What is Money Laundering?

Introduction

Whilst the term “money laundering” was invented and used for the first time only in the 20th Century, money laundering as a practice goes back much further, for example, as long ago as 4000 BC, Chinese merchants found ways of moving their money around in order to avoid identification and confiscation by the rulers of the Chinese State.

Activities that are now predicate crimes, go back as far, as opium usage would have been practiced around this time too and also later in 640 BC coins were counterfeited by clipping alloys and using the shavings to make new coins, the case of Hegestratos’ Fraud in 300 BC,[1] Roman laws addressing forgery enacted around 80 BC, and slavery, terrorism, murder, smuggling and theft of course not at all uncommon throughout antiquity.

What is the origin and true meaning of the term “Money Laundering”?

Fast forward to the Twentieth Century, the term “money laundering” is often said to have originated during “Prohibition” and from the activities of US gangsters, who needed to find ways to disguise the origins of the large amounts of cash, often in small denominated coins, generated by the illegal import and sale of alcohol and other activities such as gambling and prostitution.

With the Banks’ likely suspicious if large amounts of coins were deposited and the storage of large amounts of money in low value coins a challenge they created businesses, one of which was slot machines, and another of which was laundromats, which of course took coins to operate the machines, and so could pass off the proceeds of crime as proceeds from legitimate businesses. So it is thought by some that the term “money laundering” was born.

One of the first modern examples of money laundering followed the conviction of America’s most wanted at the time, Al Capone. It was the conviction for tax evasion that seems to have led to others fearing the same fate, paying closer attention to the financial side of their criminal businesses and establishing money laundering operations that would protect them and make

any prosecution much more difficult. Meyer Lansky a cohort of Al Capone and known as the mob’s accountant, came up with a scheme that would be copied by many in later years. Lansky not only established offshore accounts with foreign banks, away from the gaze of US

prosecutors, but he also borrowed from these Banks, receiving what looked like legitimate loans, backed by the deposited criminal monies. These loans could even be disclosed to the revenue service and a tax deduction declared if necessary. Even so this scheme and others, were not described using the term, “money laundering.”

Whilst some commentators reject this historical origin for the term, whilst accepting coin operated laundromats may have been used amongst other retail and cash intensive businesses, they prefer a descriptive genesisfor the term. For example, Jeffrey Robinson in his 1995 “The Laundrymen” where he considered money laundering mainly the proceeds of drug trafficking was the third largest industry in the world behind foreign exchange and oil and gas, (this is clearly an overstatement, see below), he also alleged that much of the laundered money was reinvested throughout the world by otherwise legitimate businessmen, lawyers, accountants and bankers, describing why it is called as it is, as follows:

“*Money laundering is called what it is because that perfectly describes what takes place*

illegal, or dirty, money is put through a cycle of transactions, or washed, so that it comes out the other end as legal, or clean, money. In other words, the source of illegally obtained funds is obscured through a succession of transfers and deals in order that those same funds can eventually be made to appear as legitimate income".[2]
.......Jeffrey Robinson, "The Laundrymen"

Whilst the arguments over the origin of the term will continue, money laundering as a term of expression appears to have been used first, at least as far as we can tell from records available, as part of the reporting of the Watergate scandal in the early 1970s.

Investigating, the burglary of the Democratic National Committee Headquarters in Washington's Watergate building on 17 June, 1972, Washington Post reporters, Bob Woodward and Carl Bernstein, chronicled in All the President's Men, broke the story that led to the resignation of then US President Richard Nixon.

The reporters learned that investigations carried out by Miami Dade County chief investigator Martin Dadis uncovered a cashier's cheque for US$25,000 deposited into a Boca Raton bank account of one of the burglars, Bernard Barker. Dadis had subpoenaed the Boca Raton bank records upon learning that Barker was carrying more than US$5,000 in new, consecutively numbered US$100 bills when he was arrested. Dadis followed

the new bills back to the Boca Raton bank and uncovered the US$25,000 cheque payable to Ken Dalhberg deposited in Barker's account. The reporters pursued the Dahlberg connection and learned Dahlberg wasthe Republican's Midwest finance chairman of Nixon's 1972 re-election campaign. Dahlberg had collected US$25,000 in cash from a Nixon re-election donor who wished to remain anonymous in order to avoid disclosing the contribution under the new campaign financing laws.

