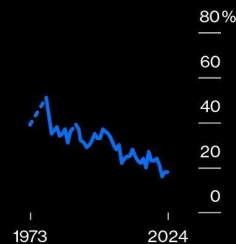
Congress



Big business



Newspapers



The presidency



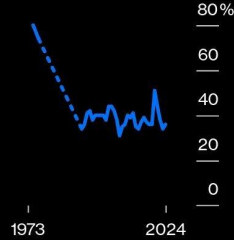
The Supreme Court



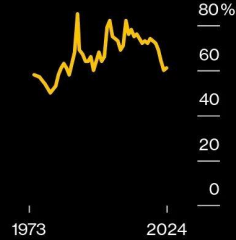
The church or organized religion



The medical system



The military



Small business





Government Trust is Withering Globally

“35% of the UK population stated that they trusted the national government”

— *Office for National Statistics, 2022*

"France has reached a new historic low, where 82% of citizens believe the country is heading in the wrong direction"

— *Institut Public de Sondage d'Opinion Secteur (IPSOS), 2024*

On a global scale, average public trust in governments hovers around just 41%

— *OECD, Trust in government, 2022*



“Over two-thirds of countries score below 50 out of 100, which strongly indicates that they have serious corruption problems.

The global average is stuck at only 43, while the vast majority of countries have made no progress or declined in the last decade. What is more, 23 countries fell to their lowest scores to date this year.

Both authoritarian and democratic leaders are undermining justice. The global trend of weakening justice systems is reducing accountability for public officials, which allows corruption to thrive.”

— *Transparency International's 2023
Corruption Perceptions Index (CPI) report*



“Government debt will grow to dangerous and unsustainable levels in most advanced and many emerging economies over the next 25 years”

— *The Peterson Institute for International Economics, 2011*



Since 1800s, 52 countries saw a
debt-to-GDP above 130%

51 defaulted.

Today, US is ~120%

By 2033, above 130%

By 2050, beyond 150%

— *The Congressional Budget Office (CBO), 2018*



The fiscal challenges confronting the United States are not unique

They are part of a broader trend that threatens the economic stability of many developed nations.

The National Intelligence Council (NIC) has projected that many governments in the developed world are likely to experience the same substantial economic difficulties.



FATF Unaccountability

- Lack of Legal Personality
- Enjoys Sovereign Immunity
- Member State Responsibility
- Economic Lockout
- No Opt Out



“Human capital and the value of institutions (as measured by rule of law) constitute the largest share of wealth in virtually all countries.”

— *The World Bank, Where is the Wealth of Nations? (2006)*

It's time to let go of
KYC/AML.

Create Efficient
Parallel Institutions

