Five Recommendations to "Effectively" combat Money Laundering

Fighting crime has always been tough, increasingly so in a globalised world. In spite of law enforcement efforts, the age-old maxim "crime doesn't pay" seemingly no longer applies as money laundering[1] continues to hit the headlines and ever greater estimates of criminal proceeds are announced.

According to the UN it estimated that for 2009 Global Criminal Proceeds may amount to US$2.1 trillion,[2] (3.6% Global GDP) a figure which exceeds recent figures on illicit trade values of US$1.79 trillion[3] for the amount of black market crime, which is mostly made up from the proceeds from illegal drugs (approx US$411bio), no longer the largest amount as now surpassed by proceeds from counterfeiting and piracy -prescription drugs, food, clothing, shoes, luxury brands, movies, music, electronics, machine parts

and currency (US$691.5bio), by human trafficking,-slavery, prostitution, economic migration, child exploitation (US$240bio), and smuggling -oil and gas, alcohol, tobacco and weapons (US$162bio), and by illegal gambling -illegal casinos and card clubs (approx US$140bio).

These figures could even understate the problem, if youalso add in Corruption and Fraud. The World Bank hasestimated the amount of bribes paid at between US$1trillion to US$1.6 trillion for example.[4] Whilst thereappear few reliable estimates for Fraud, it is clear thatsignificant sums are lost, perhaps as much as US$2.75trillion, if you apply available estimates for both theUK[5] and the US[6] to other countries. These figuresprovide a stark reminder of "Follow the money" is 21st Century Crime.

Organised and able to operate effectively across borders, criminals pursue these activities because they generate huge profits. They target markets where demand is strong and wealth is greatest. This means focusing on consumers in countries generating the most economic activity.

Top 10 representing 81% of Total Proceeds (US$ 1,933 Bio)

Whatever the true numbers, they are large and requirea formidable response. It is axiomatic that governments need to design and implement effective measures to reduce both supply of criminal activities and demand for the products and services derived from such activities. However, governments have not succeeded in rolling back global criminal enterprises or successfully addressing the amounts laundered. According to the UN that estimated Global Criminal Proceeds of US$2.1 trillion, in 2009 they also estimated that money flows laundered was estimated at US$1.6 trillion and that money flows related to transnational organised crime was estimated at US$870bio of which US$550bio was available for laundering through the financial system. Approximately only US$3.1bio or 0.2% of this amount is being seized.[7] According to US Senator Carl Levin, as far back as 1999, "estimates are that US$500bio US$1 trillion" are moved internationally "and that half of that money comes to the US".[8]

On the supply side, much has been tried but little has proven to be sufficiently effective. Numerous individual successes can be claimed, but once an organisation is broken, or a leader imprisoned, another quickly takes their place. Precious little has been done to address the demand side of the problem. In response to the challenges faced by conventional law enforcement efforts aimed at limiting supply and apprehending criminals engaged in criminal activity, attention has shifted to identifying, tracing and seizing the proceeds of crime as they make their way through the illicit of economy to the legal one. "Follow the money" is a common term today, but several decades ago phrase and practice was a novel one born out of the difficulty governments were having in tackling criminal enterprises by focusing solely on their criminal acts. This fight against money laundering -or anti-money laundering (AML) - necessarily focuses on the financial system and the legitimate financial institutions that operate it.

The first war against drugs.

The history of combating drug trafficking is an instructive case study for the advent of AML. A hundred years ago, at the US' behest, the great trading nations of the world came together, and finally agreed to criminalise the production and distribution of opium. The trade in opium had generated huge profits for trading companies and for States through taxation (none more than for the British Empire). However, the increasing addiction rates of populations, the deleterious effect on productivity, and the immorality of this enterprise led to the signing of the Hague Convention in 1912,[9] hailed as a remarkable breakthrough whenit came into force as part of the Treaty of Versaillesin 1919 at the end of the First World War. The focuson supply-side prohibition of opium after significant insatiable demand had been established would bea policy response repeated when other drugs, like cannabis, amphetamines and cocaine, were made illegal.[10]

Notwithstanding the repugnance of the drug trade and the good intentions behind delegitimizing it, the net effect of withdrawing supplies of opium to millions of addicts was the creation of a massive illegal market, with huge profits to be made by producers and traders who were prepared to provide illicit supply. This should not have been a surprise, as this very outcome was predicted by British Prime Minister William Gladstone (who liked to take a drop of opium in tea often before giving a speech) in an earlier self-serving defence of the British government's support for its own Empire's addiction to taxes levied on the opium trade when he said "[Opium] prohibition would unleash organised crime, allow others to step in and further the insatiable demand for [drugs]".

