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A BILLION DOLLAR PROBLEM:

MONEY LAUNDERING IN THE 21ST CENTURY

by

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ABSTRACT

Money laundering hides the illicit origin of proceeds of illegal activities such as drug trafficking, organized crime and international terrorism, but they also pose a threat by contaminating the financial institutions and undermining confidence in the international financial system. The purpose of this thesis is to explore the nature of money laundering, terrorist financing and the problems with tackling illicit funds entering in to the financial system, focusing mainly at the difficulties of enforcing international laws. This dissertation begins by introducing the international organizations, which tackles money laundering, then examines the anti-money laundering legislatives in different jurisdictions and the challenges they are facing. Furthermore, this dissertation will explore the main stages of money laundering and some known methods of money laundering with some real world scenarios. The research questions I include are why is Money Laundering so prevalent today even though there are many legislations and International bodies in place? Why is there an increase in organized crime and terrorist organisations? Why do banks get huge fines and increases in compliance? It is important to ask these questions as Money Laundering affects society as a whole. Money Laundering is relevant in today's society as it maintains a rule of law and in order to develop a country, there should be a rule of law, which combats crime and terrorism. The purpose of this thesis is to identify ways in which money laundering can be reduced so living standards can be improved in the economy. By stopping organized crime, and terrorist attacks, the income gap lessons and commodities like housing can become affordable.

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LIST OF ABBREVIATIONS

AML:	Anti-Money Laundering
BSA:	Bank Secrecy Act
CCO:	Chief Compliance Officer
CDD:	Customer Due Diligence
CFT:	Countering the Financing of Terrorism
CIP:	Customer Identification Program
CTRs:	Currency Transaction Reports
DNFBPs:	Designated non-financial business or profession (DNFBPs)
EU:	European Union
FATF:	Financial Action Task Force
FIU:	Financial Intelligence Unit
GDP:	Gross Domestic Product HIFCAs: High Intensity Financial Crime Areas
IBC:	International Business Corporations
IMF:	International Monetary Fund
IRS-SB/SE:	Department of the Treasury Internal Revenue Service-Small Business/Self-Employed Division
IVTS:	Informal Value Transfer System
KYC:	Know Your Customer
MIS:	Management Information Systems
ML/FT:	Money Laundering/Financing of Terrorism
ML/TF:	Money Laundering/Terrorist Financing
MSB:	Money Service Business
MVTS:	Money or Value Transfer Services
NDIP:	Non-Deposit Investment Products
NGO:	Non-Governmental Organizations
OFC:	Offshore Financial Centres
OSCE:	Organization for Security and Co-operation in Europe
PEPs:	Politically Exposed Persons
PICs:	Private Investment Companies
PTAs:	Payable-Through Accounts
RBA:	Risk-Based Approach
UN:	United Nations
UNSCR:	United Nations Security Council Resolution
Vienna Convention:	The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988

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DEDICATION

To my son, Sunil

PREFACE

As financial systems are becoming increasingly globalized, complex, supervised, organized, and structured, Money Laundering and Terrorist Financing (ML/TF) are two of the most serious and difficult risk issues facing financial institutions today. ("Combating Money Laundering", 2009) The International Monetary Fund (IMF) organization has estimated that the entire amount of money laundering in the world is between $900 billion and $2.25 trillion Canadian dollars equalling 2 to 5 per cent of the world's gross domestic product (GDP) (Smith, 2011). This is the reason why the international banking and financial systems are finding themselves in the front line of the war with criminal organizations and money launderers.

Rationale and Importance

Since the first international legislation to combat money laundering in 1977 (Council of Europe), there have been significant developments of domestic and international laws. Even though global Money Laundering transactions are estimated between 2 to 5% of the global economy, the authorities currently seize less than 1% of illicit financial flows. **(**PricewaterhouseCoopers, 2017). According to new figures, global spending on Anti-Money Laundering compliance is set to grow over $8 billion by 2017 **(**PricewaterhouseCoopers, 2017).

With Money Laundering methods becoming more creative over time, the cost and consequences of non-compliance within financial institutions leads to

greater financial consequences by Money Launderers having to pay huge monitory fines if captured (PricewaterhouseCoopers, 2017). As any violation of the AML legislations will be deemed as a criminal offence and destroy the reputation of the financial institution all in efforts to combat money laundering.

In 2012, HSBC agreed to pay $1.9 billion to the US prosecutors as money laundering penalties (Peston, 2012). HSBC was founded in 1865 to finance trade between Asia and the West, today HSBC is one of the world's largest banking and financial services organizations serving more than 37 million customers worldwide. They have been accused of laundering $881 millions of drug money out of Mexico and other banking laps (Viswanatha & Wolf, 2012).

In 2015, city group settle for $140 million to the regulators as they ignored the weakness through their AML programs (Reckard, 2015). Increased regulatory inspections, complexity of regulatory changes and dishonest customers are a few reasons for widespread compliance failure. In addition, hidden accounts, with untraceable money transfer and anonymous company ownership through offshore banking are costing billions of dollars for the governments around the world.

All these illegal activities have greater social, political, economic, and financial consequences which affect all levels of globalization while trickling all the way down to individuals. Money Laundering is relevant in today's society as it maintains a rule of law and in order to develop a country, there should be a rule of law, which combats crime and terrorism. My hope is to shed light on the severity

that the world is facing with the excessive amount of Money Laundering and Terrorist Financing that occurs on a daily basis in the developed world.

Purpose

The main purpose of this thesis is to explore the nature of money laundering, terrorist financing and the problems with tackling illicit funds that are entering into the financial systems. I will focus mainly on the difficulties of enforcing international laws and I will introduce the international bodies, which tackle money laundering, examine the anti-money laundering legislatives in different jurisdictions and explore the challenges they are facing. Furthermore, I will explain the stages and known methods of money laundering and provide real world examples. By identifying ways in which money laundering, criminal and terrorist attacks can be reduced, overall living standards can begin to improve in the economy.

Research Questions

The research questions I include are: Even though there are many legislations and International bodies in place, why is Money Laundering still so prevalent today? Why is there an increase in organized crime and terrorist organisations? Why do banks get huge fines and increases in compliance?

Organization of the Thesis

In Chapter One, I will introduce the definitions and key terms of money laundering and terrorist financing that I use in this thesis. In Chapter Two, I elaborate on these concepts and providing an in depth explanation. In Chapter Three, I will explain the problems with enforcing anti-money laundering laws. Finally, in Chapter Four, I draw conclusions and make recommendations.

CHAPTER ONE: KEY TERMS AND DEFINITIONS

Since Financial Institutions (FI) such as banks, trust companies, insurance companies, brokerage firms, and investments dealers are engaged in the business of dealing with monetary transactions regularly, they are the main targets where money laundering can occur. The reason for this is that these companies and establishments conduct financial transactions such as investments, loans, currency exchanges, and deposits on a regular basis.

A number of inter-government organizations, professionals, and national legislative bodies provide recommendations and regulations to combat Money Laundering in order to safeguard these financial institutions. The World Bank, the United Nations (UN), the International Monetary Fund (IMF), and the Financial Action Task Force (FATF) are among significant inter-governmental and international organisations organizations. I will define and provide more details of these organizations later on in this chapter. By providing real world examples, situations, and scenarios of Money Laundering and Terrorist Financing, allows me to widely discuss the operation of the organizations mentioned above use legislations to combat money laundering.

Key Terms

In this chapter of the thesis, I will define the key terms that I use in this paper.

Money Laundering (ML)

Money laundering is a process where proceeds earned from various crimes are converted into legitimate funds. This process uses complicated transactions often done by using financial intermediaries or law firms making illegitimate funds appear legitimate (Odeh, 2010). Money Laundering affects the economy as a whole, which impedes the social, cultural, political, and economic development of societies all over the world (Chatain, 2009).

Criminals and terrorist organizations can generate large profits by committing serious crimes. Some examples of these crimes can include but are not limited to drug trafficking, human trafficking, migrant smuggling, prostitution, racketeering, illegal firearms sales, traffic in body organs, smuggling, insider trading, bribery, credit card fraud, or computer fraud (Odeh, 2010). By using the funds that are earned from such illicit sources, criminals risk drawing the authorities' attention to the underlying criminal activity and exposing themselves to criminal prosecution (Hubbard, 2004). Therefore, the origin of the excessive and illegal funds must be concealed through money laundering.