Dahlberg converted the cash into a cashier's cheque payable to himself and gave the cheque to Maurice Stans, finance chairman for the Nixon campaign. Dardis explained that the new campaign finance law that came into effect on April 7 1972 had triggered a massive effort by Stans to solicit re-election contributions from donors. Stans would tell reluctant donors that if they didn't want their contributions traced back to them, their anonymity could be ensured by moving their contributions through Mexican banks because Mexico does not allow the US to subpoena bank records. Dardis explained, "It's called laundering. You set up a money chain that makes it impossible to trace the source. The mafia does it all the time. So does Nixon...This guy Stans set up the whole thing."[3]

This system allowed Nixon's re-election campaign to receive illegal contributions from corporations, and other impermissible or illicit donor groups. Stans used Banco Internacional in Mexico City for the scheme and it was Banco Internacional that issued the US$25,000 Dahlberg cashier cheque.

As a result an article appeared in the Washington Post on 1 August 1972 headlined: "Bug Suspect Got Campaign Funds". The story immediately triggered three separate investigations and helped seal Nixon's fate. As one Post reporter commented: "It [the cheque] was the first real connective glue between Watergate, its funding and the Nixon campaign."[4]

The expression first appeared in a formal context, in a US court in 1982 in the case US v US$4,255,625.39 (1982) 551 F Supp.314. This matter involved a forfeiture case, where it was decided that over US$4mio in cash currency plus the balance on a bank account in Miami of more than US$3.6mio could be seized, as a "substantial connection" between the money and narcotics transactions was made. The court in its judgment mentioned the fact that:, "Miami has become a centre for drug-smuggling and money laundering."[5]

Money laundering was first criminalised in the USin 1986 with the passing of the Money Laundering Control Act. In the 1986 Act Money Laundering was described as:

"*between money laundering and organised crime. Congress's primary intent was to criminalise the, "process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate*."
.......US Money Laundering Control Act 1986[6]

In 1988 in the UN Convention against illicit trafficin narcotics and psychotropic substances, also knownas the Vienna Convention was the first international instrument which included in its purposes criminal asset forfeiture in order to combat serious crime and Money Laundering was defined as:

"*the conversion or transfer of property, knowing that such property is derived from any (drug trafficking) offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions; the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offense or offenses or from an act of participation in such an offense or offenses; the acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offense or offenses..or from an act of participation in such offense or offences*."
..........UN Vienna Convention 1988[7]

In 1999 the UN in its International Convention for the Suppression of the Financing of Terrorism defined "terrorism financing" as follows:

"*Any person commits an offence within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and wilfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out" (a) An act which constitutes an offence within the scope of and as defined in one of the following treaties: Convention for the Suppression of Unlawful Seizure of Aircraft, done at The Hague on 16 December 1970*."
............United Nations 1999 International Convention for the Suppression of the Financing of Terrorism[8]

The money laundering definition used in the Vienna Convention remains current and are referenced as the standard by FATF in its 2012, 40 Recommendations, where it states

"*FATF incorporate the Vienna Conventions technical and legal definition of Money Laundering and recommends expanding the predicate offences to include all serious crimes*."
It also states the following in the 40 Recommendations in 2012 referring money laundering to

"*The processing of...criminal proceeds to disguise their illegal origin in order to legitimise the ill-gotten gains of crime*."[9]

FATF also include a definition of Terrorist financing which is:

"*Terrorist financing is the financing of terrorist acts, and of terrorists and terrorist organisations*."
......FATF 2012, 40 Recommendations[9]

Other Definitions or Descriptions of Money Laundering / Terror Financing

The following are a selection of definitions and descriptions of "**money laundering**" and "**terror finance**" from all over the world:

"*the conversion or transfer of property, knowing that such property is derived from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence or offences to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from serious crime*."
..........Article 1 EU First Money Laundering Directive 1991[10]