The organised crime syndicates that followed have prospered and become transnational, controlling illegal drug production, transit and distribution. The last 100 years have seen illicit drug supply increase and expand in terms of substances (from opiates to narcotics and socalled psychotropic substances), size, and geographical scope. The organised transnational and local criminal enterprises that operate the drug trade also have expanded into new areas of illicit activity, cited above.[11]

Advent of AML

To respond to the burgeoning narcotics trade, more than 25 years ago, the "follow the money" idea was conceived and embraced by governments of all shades, leading in 1988, to the Vienna Convention[12] that required "all members to adopt all necessary measures to enable confiscation of criminal proceeds from illegal drugs." One year later, the Financial Action Task

Force ("FATF") was established by the then G7 group of nations to promote global standards on money laundering prevention. FATF has since extended its focus from drug trafficking to corruption, terrorism financing, WMD Proliferation Finance and other major crimes, that, also now include tax crimes. The idea is

a simple one: focus on the money flows, the working capital, and the profit from serious crimes, in order to catch the criminals, to materially disrupt their criminal activities, and to create effective disincentives that will reduce serious crime.

Focusing on the financial proceeds of crime, as opposed to the underlying criminal activity, required fresh thinking, new methodologies and new players. FATF recognised the necessity of novel laws and regulations, as well as unprecedented co-operation among sovereign countries, their numerous law enforcement bodies

and the financial services industry. Enlisting the financial sector was critical because it was assumed that criminals used banks and other financial intermediaries extensively – first introducing criminal proceeds into the sector (placement), then moving these funds to disguise their illegitimate origin (layering) and finally laundering their funds to obscure their illicit origin (integration).[13] It was presumed that banks, exercising reasonable diligence, would be uniquely able to spot criminals and their financial activity. To help accomplish this, laws were passed requiring banks and others to introduce money laundering prevention programmes based on (i) knowing their customers -identification and due diligence – (ii) monitoring of transactions to detect suspected criminal activity, and (iii) reporting such activity to government agencies that would launch investigations, prosecutions and seize financial assets.

According to criminologists, a rational person will only commit a crime if he believes the benefits outweighthe costs. In other words, to effectively deter criminal activity the probability of apprehension and conviction times the projected severity of punishment (including forfeiture of gains) must exceed the expected rewards. The hope behind AML efforts was that banks and others could provide enough information to law enforcement authorities who would follow up with successful prosecutions and asset seizures that would check the growth of, and potentially reduce, serious crime.

The first 25 years

Contrary to the perception in some quarters that financial institutions have not done much to prevent criminal enterprises from abusing their services, banks have made significant contributions, perhaps as much as US$18bio[14] both in terms of the billions of US$ they have spent and the effectiveness of their actions. All reputable financial institutions, recognise they have an important role to play in combating money laundering, and they support the general strategy charted by governments.

Banks have worked tirelessly with governmental authorities, and international and national standardsetters, to establish and invest in programmes asnew threats emerge and priorities change from drug trafficking and organised crime (where measureshave increased the risks of detection and the costs of criminal activity) to corruption committed by so-called kleptocrats, who have found their access to the formal financial sector certainly impeded. Extensive efforts have been dedicated to combating terrorism finance and WMD proliferation finance, where automated systems and detailed knowledge of customers and transactions can provide crucial information quickly in response to governmental requests. With respect to the introduction of smart economic sanctions and embargo measures, the involvement of financial institutions has been critical to isolating rogue states and individuals from the formal financial sector. At the same time, the amount of information, in the form of Suspicious Activity Reports (SARs), filed by Banks and others in the industry has risen, year on year, to a level approaching 2 million individual reports a year.[15]

These are impressive results and the result of investments made in designing and implementing serious programmes to support the authorities in the fight against money laundering, corruption, terror finance, WMD proliferation finance, sanctions compliance and other serious crimes.