There is a three-stage process that money launders use to conceal their illicit funds. This process involves placement, layering, and integration. Placement is the the first stage in the process and it involves the physical introduction of bulk cash into the financial system (Odeh, 2010). The second stage is layering. This stage involves separating the proceeds of criminal activity from the source through complex layers of transactions (Odeh, 2010). The third and final stage of money

laundering is called integration. This stage involves placing the laundered proceeds back into the economy in such a way that they enter into the financial system as legitimate funds (Odeh, 2010).

Furthermore, it is also interesting to note that the term "money laundering" is thought to have originated when Al Capone concealed his bootlegging earnings through a chain of clothing laundries ("What is Money Laundering?, 2015).

Terrorist Financing (TF)

The International Monitory Fund (IMF) organization defines Terrorist Financing as anything involving collection, soliciting or providing of financial assets with intention to support the terrorist act or organizations ("Anti-Money Laundering", 2017). Many governments maintain lists of terrorist organizations where laws are passed to prevent money laundering from being used to finance acts of terrorism.

In 1999, conventions were ratified and adopted with specific provisions for AML/CFT related crimes (Elkhazen, 2017). According to Article 2 (1) of the International Conventions for the Suppression of the Financing of Terrorism, a person, or an organization commits the crime of financing terrorism by doing the following:

> 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 ("Anti-Money Laundering", 2017, para 13).

Furthermore, the Financial Action Task Force (FATF) recommends that ways to combat terrorist financing is to follow the money, which provides the identity of the person, or an organization who is involved in terrorism:

> Money trail will provide valuable information to investigators and often allow them to identify those involved in the terrorist attacks. More importantly, by depriving terrorists and terrorist organizations of access to funding and the financial system, terrorist attacks could be prevented ("Terrorist Financing", 2017)

As stated above, Terrorist Financing can be prevented if preventive measures are taken to by following the money trail. This not only can prevent access to funds but also attacks of terrorism can be stopped.

Terrorist Organizations

Terrorist Organizations are typically comprised of individuals who have political or religious ideologies and use of violence to attain their goals (Ganor, 2008). Terrorist Organizations acquire monies usually in various illegal ways to fund operations, propaganda, recruitment, training, salaries, sand member compensation, and social services ("FATF Report: Emerging Terrorist Financing Risks", 2015). Often these funds are raised illegally and can be laundered so they are not traced back to the Terrorist Organizations.

A real example of Terrorist Organizations acquiring monies illegally is explained in the 2015 FATF Report: Emerging Terrorist Financing Risks, where an Islamic school in Thailand was used to provide material support to terrorists:

> An Islamic school in southern Thailand provided a shelter for terrorists. The search of the school found guns and it was later proven that they were used in several terrorist incidents, and motorcycles, which were reported to have been lost (but were in fact stolen). The search also found documents indicating forgery of receipt for stationary purchases and purchases of other teaching items in order to receive reimbursement for such items from the authorities. The school continually supported terrorist groups in various activities (p. 10).

The example above demonstrates how theft and forgery were among the crimes committed to support this Terrorist Organization. In this case, Terrorist Organizations used illicit funds to finance their operations, which is known as Terrorist Financing.

The Impact of Money Laundering

Money Laundering has countless social consequences. Successfully laundering money rewards criminals to expand and fund their operations, which in turn, the cost of law enforcement both to combat the basic crime and in some cases, its indirect consequences such as petty crime used to support drug addiction increases (Layton, 2006). ML can also increase other social costs such as health care costs for the treatment of drug addiction and its consequences. It has the potential to undermine and corrupt financial communities because of the sheer magnitude of the sums involved (Layton, 2006).

The wealth gap increases in society, which undermines the government's ability to spend funds on health, education and other public spending. Money laundering influences the crime rate, unemployment rate, and it decreases

wages due to illegal immigration from human trafficking (Layton, 2006). It also helps terrorists to fund money to carry out terror attacks anywhere in the world.

Money laundering will also diminish government tax revenue and therefore indirectly harms honest taxpayers and reduces legitimate job opportunities. Corrupt public officials conceal and wash bribes and funds stolen from public coffers (Layton, 2006). Furthermore, money laundering allows countries that facilitate money laundering to attract undesirable elements, which could degrade their quality of life and raise concerns about national security (Layton, 2006). Therefore, the impact of money laundering does shake many people and has a domino effect where everyone is affected.

International Bodies to Combat Money Laundering

In this section, I introduce the role of the following international organizations, international bodies, and intergovernmental bodies: The Financial Action Task Force (FATF), the United Nations Office on Drugs and Crime (UNODC), The World Bank (WB), International Monetary Fund (IMF), United Nations (UN) and the Council of Europe (COE). I will discuss these inter-government organizations in more details in later sections of this thesis.

The Financial Action Task Force (FATF)

In 1989 in Paris, France at the Summit of Leaders of the Group of Seven Nations and the Presidents of the European Commission, 37 Member-inter-governmental bodies ("The Financial War on Terrorism", 2004) established the Financial Action Task Force. It works in close cooperation with other key international organizations, including the IMF, the World Bank, the United Nations, and FATF-style regional bodies (FSRBs) ("IMF: Factsheet", 2016). The objectives of the FATF are explained below:

> The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory, and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas. ("FATF: Who we are", 2017, para 1).

While the decision-making body, FATF plenary, meets three times per year, they have developed a series of recommendations that are recognized as the international standard for combating Money Laundering and Terrorism Finance ("FATF: Who we are", 2017). Originally, the FATF was established solely to battle criminal money laundering but after the Twin Towers were attacked in New York, New York in the United States of America on September 11, 2001, the responsibilities of the FATF expanded to combat the financing of terrorism ("The Financial War on Terrorism", 2004).

United Nations Office on Drugs and Crime (UNODC)

Established in 1997, UNODC is one of the main United Nations' bodies in the fight against illicit drugs and international crime. It carries on field-based technical cooperation projects to enhance the capacity of Member States to counteract illicit drugs, crime, and terrorism (Cao, 2017). The Law Enforcement, Organized Crime and Anti-Money-Laundering Unit of UNODC was established in 1997 in response to the mandate given to UNODC through the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988 (Elkhazen, 2017).

The UNODC's objective is to strengthen the ability of Member States to implement measures against money-laundering and the financing of terrorism and to assist in detecting, seizing and confiscating illicit proceeds, as required pursuant to United Nations instruments and other globally accepted standards, by providing relevant and appropriate technical assistance upon request ("United Nations Office on Drugs and Crime", 2017).

The World Bank (WB)

The World Bank is an international financial institution that provides loans to developing countries for capital programs, in an attempt to reduce poverty ("About the World Bank", 2017). While operating 189 countries and under the United Nations system, it provides various supports to combat Money Laundering by funding and cooperating with other Inter-government organizations. It also

carries out project research, and a series of publications to help to lessen Money Laundering and Terrorist Financing (ML/TF).

The World Bank has developed an advisory package to guide countries in conducting their ML/TF risk assessments. The package consists of risk assessment tools, training on the use of the tools and technical guidance. The adversary package started in 2007 and now is assisting more than 40 countries in performing their national risk assessment ("Risk Assessment Support for Money Laundering/Terrorist Financing", 2016).

International Monetary Fund (IMF)

Created in 1945, the IMF is governed by and is accountable to the 189 countries that make up its near-global membership. The International Monitory Fund (IMF) is an organization of 189 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trades, promote high employment and sustainable economic growth, and reduce poverty around the world ("About the IMF", 2017).

Over the Last decade, IMF shape domestic and international Anti Money Laundering (AML) and Combatting the Financing of Terrorism (CFT) policies. They included over 70 AML/CFT assessments, multiple involvements in Article IV consultations, Financial Sector Assessment Programs (FSAPs), and inputs into the design and implementation of financial integrity-related measures

in fund-supported programs, as well as a large number of capacity development activities, and research projects ("IMF: Factsheet", 2016).

United Nation (UN)

Founded in October of 1945 ("Charter of the United Nations", 2016), the UN actively operates a worldwide program to fight money laundering with currently 193 member states around the world ("UN: Overview", 2016). It could be argued that the UN is the most effective organization successfully able to combat Money Laundering with its Global Program against Money Laundering (GPML) ("United Nations Global Programme against Money Laundering", 2017). The UN has power to adapt international treaties and conventions that have the effect of law in a member state while; the UN Security Council has the authority to bind all member states through a Security Council Resolution.