"*Money Laundering is the process by which criminal proceeds are sanitised to disguise their illicit origins. Acquisitive criminals will attempt to distance themselves from their crimes by finding safe havens for their profits where they can avoid confiscation orders, and where those proceeds can be made to appear legitimate. Money laundering schemes can be very simple or highly sophisticated. Most sophisticated money laundering schemes involve three stages: Placement the process of getting criminal money into the financial system; Layering the process of moving money in the financial system through complex webs of transactions, often via offshore companies; Integration the process by which criminal money ultimately becomes absorbed into the economy, such as through investment in real estate. Prosecutions for money laundering can involve any of these stages in the money laundering process*."
...........UK Proceeds of Crime 1992 Preamble[11]

"*The basic characteristics of the laundering of the proceedsof crime, which to a large extent also mark the operations of organised and transnational crimes are its global nature, the flexibility and adaptability of its operations, the use of the latest technological means and professional assistance, the ingenuity of its operators and the vast resources at their disposal*."
..........UN report 1993[12]

"*Money laundering is the process of making illegally-gained proceeds (i.e. "dirty money") appear legal (i.e. "clean"). Typically, it involves three steps: placement, layering and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the "dirty money" appears "clean." Money laundering can facilitate crimes such as drug trafficking and terrorism, and can adversely impact the global economy*."
...........Fincen[13]

"*Money Laundering is broadly interpreted as feeding the proceeds of crime or corruption into the financial system in order to give it the appearance of proceeds of legitimate activity, and the financing of illegal activities including terrorism through financial systems*."
........UBS Global AML Policy since 2004[14]

"... (i) the conversion or transfer of property derived from criminal activity to conceal or disguise its illicit origin; (ii) the concealment or disguise of the true nature, source, location, disposition, movement or ownership of property known to have been derived from criminal activity; (iii) the acquisition, possession or use of property known to have been derived from criminal activity; (iv) the participation, or assistance, in the commission of any of the activities above."
and...."terrorist financing" means the

"*provision or collection of funds to carry out any of the offences defined in Council Framework Decision 2002/475/ JHA on combating terrorism, such as hostage taking, the drawing-up of false administrative documents and the leadership of a terrorist group*."
..........EU Third Money Laundering Directive 2005[15]

"*Money laundering is the conversion of the proceeds of criminal activity into apparently clean funds, usually via the financial system. This is done by disguising the sources of the money, changing its form, or moving the funds to a place where they are less likely to attract attention. "Criminal activity" includes fraud, corruption, drug dealing and other serious crimes.* "
.........EU press Release 2012[16]

"*Money laundering is the attempt to conceal or disguise the nature, location, source, ownership, or control of money*."
..........MoneyGram[17]

"*Money laundering is the covert introduction of illegally acquired assets into the legitimate economy with the aim of disguising their true illegal origin*."
..........Swiss Bankers Association[18]

"*Legitimisation (washing) of illegally obtained money to hide its true nature or source (typically the drug trade or terrorist activities). Money laundering is effected by passing it surreptitiously through legitimate business channels by means of bank deposits, investments, or transfers from one place (or person) to another*."
..........BusinessDictionary.com[19]

"*money laundering is any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources*."
..........Interpol[20]

"*Disguising the source of money generated through illegal activities so that it resembles legitimate income. Money laundering involves breaking up large amounts of cash into smaller transactions, changing its form through investments or deposits into bank accounts, and moving the money through seemingly legitimate businesses to bring it into mainstream economy*."
............Nasdaq[21]

"*Money laundering is generally defined as engaging in acts designed to conceal or disguise the true origins of criminally derived proceeds so that the proceeds appear to have derived from legitimate origins or constitute legitimate assets*."

and

"*Terrorist financing may not involve the proceeds of criminal conduct, but rather an attempt to conceal either the origin of the funds or their intended use, which could be for criminal purposes. Legitimate sources of funds are a key difference between terrorist financiers and traditional criminal organisations.....Funding for terrorist attacks does not always require large sums of money and the associated transactions may not be complex*."
............FINRA[22]