It would be incorrect and unfair to use enforcement proceedings against individual banks to detract from the overall performance and contributions made by the financial industry.

From 1989 to end-2013 financial penalties incurred by financial institutions for failure to comply with money laundering related laws, regulations or expectations, including for sanctions, violations, market abuse and fraud have topped US$23.45bio, with more than half coming in the last 5 years.[16]

Without excusing some serious cases at financial institutions, it is predominantly weaknesses in implementing and complying with complex AML regulations that is the main issue and not aiding and abetting criminal activity. It is the criminals that should remain central to our concerns. Beyond gains achieved in the areas of terror finance, WMD proliferation finance, and Sanctions Compliance, the substantial efforts of banks have not resulted in the expected gains by others.

According to the "follow the money" strategy, information provided to governmental authorities by the banks and others should lead to prosecutions and asset seizures. With almost 2 million Suspicious Activity Reports ('SARs') filed annually, there is no shortage of information. Nevertheless, despite these opportunities, asset seizure and forfeiture rates remain significantly below any form of tipping point. Whilst consistent figures are scarce albeit thankfully climbing in many countries (albeit flattered by forfeiture levies on financial institutions)so is the haul by criminals of the proceeds of crime.

According to the UN based on all available estimates, less than 1% of the total amounts that are being laundered are detected. The UN report issued in 2011[17] found and reported that, "Data collected by the US State Dept suggest that some US$3.1bio were seized

in connection with money laundering activities in32 countries out of 62 analysed (2010 or latest data available); more than 80% of this was seized in North America. This would be equivalent to some 0.2% of the best estimate of the extent of money laundering at the global level. In comparison, more than 20% of the globally produced opiates are being seized and more than 40% of cocaine."

Other figures indicate the seizure rates, particular over the last few years are actually much higher than those reported in the UN study, particularly in the US[18]but also elsewhere[19] though recent increases are not as large. There is evidence however that increases are being made by the targeting of big ticket corporate fraud

and bank enforcement cases which are overshadowing recoveries from the original targets being serious and Organised crime, particularly in the US. In Europe the picture is mixed. Whilst there is relatively little seized and forfeited in many European Countries a recent €1.6bio success against the Italian Mafia, by the Italian authorities is cause for optimism.[20]

Despite some success it appears that few of these directly relate in some way due to the filings from SARs or at least there is little or no evidence to suggest that this is the case, or that the majority of the seized assets are in the form of banked assets. For example, it is likely that most of all seizures are in the form of physical assets, such as real estate, businesses and cash, or from financial institutions' forfeiture fines.

In sum, although the situation would have been worse without the last 25 years of anti-money laundering efforts and certain costs have been imposed on offenders, the cost-benefit calculus would appear to still tip decisively in favour of the criminal. Criminals enjoy not only a tax free income, but can expect to retain almost all of their illicit bounty. With large new markets to exploit, both geographic and industrial, the benefits to criminals in committing crime for profit remain compelling and growing.

The next 25 years

In response to the current situation, authorities have called for more of the same. In 2010, UNODC Head Antonio Mario de Costa reiterated his support for this strategy with the words,[21] "Criminals are motivated by profit, so let's go after their money," and in 2012 FATF announced revised recommendations[22] extending the "follow the money" approach, essentially increasingthe ask on banks for the future even further. But there is no reason to believe that this will lead to materially improved results. Indeed, extension and intensification of the existing strategy may compound difficulties and make the effort, less efficient and no more effective than today.

What can be done is a genuine evaluation of "effectiveness". FATF have indeed recognised this and deserve praise for not only making compliance with FATF standards an important part of the next round of Mutual Country Evaluations but also by including effectiveness as a core element that will also be evaluated, this should enable FATF, its sponsors and members, to critically assess the effectiveness[23] of the "follow the money" strategy and develop recommendations for action.