The United Nations Security Council Resolution is a UN resolution that has power to bind upon all of the UN member states. The Security Council Resolution passed in response to a threat to international peace and security under Chapter VII of the UN Charter ("Charter of the United Nations", 2016). The Security Council Resolutions 1373 (adapted by the Security Council at its 4385th meeting on 28 September 2001) and the Resolution 1267 (adapted on 15th October 1999) and successors are the most notable resolutions for criminalizing Terrorist Financing.

Council of Europe (COE)

The Council of Europe (COE) is an international organization, which focuses on promoting human rights, democracy, and the rule of law in Europe. It was founded on May 5, 1949 in London, United Kingdom and it currently has 47 member states ("COE: Who we are", 2017). COE was the first international organization to establish a framework to combat Money Laundering in a global context ("COE: Who we are", 2017).

In 1977 the Council of Europe's European Committee on Crime Problems (CDPC) established this committee to investigate illicit transfer of funds of criminal origin. The committee implemented recommendations on measures against the transfer and safekeeping of funds of criminal origin, which commended a comprehensive anti-money laundering program ("COE: Who we are", 2017). Today the committee of experts on the evaluation of Anti-Money laundering and the financing of terrorism, MONEYVAL, is the permanent monitoring body of the COE.

Basle Committee Statement of Principle

The central bank governors of G10 countries ("History of the Basil Committee", 2014) formed the Basle Committee on Banking Supervision in 1974. The Basle Committee does not have formal or international supervisory authority to enforce law; however, it forms standards, guidelines, and recommendations for best practice on a wide range of banking supervisory issues (Devraj, 2013).

International Conventions

There are some international conventions, which play a large role in anti-money laundering and terrorist financing. I will explain them in more detail below.

International Convention for the Suppression of the Financing of Terrorism

Adapted in 1999 by the United Nations, this convention came in effect in April 10, 2002 with 132 countries signing the convention and 112 countries ratifying it ("International Convention for the Suppression of the Financing of Terrorism", 1999). The main objectives of the International Convention for the Suppression of the Financing of Terrorism are to:

> enhance international cooperation among States in devising and adopting effective measures for the prevention of the financing of terrorism, as well as for its suppression through the prosecution and punishment of its perpetrators ("International Convention for the Suppression of the Financing of Terrorism", 1999, para 1).

The Vienna Convention

The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (is sometimes also referred to as the Vienna Convention) was signed in 1988 and initiated by the UN through the United Nations Drug Control Program (UNDCP). It was the first international instrument used to establish money laundering as a criminal offence and became effective in

1990 ("United Nations Treaties", 2016). The main purpose of this convention is to take action against drug trafficking with a provision against Money laundering and precursor chemicals (Restrepo, 2017). The signatories include the G7 and the European Union countries establishing international body (FATF) to implement of the principles of the Vienna Convention.

Palermo Convention

The United Nations Convention against Transnational Organized Crime (Palermo Convention), adopted by General Assembly resolution 55/25 of 15 November 2000, is the main international instrument in the fight against transnational organized crime (Restrepo, 2017). It was later amended with three protocols including punishing human traffickers, smuggling migrants and illicit manufacturing and trafficking firearms (Restrepo, 2017).

The 1990 Council of Europe Convention

Adapted in November 1990, the aim of the convention is to establish common criminal policy on Money Laundering, also to set out common definition and measures to combat money laundering ("COE: Full list", 2017).

Legislations

Different countries have adapted different Legislative Acts to their domestic law in order to combat Money Laundering and Terrorist Financing. At this point of the thesis, I will introduce the history of anti-money laundering legislations in the United States of America, United Kingdom, Canada, and Australia. I have chosen these counties for the following reasons. All four countries have long standing and rule of law. The UK, Canada and Australia have a common law derestriction meaning whatever the law is made can take precedent over future laws. These countries have a long-term history of fighting terrorism and especially in the United States where the smuggling, drugs and organized crime has aggressively increased over the years. These four countries have more influences in international laws and international organizations. I will also outline whether or not they respect international standards.

UNITED STATES

Bank Secrecy Act (BSA)

The Bank Secrecy Act (also referred to as Currency and Foreigner Transactions) was designed to combat Money laundering and other crimes. The act help to prevent financial institutions being used to hide the transfer or deposit of money earn by criminal activities. It has established regulatory reporting, record keeping standards and requirements ("Bank Secrecy Act", 2016). The Bank Secrecy Act (BSA) of 1970, which is also referred to as the Currency and Foreign

Transactions Reporting Act, was mandated for American banks to help United States government agencies to combat money laundering. The bank employees were asked to record evidence of the daily cumulative cash transactions valuing $10,000 or more and report these acts to the proper authorities (Smith & Hung, 2010).

The Money Laundering Control Act 1986

Up until 1986 in the United States, Money Laundering was not a federal Crime ("Brief Review of the Money Laundering Control Act of 1986", 2017). The main objective for designing this act was to recognize money laundering as a federal crime, to support the Bank Secrecy Act (BSA) in various ways ("Brief Review of the Money Laundering Control Act of 1986", 2017). The Money Laundering Control Act of 1986 criminalized money laundering in the United States and actually fined and jailed individuals who were caught within money laundering schemes. It paved the way to develop and enforce anti-money laundering legislations in the United States:

> Money Laundering Control Act of 1986
> Laundering of monetary instruments
>
> (a)
>
> (1) Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity—

(A)

(i) With the intent to promote the carrying on of specified unlawful activity; or

(ii) With intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code of 1986; or

(B) Knowing that the transaction is designed in whole or in part—

(i) To conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or

(ii) to avoid a transaction reporting requirement under State or Federal law, shall be sentenced to a fine of not more than $500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both ("Money Laundering Control Act", 1986).

Crime Control Act of 1990 (Section 2532)

Crime Control Act of 1990 (Section 2532), allowed US law enforcement agencies to work with foreign banking authorities on collecting data, analysing and investigating possible bank or currency transaction related violations (Biden, 1990).

Anti-Money Laundering Act of 1992 (Annunzio-Wylie)

The Anti-Money Laundering Act of 1992 increased the penalty on financial institutions if found guilty of money laundering. This Act amends several provisions of BSA, including reporting suspicious transactions ("Title XV: Annunzio-Wylie Anti-Money Laundering Act", 2016.).

Money Laundering Suppression Act of 1994

The Money Laundering Suppression Act of 1994 requires federal banking agencies to improve training and examination procedures to identify money-laundering schemas within financial institutions (Gonzalez, 1994).

Money Laundering and Financial Crimes Strategy Act of 1998

The Money Laundering and Financial Crimes Strategy Act of 1998 have the Secretory of the Treasury consult with the Attorney General.
The Secretary of the Treasury is the head of the U.S. Department of the Treasury, which is concerned with financial and monitory matters. The United States Attorney General is the head of the United States Department of Justice, which is concerned with legal affairs and is considered as the chief law enforcement officer and the chief lawyer in the country. Both these two officials and other relevant law enforcement agencies work together to implement a strategy to combat money laundering while evaluating the effectiveness of the current policies used to combat money laundering in the United States (Gonzalez, 1994).

Up until 2003, the US Department of Treasury included several law enforcement agencies especially assigned to combat money laundering, and those in violation of monitory policies. The Money Laundering and Financial Crimes Strategy Act of 1998 authorized the appropriation of $50 million to enforce these programs over the 1999–2003 years (Leach, 1998).

The United States Patriot Act

In addition to the Money Laundering Act of 1986, the Patriot Act of 2001 was ratified to catch corrupt foreign officials, certain foreign smuggling, and export control violations to the United States list of predicate crimes (Odeh, 2010). Specifically Title III of the Patriot Act entitled "International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001", dealt particularly with international money laundering and terrorist funding. The three areas that it dealt mainly with are intensifying banking rules, progressing contact between law enforcement agencies and banks and controlling illegal activities such as smuggling and counterfeiting (Smith & Hung, 2010). All this was in efforts to minimize money laundering schemes and catch those who were in violation of the law.