"*The attempt to conceal or disguise the ownership or source of the proceeds of criminal activity and to integrate them into the legitimate financial systems in such a way that they cannot be distinguished from assets acquired by legitimate means. Typically this involves the*

conversion of cash-based proceeds into account-based forms of money."
...........OECD[23]

"*Money laundering is the name given to the process by which illegally obtained funds are given the appearance of having been legitimately obtained*."
...........Austrac[24]

"*Money Laundering is the process by which proceeds from a criminal activity are disguised to conceal their illicit origins...involving the proceeds of criminally derived property rather than the property itself.......and Financing of terrorism is the financial support in any form of terrorism or of those who encourage, plan, or engage in it*."
............The World Bank[25]

"*Terrorist financing refers to the processing of funds to sponsor or facilitate terrorist activity. A terrorist group, like any other criminal organisation, builds and maintains an infrastructure to facilitate the development of sources of funding, to channel those funds to the providers of materials and or services to the organisation, and, possibly, to launder the funds used in financing the terrorist activity or resulting from that same activity. Terrorist organisations derive income from a variety of sources, often combining both lawful and unlawful funding, and where the agents involved do not always know the illegitimate end of that income. The forms of financing can be grouped in two types: Financial support – In the form of donations, community solicitation and other fundraising initiatives. Financial support may come from states and large organisations, or from individuals. Revenue generating activities Income is often derived from criminal activities such as kidnapping, extortion, smuggling or fraud. Income may also be derived from legitimate economic activities such as diamond trading or real estate investment.*

The terrorist financier will want to disguise the illegal end of the funds, while trying to maximize the revenues forthe organisation sponsored. It may be necessary to disguise the source of the funds, as well, either because such funds have an illegal origin, or because the organisation wantsto preserve the continuity of the legitimate financing. The need to camouflage the source of the funds means that terrorist financing has certain similarities with traditional money laundering, namely the use of three stages to place, layer and integrate the funds in the international financial system."
...........Fides[26]

"*Money Laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of criminal activities. If successful, the money can lose its criminal identity and appear legitimate. Illegal arms sales, smuggling, and the activities of organised crime, including for example, drug trafficking and prostitution, can generate huge sums. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to "legitimise" the ill-gotten gains through money laundering. When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. In summary, the money launderer wants to:place his money in the financial system, without arousing suspicion; move the money around, often in a series of complex transactions crossing multiple jurisdictions, so it becomes difficult to identify its original source; and then move the money back into the financial and business system, so that it appears as legitimate funds or assets*."
.... Financial Supervision Commission Isle of Man[27]

"*Terrorist financing involves the solicitation, collection or provision of funds with the intention that they may be used to support terrorist acts or organisations. Funds may stem* *from both legal and illicit sources. More precisely, according to the International Convention for the Suppression of the Financing of Terrorism, a person commits the crime of financing of terrorism "if that person by any means, directly or indirectly, unlawfully and wilfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out" an offense within the scope of the Convention. The primary goal of individuals or entities involved in the financing of terrorism is therefore not necessarily to conceal the sources of the money but to conceal both the financing and the nature of the financed activity.*" **.............IMF**[28]

"*The process of creating the appearance that large amounts of money obtained from serious crimes, such as drug trafficking or terrorist activity, originated from a legitimate source.*" **............ Investopedia**[29]

And many more........

What are the stages of "Money Laundering"?

So much for the origin of the term "Money laundering" but what is it? According to FATF, money laundering is made up of the following 3 stages;[30] placement, layering and integration

Placement

In the initial or placement stage of money laundering,the launderer introduces his illegal profits into the financialsystem. This might be done by breaking up large amountsof cash into less conspicuous smaller sums that are thendeposited directly into a bank account, or by purchasinga series of monetary instruments (cheques, money orders, etc.) that are then collected and deposited into accounts at another location.