In the US, new FINCEN Director, Ms Shasky Calvery who until 2010 held the position of Chief of the Asset Forfeiture & Money Laundering Section of the US Department of Justice has begun to ask the difficult questions. In a speech to the American Bankers Association/American Bar Association, Ms Calvery acknowledged that institutions are spending a great deal of time and money on compliance programmes, however, she raised questions whether the money being spent is being spent in the right ways. "Industry and others often ask questions such as how does industry effort on compliance risk compare with illicit financing risks and what is the delta between them." These are

questions that need to be answered by regulators, law enforcement and industry" in order to answer these questions a "Delta Team" has been established.[24]

Where FATF and the US are already leading others should follow by ensuring effectiveness is a key theme for 2013 and beyond, reaching out to all stakeholders including financial institutions, establishing their own "Delta Teams" and considering the following

5 Recommendations to effectively combat Money Laundering as part of their work.

5 Recommendations to Effectively Combat Money Laundering

Five Recommendations to "Effectively" combat Money Laundering	
1	Set and reach a target for asset seizures (for example, 5% or US$100bio in 5 years): Focus urgently on implementing all necessary measures to remove obstacles.
2	New Regulations should apply fully also to non-banks, and ensure international consistency on critical areas, e.g., CID, PEPs, BOs, DNFPBs, Wires; and be subject to a cost benefit analysis
3	Information on Risks and Threats must be shared and communicated: National Threat Assessments published and tailored for use by FIs, predicate priorities identified, typologies and strategies communicated.
4	Encourage financial institutions (who must improve cultures of compliance) enhance risk based approaches and provide incentives
5	Educate Consumers targeting demand as well as supply to refrain from supporting criminal actors in purchasing decisions and in understanding the money laundering broader context

Recommendation 1

Asset Seizure Targets Firm asset seizure targets could be set with regards to the proceeds of crime.At least 5% of criminal proceeds, approx US$100bio should be the medium term goal (e.g. after 5 years).

In order to achieve this, enforcement authorities will need to invest additional resources to investigate the information provided from reports already filed by financial institutions that should be a road map for prosecuting many more criminals and seizing criminal assets. As a start, public resources directly employed to these tasks should match at least those invested by the private sector and results should be published.

A detailed study of the problems faced and the impediments to success and recomendations to improve asset seizure and forfeiture the system was conducted by Matrix Insight and released in July 2009, following a request by the European Commission.[25] These recommendations should be acted upon.

FATF's 2012 Best Practices on Confiscation and a Framework for Ongoing Work or Asset Recovery[26]and the EU's proposed Directive on freezing and confiscation of the proceeds of crime[27] are a start but by themselves will make little impact and will not address the problem.

Recommendation 2

Regulations should ensure consistency and subjectto Cost Benefit analysis The introduction of new Regulations concerning AML largely falls upon financial institutions, and within FIs on Banks. Non-Bank

FIs[28] and non-FIs[29] identified as presenting real risks should accept greater responsibility and increase their contributions to match those of the Banks. The Banks should not be expected to provide assurance where regulation is required on third parties.

New regulations are targeted at perceived gapsor perceived risk areas in the money laundering frameworks rather than on any assessment or threshold test, for example a cost benefit or effectiveness test before introduction. In many cases it is unclear whether proposed changes will have any material affect on the underlying levels of crime or criminal proceeds and yet the costs of introduction and compliance are largely ignored.

Regulations are also introduced across jurisdictions often inconsistently. The complexity of trying to comply with international best practices and at the same time national regulations can create confusion, drive up unnecessarily compliance costs and raise complexity. Financial institutions operating globally should be entitled to rely on internationally accepted standards, recognising that such standards may have an element of gold plating.

For core issues, such as, without limitation, (i)the definition of "Customer" (ii) the definition of "beneficial ownership" and definitions such as (iii) PEPs, (iv) wire transfer standards and (v) agreement overtypes of and approaches towards non-FIs that should be regulated designated entities, these should be universally consistent.

Recommendation 3

Information on Risks and Threats must be sharedand communicated It has become a cliché that flow of information sharing should not be a one-way catch everything and winds up missing too much of the street; governments should share information with financial institutions. However, after years of lip service, governmental authorities have made little progress. If governments want to promote successful collaboration to combat financial crime and achieve more impressive results, they must entrust financial institutions with more information. A robust National Risk and Threat Assessment identifying and prioritising risks and threats honestly is essential as well as identifying where FIs can and should provide assistance. Furthermore, financial institutions should be able to maintain appropriate records, share certain information amongst themselves and across borders, without any conflict with applicable data protection or other laws or regulations. This need not include any individual SAR filing made in another country, though the underlying case facts and details should be included.