UNITED KINGDOM

The Money Laundering Regulations 1993

The Money Laundering Regulations Act of 1993 is used to measure bank and banking financial services in relation to preventing the use of the financial system for money laundering ("Money Laundering Regulations 1993", 1993). The Act also incorporated with the section 2 (2) of the European Communities Act 1972 (The European Communities Act 1972 (c. 68) is an Act of the Parliament of the United Kingdom which legislated for the accession of the United Kingdom to the European Communities (EC).

The Terrorism Act 2000

Even though the Terrorism Act 2000 designed mainly to combat terrorism, Part 3 (section 18) classified money laundering as an offence:

> (1) A person commits an offence if he enters into or becomes concerned in an arrangement which facilitates the retention or control by or on behalf of another person of terrorist property –
>
> (a) By concealment, (b) by removal from the jurisdiction, (c) by transfer to nominees, or (d) in any other way (Terrorism Act 2000, 2000).

The Act was amend soon after month of the the London Bombing in 2005, the new Terrorism Act 2006 replace the 2000 Act by creating new offences relating to terrorism (Terrorism Act, 2006).

The Proceeds of Crime Act 2002 (POCA)

Part seven of the POCA set up primary offences relating to money laundering. A person commits an offence if he or she:

> - conceals, disguises, converts or transfers criminal property or removes it from England and Wales or Scotland or Northern Ireland;
>
> - enters in to or becomes concerned in an arrangement which he or she knows or suspects facilitates the acquisition, retention, use or control of criminal property;
>
> - Acquires uses or has possession of criminal property

("Serious Crime Bill", 2014).

Money Laundering Regulations 2003

Similar to the Money Laundering Regulation of 1993, the Money Laundering Regulations 2003 is designed to prevent the use of the financial system for money laundering ("Money Laundering Regulations 2003", 2003). However, in order to prevent any complication of law, the updated Act revokes previous money laundering regulations such as the Money Laundering Regulation 1993, the Money Laundering Regulation 2001 Financial Service, and Market Act 2000.

Money Laundering Regulations 2007

The Money Laundering Regulation 2007 is the third and latest regulation to combat Money Laundering in the UK following series of regulations in the 1993 and 2003. The regulation 2007 introduced new strategies to prevent and control money laundering, train staff to combat money laundering and appointment of a supervisory body in charge of money laundering issues while giving more power to Serious Organize Crime Agency (SOCA) ("Explanatory Memorandum to the Money Laundering Regulations 2007 No. 2157", 2007). SOCA was a public body of the United Kingdom until it was replaces with National Crime Agency (NCA) in 2013. SOCA was in charge of combatting organized crime, money laundering and terrorist related activities.

The Money Laundering Regulation 2007 also introduced a risk-based approach, which means that businesses should take action based on their knowledge, and the likelihood of risk that they are exposed to money laundering,

fraud or fund terrorism ("Money Laundering Regulations 2007", 2007). Furthermore, the Money Laundering Regulation 2007 explains the laws relating to casinos and shell banks, there are penalties for businesses, and individuals who fail to adhere to these laws and must address the money laundering issues ("Money Laundering Regulations 2007", 2007).

CANADA

Proceeds of Crime Money Laundering and Terrorist Financing Act

The Proceeds of Crime Money Laundering and Terrorist Financing Act (PCMLTFA) is one of the major legislative acts to assist money laundering issues and terrorist financing. The Act has been amended in 2001 and further amended in 2006 under bill C-25. PCMLTFA established Financial Transactions, Reports, and Reports Analysis Center of Canada (FINTRAC), the government supervisory body to gather, analyze, assess, and disclose financial intelligence to combat money laundering in Canada ("Financial Transactions and Reports Analysis Centre of Canada", 2017). The objective of the Act is to:

> "implement specific measures to detect and deter money laundering and the financing of terrorist activities and to facilitate the investigation and prosecution of money laundering offences and terrorist activity financing offences" ("Proceeds of Crime (Money Laundering) and Terrorist Financing Act S.C. 2000, c. 17", 2000).

AUSTRALIA

Anti-Money Laundering and Counter-Terrorism Financing Act 2006

The Anti-Money Laundering and Counter-Terrorism Financing Act of 2006 extend from a previous legislation to combat financial crime, the Financial Transaction Reports Act of 1988. The newer act implemented record keeping, reporting and compliance reforms applying to the financial and gambling sectors, and bullion dealers, lawyers and accountants providing financial services, to provide a framework to counter money laundering and terrorist financing in Australia ("Anti-Money Laundering and Counter-Terrorism Financing Bill 2006", 2006).

In Chapter One, I defined all of the key terms relating to Money Laundering and Terrorist Financing that I use in this dissertation. In Chapter Two, I will explain the process of money laundering, the money laundering mechanisms, stages, and its involvement in the securities industry and fraud related forms of laundering.

CHAPTER TWO: THE PROCESS OF MONEY LAUNDERING

The purpose of this chapter is to discuss and analyses main three stages of money laundering. The chapter will also explain some of the popular methods used in the process of money laundering in today's world. It will also explain the Money Laundering in different industries, and challenges for Anti Money Laundering processes.

Stages of Money Laundering

There are three basic stages of money laundering - placement, layering and integration. I will explain all three of them in more detail below.

Stage 1: Placement

Placement involves the physical deposit of cash earned from illegal activates in to financial institutions such as main street banks and credit unions which are unable to identified the true identity of the money ("Money Laundering: A Three-Stage Process", 2015). These financial institutions have always been a target for criminals to convert their money in to a legitimate currency. ("Money Laundering: A Three-Stage Process", 2015). Within the placement stage, there is a type of placement called surfing.

Smurfing

While some countries such as the United States and Canada require financial institutions to report currency transactions of $10,000 or above, criminal groups can break up large amounts of cash into smaller sums (Frankl, & Kurcer, 2017). This results in less conspicuous amounts that are subsequently deposited directly into different bank accounts within amounts lower than the cash deposit reporting levels, below $10,000 dollars (Frankl, & Kurcer, 2017). Co-mingling, bribery, and smuggling are various ways smurfing occurs. Co-mingling occurs when criminal proceeds are mixed with deposits from cash businesses such as stores, bars, and restaurants ("Money Laundering: A Three-Stage Process", 2015). Bribery takes place when banks or other financial institution personnel are offered funds to accept deposits without reporting them ("Money Laundering: A Three-Stage Process", 2015). Finally, smuggling takes place when cash is brought into countries lacking anti-money laundering requirements for deposits in their financial institutions. ("Money Laundering: A Three-Stage Process", 2015).

Stage 2: Layering

Sometimes referred to as structuring; layering involves separating illicit proceeds from their source by creating complex layers of financial transactions mostly internationally by providing anonymity. As an example, criminal groups may transfer money electronically from one account to another or multiple accounts overseas ("Money Laundering: A Three-Stage Process", 2015).