Layering

After the funds have entered the financial system, the second – or layering – stage takes place. In this phase, the launderer engages in a series of conversions or movements of the funds to distance them from their source. The funds might be channelled through the purchase and sales of investment instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the globe. This use of widely scattered accounts for laundering

is especially prevalent in those jurisdictions that do not cooperate in anti-money laundering investigations. In some instances, the launderer might disguise the transfers as payments for goods or services, thus giving them a legitimate appearance.

Integration

Having successfully processed his criminal profits through the first two phases the launderer then moves them to the third stage – integration – in which the funds re-enter the legitimate economy. The launderer might choose to invest the funds into real estate, luxury assets, or business ventures. **.........FATF 2012, 40 Recommendations**

This 3 stage process, the classic description of money laundering has also been described as "immersion"; generally inserting the proceeds of crime into the legitimate financial system, "heavy soaping" or disguising the trail of the monies as they pass through the financial system and finally the "spin dry" when the funds make it into legitimate income or assets.

Furthermore FATF explain where Money Laundering may occur as follows: [31]

"*As money laundering is a consequence of almost all profit generating crime, it can occur* *practically anywhere in the world. Generally, money launderers tend to seek out countries or sectors in which there is a low risk of detection due to weak or ineffective anti-money laundering programmes. Because the objective of money laundering is to get the illegal funds back to the individual who generated them, launderers usually prefer to move funds through stable financial systems.*

Money laundering activity may also be concentrated geographically according to the stage the laundered funds have reached. At the placement stage, for example, the funds are usually processed relatively close to the under-lying activity; often, but not in every case, in the country where the funds originate.

With the layering phase, the launderer might choose an offshore financial centre, a large regional business centre, or a world banking centre – any location that provides an adequate financial or business infrastructure. At this stage, the laundered funds may also only transit bank accounts at various locations where this can be done without leaving traces of their source or ultimate destination.

Finally, at the integration phase, launderers might choose to invest laundered funds in still other locations if they were generated in unstable economies or locations offering limited investment opportunities."

For Terrorism Finance, FATF, in their 2008 Terrorism Financing Typologies Report, also highlighted 3 stages, though these were not Placement, Layering and Integration, but Raising, Moving and Using funds, both criminally originated funds, where the 3 money laundering stages would still apply, but also to legally originated funds.

What is the size of "Money Laundering"?

Money Laundering may be the 10th Largest Industry in the World and one of the most profitable.

It is often quoted and considered as conventional wisdom that money laundering is the third largest industry in global terms behind foreign exchange and oil andgas. In fact, this is clearly overstating its size, with Food, Retail, Energy including Oil and Gas, Financial Services, Tourism, Manufacturing including Automobiles, Telecommunications and Pharmaceuticals/ealthcare all substantially larger. Money Laundering is also likely behind also the Arms Industry, but may still just make it into the top 10 at number 10.

Top 10 Global Industries	
1	Food
2	Retail
3	Energy
4	Financial Services
5	Tourism
6	Manufacturing
7	Telecommunications
8	Healthcare
9	Arms & Defence
10	Money Laundering
Source: Author	

Despite its position as

perhaps the 10th largest, there is little doubt that it is one of the most profitable with huge margins and of course all proceeds are tax free According to the UN for 2009, out of US$2.1 trillion in criminal proceeds, approximately US$1.6 trillion was laundered but only US$3.1bio was seized, giving an effective tax or clean up rate of 0.2%.[32]

The figure of US$2.1 trillion is a figure that related to classic predicate offences. These numbers ignore bribery and corruption estimated at US$1 trillion US$1.6 trillion a year,[33] As predicate offences also now include insider dealing and market manipulation, fraud and tax fraud, these figures could be increased further for fraud by as much as US$2.75 trillion[34] and tax fraud and tax evasion as much as US$4.75 trillion.[35]

Final Comments / Conclusion

As criminal activity, beyond drug trafficking become classified as predicate offences to Money Laundering, the original definitions and the classical 3 stages are unlikely to be sufficient to fully describe what money laundering is and how it is carried out, particular when considering, trade based laundering schemes, insider dealing and market manipulation, terrorism finance, tax fraud and tax evasion. Furthermore with advances in technology, electronic and mobile cash and digital currencies, we may need to consider whether money alone remains the principal concern.