Additionally, clear priorities should be set and announced as to the relative importance and targets of effort.

As all agree that actions to be taken are inevitably risk-based, i.e. the areas that present the greatest risk should receive the greatest attention, this is impossible without specific information from governments on their priorities. Currently, because of this lack of information, financial institutions find themselves in a difficult situation and regulators seem unwilling to offer any guidance or safe harbours. If the government doesn't set priorities, or says that everything is a priority which amounts to the same thing then financial institutions cannot accurately assess their risks or concentrate their compliance efforts on those areas that pose the greatest risk, and regulators cannot focus their examination and enforcement efforts on those areas either.

If priorities are set and clearly communicated then banks can and will translate the government's priorities into compliance systems across their mix of products and services, assessing the risks that their various business lines present and designing compliance systems that address those risks.

At the same time, regulators will design examination and enforcement protocols designed to ensure that banks have in place procedures that will adequately identify and control the risks associated with money laundering and terrorist financing. But in order to have a risk-based system, banks must know which crimes or similar activities should be given the highest attention and how regulators will approach Banks judgements in this respect. Absent this information, the result is likely to be in many cases unfocused compliance that tries catch everything and winds up missing too much of the things that are most important.

Based on harms and threats it would appear reasonable to assume that terrorism finance and WMD proliferation finance are indeed major prioritiesfor many governments, though again, these should

be expressly confirmed and remaining priorities enunciated. Based on the amounts of criminal monies derived, there is a case for considering that Counterfeiting and Piracy should increase in priority. Other priorities for inclusion will likely include, Corruption (kleptocracy); Fraud (specific elements, for example VAT Tax Fraud, Cybercrime); Illegal Gambling; Drug Trafficking; Human Trafficking and Smuggling which together make up to 95% of likely criminal proceeds.[30]

For each, tailored strategies should be developed and the existing one size fits all, with excessive reliance on financial institutions, KYC, Monitoring and SAR filing should be reconsidered.

Recommendation 4

Encourage Financial Institutions – financial institutions must focus on preventing and detecting criminal proceeds, as well as implementing applicable AML Laws and Regulations and ensuring an institutional "culture of compliance" exists which emphasises the important role banks play

in maintaining the integrity of the international financial system, national security and corporate social responsibility.

Financial institutions should be encouraged toadopt a “risk based approach”, in their design and implementation of AML programmes and shouldnot be second guessed provided such programmes are reasonable and proportionate and ultimately reasonably effective, particularly absent published regulatory specificity.

Contributions by financial institutions should be recognised and where appropriate taken into account when assessing an institution’s record particularly before imposing fines and penalties. Banks should be encouraged to treat AML compliance costs differently than regular business expenses (e.g., facilities costs) and more like important capital investments that promote profitability and critical public goods.

Banks that routinely dedicate resources to efficient and effective compliance should be given direct economic benefits – reduction of examination fees and other supervisory assessments, consideration in calculating capital, or tax advantages.

Recommendation 5

Educate Consumers Someone must educate the public about the true cost of money laundering and how money laundering plays a fundamental role in facilitating the drug trafficker, the organised criminal, the fraudster and the terrorist. Money laundering is not a victimless crime. Whilst it does not have the trauma of a robbery or produce the damage resulting from violent crime, money laundering can only take place after a predicate crime (such as robbery or drug dealing) has taken place. Reinforcing the clear link may also persuade and incentivise otherwise law abiding citizens of the consequences of paying for counterfeit or smuggled goods, use of economic migrants as cheap labour, prostitution, drug taking or involvement in illegal gambling. The economics of crime are no different from the economics of trade and reducing demand will have just as much an impact as disrupting supply.

Conclusions and Final Remarks

Financial institutions operate on the front line on the right side of a just war on the proceeds of crime, on a battlefield that is constantly changing, against an enemy who remains cunning, elusive and very well resourced, without being provided with much useful intelligence and in constant concern over the risk of friendly fire. This is no way to win a war!

The battle is not yet lost and we have plenty of fightleft in us, so let us join once more to address the weaknesses in the strategy and to try to work ever more closely together as banks, regulators, policy makers, law enforcement and governments focusing on the common enemy, criminals and proceeds of their crimes.