The Process of Money Laundering and Terrorist Financing

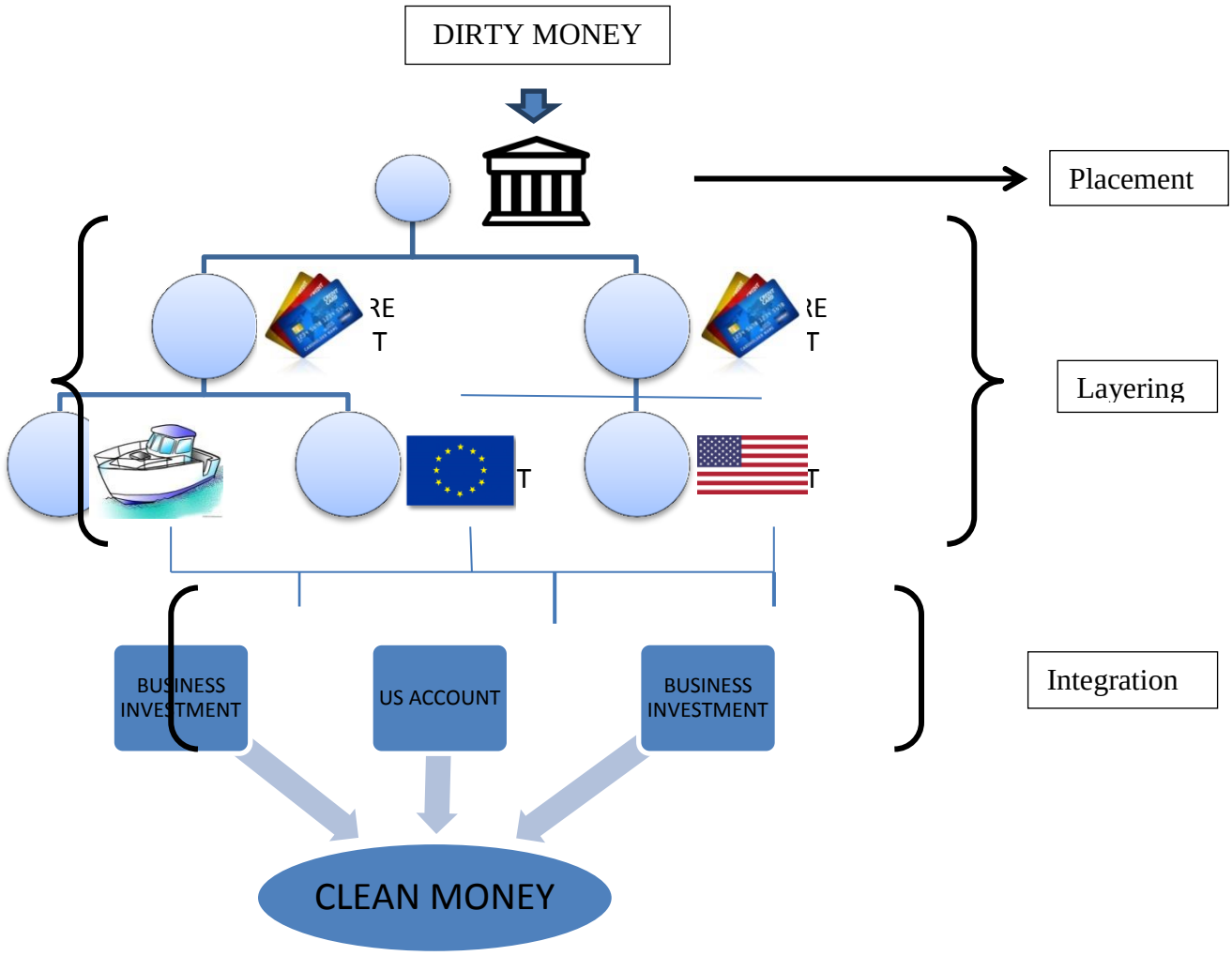

Figure 1.1

Movement of Funds

Layering frequently involves the movement of funds across borders to make tracing the source more difficult for law enforcement. In this stage of money laundering, the investment business is more at risk as funds can change form into entirely different assets ("Money Laundering: A Three-Stage Process", 2015). The origin of the funds can be hidden by executing frequent buy and sell transactions using various investment instruments in the financial market, or the launderer may simply wire the funds through a series of accounts at various banks overseas ("Money Laundering: A Three-Stage Process", 2015). Financial instruments are monetary contracts between parties and they can be created, traded, modified, and settled. They can be cash (currency), evidence of an ownership interest in an entity (share), or a contractual right to receive or deliver cash (bond) ("Money Laundering: A Three-Stage Process", 2015).

Most attractive financial instruments are securities transactions, which can easily be converted into liquid assets and investment portfolios with containing both lawful and illicit earnings that can be sold ("Money Laundering: A Three-Stage Process", 2015). In addition, the certificated securities can also be easily moved across borders. A security, in a financial context, is a certificate or other financial instrument that has monetary value and can be traded, such as stock and bonds ("Money Laundering: A Three-Stage Process", 2015).

Stage 3: Integration

Integration is the third and final process where criminally derived wealth becomes legitimate. If the layering process has succeeded, integration place the laundered earnings back into the economy, then the funds re-enter into the financial system with the presence of normal business operational funds ("Money Laundering: A Three-Stage Process", 2015).

Frequent techniques include the use of corporate entities controlled by the launderers to make loans themselves without repayment. The loans are then used either to purchase high value items such as businesses or real estate that can be used by the launderers without charge, for personal use or to generate additional, seemingly legitimate income ("Financial Transactions and Reports Analysis Centre of Canada", 2016).

Money Laundering Mechanisms and Strategies

There are numerous mechanisms that money-laundering criminals frequently use to hide an audit trail. Those are including smurfing, funnelling funds through foreign exchange currency houses, transferring funds across international borders and using the capital markets.

The Geographical Flow of Funds

Successful money laundering processes involve multiple layers of currency transactions, which involve more than one financial institution. The

geographical flow of funds allows money-laundering criminals to use multiple jurisdictions to avoid being caught (Shin et al., 2014). The use of cross border transactions are helpful for launders as it hides the audit trails as the law enforcement agencies often face jurisdictional difficulties and limited recourses when investigating money trails outside of their own countries (Shin et al., 2014).

In today's world money, laundering is significant result of almost all profit earning crimes, and it could arise anywhere in the world. Criminal organization is mostly active in the countries or jurisdictions, which has a low risk of exposure of illicit funds due to week or ineffective anti money laundering establishments (Shin et al., 2014).

Mail or Smuggle Blocks of Cash

It is common that customs and border protection officials discover large sums of money hidden inside luggage, cargo containers, children's toys, or even in coffins at the port of entry (Cooper, 2015). If it is successfully smuggled, this money will be deposited into bank accounts outside of the money's original country of origin. For example, large dealers employ a number of people to take illegitimately earned money in the United States to smuggle into Europe or Latin American countries and then they are deposited into either European bank accounts or offshore banks. Then that money is wired back to the United States as "clean" or legitimate money.

Spend Illicit Funds on Hard Goods

Smugglers can also spend the illicit funds for purchasing physical assets such as cars, jewelry, appliances, and farm equipment, and then export the goods outside of the country for resale in another country (Naim, 2006). This process will make even greater profits by criminal gangs entering into legitimate export markets while undercutting other legitimate exporters (Naim, 2006). This will lead many exporters to lose their business due to monopoly power of criminal organizations.

Use Casinos and Cheque-Cashing Outlets

According to the Canadian Law enforcement known as the Royal Canadian Mounted Police (RCMP), a loophole in the casino system in the Canadian province of Ontario was exposed in May of 2008 (CBC News, 2008). The investigation conclude that drug trafficking gang used a Casino in the city of Toronto by depositing $9,000 each time at least twice a day into the slot machine, then members of the gang either withdraw those money by cash out or asking for a cheque. Often criminal use this strategy to deposit amounts significantly smaller than $10,000 where they can avoid being noticed.

Use Cash-Based Retail Businesses

Naylor (2014) explained that the rise of the small service sector business provide ideal environment for Money Launderers. Car washes and Restaurants are best source of small business to mix illegal money with legal receipts where authorities concentrate on how much the business owners pay in tax instead of how much they are increase their taxable earning to hide money-laundering operations (Naylor, 2014). The same theory applies for video rental shops, dry cleaners, bars, and vending machines. When illegal money mixed up with legal payments and wages have been paid to employees does not exist from the business, by inflating the cost of input, expenses and raw materials, these businesses are converting multibillion dollar illegitimate funds to clean money by avoiding audit trails and law enforcement agencies (Naim, 2006).

In Elias K 1979, a client set up a contracting business and received a loan from the local bank claiming that the loan was to buy supplies for his business (Naylor, 2014). Instead, he bought drugs from a wholesaler (dealer) and sold it to different customers. The customers then paid back the money by checks instead of cash in to his constructing business. Those checks were deposited at the bank where he paid part of his loan off and declared the rest as a profit from the business. While Elias paid his loan payment regularly by declaring healthy profits, he managed to borrow more money while expanding his business and converting drug money for legitimate earnings by a legal financial institution.

Purchase and Resale of Real Estate

According to the Financial Action Task Force (FATF), 30 percent of criminal assets were seized worldwide between 2011 and 2013 are account for real estate ("FATF Report: Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", 2013). While setting up offshore accounts, criminals were able to buy real estate properties under different accounts and in turn, they gained more profit from the booming property prices in cities around the world. Real estate has additional motivations in terms of attractive tax breaks, rental income, and possible wealth increase. According to leaked Panama papers, it shows that many properties in London own by offshore companies, where people suspected of corruption overseas (Evans, 2016).

According to the 2016 publication, London Property: A Top Destination for Money Launderers, Transparency International is a Non-Governmental Organization (NGO) with the main purpose of combating corruption in the UK and all around the world ("Transparency International UK", 2016). This organization issues publications and recommendations based on the research they carry out. They have said that ninety-one percent of overseas companies own London properties are registered in secrecy jurisdictions ("Transparency International UK", 2016). In addition, 180 million pounds (GBP) worth properties has been subject under criminal investigation for proceed of corruption ("Transparency International UK", 2016). The publication also suggests that over the 75 percent of the land titles are owned by the companies based in Panama and British Virgin Islands. The

following information will display the places where property purchased companies were incorporated:

- British Virgin Island: 8,373 Companies
- Jersey and Guernsey: 5,472 Companies
- Isle of Man: 1,635 Companies
- Netherlands: 760 Companies
- Panama: 641 Companies

("Transparency International UK", 2016).

According to the leaked Panama Paper, many Politian and dictators around the world also owe significant numbers of valuable properties in London through offshore companies. Among that, an associate of Syrian president Bassar Al-Assad has luxury apartment buildings worth 6 million pounds, son of former Egyptian president Hosni Mubarak owes 8 million pounds in property. (Financial Times Research: Land Registry, n.d.).

In addition to London, other property markets in cities such as Vancouver, BC Canada, Sydney, Australia and Paris, France are also facing similar problems. As an outcome, the price of an average house has been raised 30-40 percent within the last few years. This leads to unaffordability for domestic buyers to purchase a property and a rent hike for renters.

Money Laundering Mechanisms Involving the Securities Industry

Securities industries combined with banking and insurance industries are the backbone of any country economy. Through these industries, people and entities can access to financial system. On a global scale, securities industry can be characterized by its diversity ease of access to currency, bond, or stock trading platform with regardless to national borders and jurisdictions.

Therefore, those opportunities within the security industries are subject to vulnerability for money launderers even though the industry has been safeguarded by anti-money laundering and terrorist financing laws both domestically and internationally. The complexity of today's financial system allows opportunities to carry out a fast-paced financial transaction across the borders with great degree of anonymity.

Proceeds of crime laundered through the capital markets can generate by illegal activities both inside and outside the securities industry. In both cases, money launderers are benefiting either way by using Securities industry to launder illicit funds and taking additional profit out of the laundered money.

As explained above, Securities transactions can be used for covering the source of the funds and obscuring an audit trail. The criminals can use their illicit funds to buy market shares or corporate and government bonds using main street banks. As mentioned, British Bank HSBC had paid a 1.9 billion dollar fine to settle United State money laundering accusations in 2012 (Peston, 2012) where the bank laundered millions of Mexican Drug Cartel funds.

In the securities industry, insider trading, securities fraud and market manipulation are all common tactics that money launderers are inclined to use. Insider trading involves a scenario where a person, who is in charge of dealing securities, has access to the information where the general is public not aware of, then uses such information to make profit by informing certain people, often criminal to invest in certain assets or commodities in order to make huge profits (Macey, 1991).

Market manipulation can be classified as an act of artificially inflating or deflating the price of a security. Either often, changing the price of a security, up or down in order to a make profit from the price difference is an example of market manipulation **(**Markham, 2014).

Market Manipulation: Pump and Dumps

"Pump and dump" schemes are illegal acts which are frauds used to artificially inflate stock prices based on misleading information (Ryder, Turksen, & Hassler, 2016). Money Launderers can layer and integrate proceeds of crime through these schemes and generate further wealth.

The "Pump" Phase

During the pump phase, individuals fund managers and securities dealers obtain large blocks of a stock at extremely low prices from inactive companies, not yet operational or trades shares over-the-counter such as Initial

Public Offerings (IOPs) (Macey, 1991). They then use methods or manipulative techniques such as trading among themselves through multiple brokers to increase the price of the stock. They also release misleading information to public through social media such as twitter, Facebook, blogs or their own marketing campaigns about the company's business operations. All these techniques lead to stock price increases (Ryder, Turksen, & Hassler, 2016).

The "Dump" Phase

During the "dump" phase, the individuals utilize corrupt brokers or financial advisors to promote their securities to clients, supported by the misleading information. Often these promoters claim to have inside information of the company, which is untrue (Ryder, Turksen, & Hassler, 2016). The shares sold to real investors come from the holdings of the perpetrators, who profit from the false inflation of the price. As soon as the required amounts of stock are sold, the propaganda begins to stop, as does the popularity of the stock. As a result, the price of stock begins to fall. The initial investors lose their investment while perpetrators will make profits and dump the stock to the market.

Fraud Related to the Securities Market

Any type of schemes or practice incorporated with buy or sales of securities can be classified as securities fraud. Such fraud generally operates within unregulated investment funds, hedge funds, portfolio managements etc.

According to the report of the Committee of Experts on Anti-Money laundering Measures and Financing of Terrorism (MONEYVAL), MONEYVAL is a permanent monitoring body of the Council of Europe to implement and assess Anti-Money Laundering compliance with respect to international standard to combat Money Laundering and Financial Terrorism (MONEYVAL Typology Report, 2008). There are six areas, which were exposed and are the most vulnerable in the securities industry:

1. Wholesale Market
2. Unregulated Funds
3. Wealth Management
4. Investment Funds
5. Bearer Securities
6. Bills of Exchange

(MONEYVAL Typology Report, 2008, p. 37).

This report also shows statistics of money laundering cases using securities in some European countries in 2006. As an example, in Bosnia and Herzegovina, there were four investigations relating to money laundering by using securities, which totaling 15,867,624 BAM (over 8 Million Euros). Furthermore, there were 19 investigations related to money laundering using securities in Poland in 2006. As a result, 13,500,000 PLN (3, 700,000 euros) have been frozen.

According to the Eurasian Group (Bremmer, 2003) general meetings in August 2013, identified seven challenging tasks to detect possible money laundering transactions through securities:

1. Enormous volume of transactions makes it difficult to analyze and investigate each transaction with respect to ML/TF guidelines.
2. Fast face liquidity and anonymity of trading requirements within Securities markets, which make potential money launderers are invisible.
3. Number of financial intermediation services raises the issue of effective monitoring and enforcement.
4. Competitive nature of financial markets may cause intermediaries, to ignore 'suspicious transactions indicators' or even provide active collaboration in money laundering activities. Such as the essential risk of corruption being used to gain entry to the securities industry
5. Jurisdictions with emerging stage of growth (Developing countries) have difficulty to enforce AML/CFT compliance due to lack of resources.
6. Potential money launderers may trade through a complex maze of entities and structure, where it harder to law enforcement agencies to detect.
7. Globalization, integration of financial markets and electronic trading networks provide seamless avenues for carrying out financial transactions across markets and regions. ("EAG Typology Report on Money Laundering Through the Securities Markets", 2013).

The EAG Typology Report explains the most popular methods of money laundering where funds are laundered, hidden, are moved, or are operated through offshore banking. Money launderers often purchase securities or real estate in another name, for example, that of a shell company. Therefore, it is important to understand the operation of offshore banking, and other financial intermediaries, which criminals use for movements of their illicit funds.

Offshore Banking

An offshore bank is a financial institution located outside the jurisdiction of the depositors residence i.e. American Citizens open overseas bank accounts in Switzerland or Panama. Offshore Banking can also be referred to as 'international' or 'overseas' banking (Black, 2017). Most offshore banks are located in tax haven countries, as they often allow its foreign clients to have tax benefits on their assets. Opening an offshore bank account is 100 percent legal in all the jurisdictions (Black, 2017). However, today's offshore banks have bad reputations as they are known to be used for criminal activates such as money laundering, and tax evasion. Many off shore banks locations are recognized for illegitimate banking activities.

According to IMF, the following jurisdictions are identified as offshore financial centers:

Africa:
Djibouti, Liberia, Mauritius, Seychelles, Tangier

Asia and Pacific:
Australia, Cook Islands, Guam, Hong Kong, Japan (Japanese Offshore Market), Macau, Malaysia (Labuan), Marianas, Marshall Islands, Micronesia, Nauru, Niue, Philippines, Singapore (Asian Currency Units), Thailand (Bangkok International Banking Facilities), Vanuatu, Western Samoa

Europe:
Austria, Andorra, Campione, Cyprus, Gibraltar, Guernsey, Hungary, Ireland (Dublin), Sark & Isle of Man, Jersey, Liechtenstein, Luxembourg, Malta, Madeira, Monaco, Netherlands, Russia, Switzerland, U.K. (London)

Middle East:
Bahrain, Dubai, Israel, Kuwait, Lebanon, Oman

Western Hemisphere:
Antigua, Anguilla, Aruba, Bahamas, Barbados, Belize, Bermuda, BVI, Cayman Islands, Costa Rica, Dominica, Grenada, Montserrat, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, Panama, Puerto Rico, St. Vincent and the Grenadines, Turks and Caicos Islands, United States (IBFs in New York, Miami, Houston, Chicago, Los-Angeles – San Francisco), Uruguay.

(Offshore Financial Centers (OFCs): IMF Staff Assessments, 2014).

Shell Companies

A Shell company or corporation is an establishment which serves a channel for business transactions without active business operations or significant assets (Findley, Nielson, & Sharman, 2014). Shell Corporations are often incorporated to conceal the true beneficial ownership of business accounts and assets owned. Similar to Offshore Banking, Shell Companies are often located in tax havens with bank secrecy jurisdictions where the laws protect the anonymity of the investors as well as the people who are operating the corporation such as accountants, lawyers and financial advisors.

In Canada, Investment Industry Regulatory Organization of Canada (IIROC) is the supervisory body of the securities market prohibits against opening or maintaining accounts for shell banks. According to the IIROC (Rule 1300 Supervision of Accounts, n.d.), "No Dealer Member shall open or maintain an account for a shell bank" (p. 2). The IIROC also characterizes Shell corporations, "a bank that does not have a physical presence in any country". (Rule 1300 Supervision of Accounts, n.d., p. 2)

However, many other countries, such as the United States legally allow domestic corporations to set up shell companies abroad to their business operations (Revisions to Rules 144 and 145: A Small Entity Compliance Guide, 2008). For an example, Google Inc. moved its jobs and profit from international or European market operations to Ireland in order to take advantage of looser tax benefits.

Shadow Banking

The shadow banking system is a collection of non-bank financial Intermediations, which provides similar services to mainstream commercial banks or credit unions without legally binding financial regulations (Pozsar, Adrian, Ashcraft, & Boesky, 2012). Shadow banks conduct maturity, credit and liquidity transformation without central banks liquidity or public credit guarantees (Pozsar, Adrian, Ashcraft, & Boesky, 2012).

The type of entities that made up shadow banking systems includes Hedge Funds, Mutual Funds, and Special Purpose entities. These entities make profit by acting as intermediaries between large borrower and large lenders while they charge service fees for their services and their own interest rates (Lemma, 2017). For an example, startup Tech Company in Silicon Valley borrowed capital from a Mutual Fund while paying agreed rate of interest and service fee while the Mutual Fund finds an investor(s) to lend money for the startup company.

Shadow Banking invests on complex financial instruments or contracts to generate huge sum of money. Such as Derivatives, Credit Default Swaps,

Repurchase agreements, Asset backed Securities and other methods (Lemma, 2017). Since the financial crisis in 2008, Shadow-banking system got popular among investors. Unlike commercial banks, these entities do not require taking case deposits; they are not subject to regulation like commercial banks (Pozsar, Adrian, Ashcraft, & Boesky, 2012). While some estimate measure, Shadow Banking makes up 25 to 30 percent of World's financial system.

Unconventional Parallel Banking

Recent studies show that most criminals and terrorist groups are using using channels outside of the traditional financial sector to move their funds (Kaplan, 2006). According to Basel Committee on Banking Supervision, Parallel Banks define as banks, which licensed in different jurisdictions by an individual or a family, group, holding company or private individuals to take advantage of different tax agreements, to avoid legal restrictions and or to trade capitol among each other. Parallel banking is not subject to supervision (Parallel-owned banking structures, 2003).

Parallel Banking exists on the jurisdictions where secrecy provisions limit access to information, where supervision and regulations are week such as merging economies or under developed countries (Parallel-owned banking structures, 2003). Due to the conflict with core banking principles, the Basel Committee recommends that Parallel Banking should not be permitted in any jurisdiction. (Parallel-owned banking structures, 2003).

Since September 11, 2001, underground or "parallel" banking systems have received considerably more attention. According to the 9/11 Commission Report, al Qaeda funded 19 operatives who carried out the attack by using anonymity provided by the large financial and domestic financial system to move and store their money. Over two years, the terrorists funded between USD 400,000 - $ 500,000 using different sources or diverted funds from another project to fund their operations (Wirtz, 2004).

These are highly efficient, unauthorized systems used to transfer money around the world similar to legitimate banking practices; even some of them are ahead of popular Western banking systems by hundreds of years.

Informal Value Transfer Systems (IVTS)

The Informal Value Transfer System (IVTS) accommodates the transfer of funds earned by immigrants in western or developed countries back to family members in their country of origin. However, recently these methods have been gained popularity with criminals, money launderers, and terrorists.

The most important value transfer systems identified so far are Hawala, Hundi and Black market peso exchange networks. While there are many other IVTS methods available, this part of the chapter will concentrate on these few popular methods of IVTS's (Passas, 2005).

Hawala, Chop, and Hundi Methods

Hawala means money transfer or sometimes trust also known as Hundi, while Chops are seals that facilitate money transactions. These systems are popular among Middle Eastern, North African, Chinese and Indian subcontinents (Trehan, 2003). The Hawala system developed in India before the introduction of Western banking practice (The Hawala Alternative Remittance System and its Role in Money Laundering, n.d.). All these system work by transferring money without actually moving it. In other words, it is a "transfer of funds without moving the funds".

As an example, an illegal immigrant can work in Italy and earn cash in hand (Nero in Italian) often without paying income tax requires sending this money to his family who are living in their country of origin. First, he walks into a commercial bank and the bank requires him to open an account (which he is unable to do without legal documents). They charge 25 euro to issue a bank draft and offer the exchange rate set by the foreign exchange market, and require five working days to receive money. He or she then talks to a Hawala dealer, the dealer offers him, 5 percent commission to handle the transaction (often 5 euros for 1000 euro transfer), a higher exchange rate than the retail banks offer and the next day the funds are delivered to his family back at home.

To reiterate, after a sender makes a payment to a Hawala dealer, the dealer then contacts his or her business partner back in the country where the money needs to be sent. The business partner then pays the money to the

immigrant worker's family back at his or her home country.

The above system exists between two or many business partners who are living in different countries. If one business partner owes money to another for export or import or even family reasons, one of the partners pays money to a third party to settle the account. The parties' all benefit when they have less bureaucracy, law taxes and less money to declare for the government.

While money laundering involve in three stages, placement, layering and integration, Hawala can be used at any phase. In the placement stage, illicit funds can be introduced to the financial system. The challenge for this stage is handling cash without being traced. Many Western countries require transactions over $10,000 dollars to be reported to the government authorities. The Hawala method will allow dealers to manipulate the business operation such as the proceeds from the crime.

Black Market Peso Exchange Method (BMPE)

The Black Market Peso Exchange is the ATM for drug dealers. This means that it is an advanced Money Laundering system which many drug cartels in the United States and in other major drug trafficking countries in South America use to clean their illicit funds. When funds made by selling drugs in the United States and the Cartels need to get drug money out of the United States and convert it to Pesos which is the currency of many Latin American countries (Richards, 2003). Therefore, the cartels use money brokers as intermediaries.

The method involves, money brokers contacting local retail stores who are buying goods from America, such as electronics and branded clothing. While the supplier in the United States are paid by the drug money made on streets of America (Gray, 2012). The retail businesses pay an equal amount of money in pesos directly to the cartel through the money brokers after retail goods are imported from the United States (Robinson, 2016). The retail business are benefitting by avoiding paying exchange fees and taxes.

In Chapter Two, I explained the process of money laundering, the money laundering mechanisms, stages, its involvement in the securities industry and fraud related forms of laundering. In Chapter Three, I will explain the problems with enforcing anti-money laundering laws.

CHAPTER THREE: THE PROBLEMS WITH ENFORCING ANTI-MONEY LAUNDERING LAWS

This chapter aims to explore the essential problems with combatting money laundering, especially with the difficulty of enforcing international laws. The chapter will discuss the use of doctrine approach to analyses the international AML laws, and then consider the comparative approach with case studies of money laundering which examines what the law enforcement agencies might encounter in different jurisdictions. This chapter also explains why it is harder to combat money laundering in Real Estate markets and Securities markets.

Problems with Enforcing International Laws

While money laundering is an organized crime involving number of different jurisdictions, it is necessary to combat money laundering globally under universal AML legislations. The uniformity of laws will therefore play a main role in combatting ML globally. The development of the international legal order to combat money laundering and terrorist financing over the past few decades has been remarkable. The starting point of signing the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) in the 1980s, gave the first legal definition for Money Laundering in international law and structure (Durrieu, 2013). This model was created to combat financing terrorism after the 9/11 terror attack and it has given new hope for law enforcement agencies around world to fight against crimes, terrorist organizations

and maintain civil liberty (Durrieu, 2013). This fundamental development of AML was influenced by the United Nations (UN), the Council of Europe, certain European Union Directives, UN Security council Resolutions and by the recommendations and suggestions of inter-governmental organizations such as FATF, UNODC, IMF, and WB.

Even though the inter-governmental organizations are in place, there are still a few barriers, which can be an obstacle when enforcing international law globally. There is difficulty in achieving uniformity of laws between different jurisdictions, and the ineffectiveness of international laws when it comes to legally binding on a state. While the United Nations includes 193 member states, it has power to adapt international treaties and conventions that have the effect of law in a member state.

Meanwhile, the UN Security Council has the authority to bind all member states through a Security Council Resolution. This law is considered as 'hard law', which refers to actual binding legal instrument and law. International Treaties or directives, as well as European Union Directives, UN Security council Resolutions are considered as 'hard law' (Durrieu, 2013).

The norm of hard law is often related with the norm of 'soft law' which can be defined as the recommendations, code of conduct and model law by the inter-governmental organizations, such as UNODC, FATF, IMF, World Banks and other Non-Governmental Organizations (NGOs) (Durrieu, 2013).

The best academically known definition of soft law suggests that soft law:

> encompasses *inter alia* inter-stat conference declarations such as the 1992 Rio Declaration on Environment and Development; UN General Assembly Instruments such as the 1948 Universal Declaration of Human Rights, the 1970 Declaration on the Principles of Friendly Relations Among states, and resolution dealing with disarmament, outer space, the deep seabed, decolonization, or natural resources; interpretive guidance adopted by human rights treaty bodies and other autonomous intergovernmental institutions; code of conduct, guidelines and recommendations of international organizations, such as UNEP's 1987 Guidelines on Environmental Impact assessment, FAO's Code of Conduct on Responsible Fisheries or Many others adopted by IMO, IAEA, FAO and so on/ Also potentially included within the category of soft law are the common international standards adopted by transnational networks of national regulatory bodies, NGOs and professional and industry associations. Finally, the term "soft law" can also be applied to non-treaty agreements between states or between states and other entities that lack capacity to conclude treaties (Boyle & Chinkin, 2007, p. 212).

Concisely, soft law could be considered as the entities that lack capacity to consider as legally binding obligations. When the inter-governmental organization issues guidelines or recommendations on AML, often they are related with the traditional international law. With respect to the FATF, it advocates and promotes strong global anti-money laundering and terrorist financing control and convinces countries to improve their laws against ML/TF. Similar to the Bassel committee in banking supervision, FATF has the objective to improve banking and financial systems through regulations. FATF also has a capacity of 130 different jurisdictions. However, unlike the United Nations, the States are not obligate to ratify soft law.

Within the FATF framework, countries with serious problem of corruption, lacks of law enforcement to combat money laundering will be give certain opportunity to improve their conditions and if failure to do so, FATF has the ability to 'name and shame' or blacklisting those jurisdictions as an action Forty plus Nine Recommendations in 2000 (Beare & Schneider, 2007). This will allow other countries to protect themselves from the risks. Therefore, the affected jurisdictions may not be dealing with their trade or business access to international finance.

This method has a significant effect on the development of a State. FATF Blacklist carried with it no formal sanction, in reality, a jurisdiction placed on the FATF Blacklist often found itself under intense financial pressure (Beare & Schneider, 2007). Blacklisting countries will isolate them from their financial activates and they will then be in a situation similar to a state with an economic sanction face such as North Korea or Iran. Therefore, it could be argued that FATF's action has an effect on its member states similar to the United Nations Security Council Resolutions against a country.

Some scholars argue that in Europe, the European court of Justice "is the only court so far with power to give a uniform construction to uniform law" according to art 220 Treaty of Rome. (Zweigert & Kotz, 2011, p.27). As an example, legislatives in the United Kingdom require its courts to apply the law of European Communities with respect to the principles drafted by the European Court of

Justice. According to Section 2 (General Implication of Treaties) of the European Communities Act 1972 states that:

> (1) All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognized and available in law, and be enforced, allowed and followed accordingly; and the expression **[**"enforceable EU right"**]** and similar expressions shall be read as referring to one to which this subsection applies.

However, while the treaties are considered as the main type of the international law (hard law) Zweigert & Kotz (2011) argue that they are "very difficult to achieve and rather clumsy in operation" (Zweigert & Kotz, 2011, p. 25). They also argue that international law is likely to prevent the development of domestic law of the State. "It is now clear that unified legislation can deprive member state and their courts of the freedom to alter and develop their law and introduce a barrier to change which thwarts the adoption of much needed adjustments at national level" (Zweigert & Kotz, 2011, P. 28). Furthermore, Zweigert & Kotz (2011) show that, unification of law can take a long time and is very costly. "[…] a state can always seek to have the unified law changed, but it would take years of negotiation to obtain the agreement of all the other states involved […]" (Zweigert & Kotz, 2011, p. 28).

Ultimately, in the end, it will be up to the State to decide how to implement or enforce foreign law into their own jurisdiction (Rider, 2009). When there is a conflict between national and international law, it could be assumed that the national laws are superior by considering the following judgments:

In Mortensen v. Peters (1906), where there was conflict surrounding legislative sovereignty, The House of Lords (UK) ruled that there is a good authority on domestic laws supremacy over international laws and domestic parliament has no limitations to exercise its power when the laws are passed in a correct manner. By drafting the Judgment, the court stated that:

In this Court, we have nothing to do with the question of whether the Legislature has or has not done what foreign powers may consider usurpation in a question with them. Neither we are a tribunal sitting to decide whether an Act of Legislature is *ultra vires* as in contravention of generally acknowledged principles of international law. For us an Act of Parliament duly passed by Lord and Commons and assented to by the King, is supreme, and we are bound to give effect to its terms

Similarly, in the case of The Zamora (1916) the Judicial Committee of the Privy Council of Great Britain states that:

> It cannot, of course, be disputed that a Prize Court, like any other court, is bound by the legislative enactments of its own sovereign state. A British Prize Court would certainly be bound by acts of imperial legislature. But it is none the less true that if the imperial legislature passed and act the provisions of which were inconsistent with the law of nations, the Prize Court in giving effect to such provisions would no longer be administering international law. It would in the field covered by such provisions be deprived of its proper function as a Prize Court. Even if the provisions of the act were merely declaratory of the international law, the authority of the court as an interpreter of the law of nations would be thereby materially weekend for no one could say whether its decisions were based on a due consideration of international obligations, or on the binding nature of the act itself. The fact, however, that the Prize Courts in this country would be bound by acts of the imperial legislature affords no grounds for arguing that they are bound by the executive order of the King in Council…

The Judgments of the above cases prove that positive national laws take president over international laws when there is a conflict of interest between domestic and International law. Furthermore, in Georges Pinson (France) v United Mexican States (1928), the Commission held that the National Courts represent of the sovereignty of each individual State and therefore, it has power to enforce or apply public law, even though they could clash with international law (Gray, 1996). Therefore, uniformity of international law between states is difficult to achieve in practice to combat Money Laundering because they are not obliged to legally binding or ratify by the States.

Vulnerabilities of Financial Institutions

A sustainable financial sector is vital to any State's economy. It allows foreign investors to enter into the market and invest in the State with confidence. Therefore, States should maintain its integrity of good governance. The pillar of good governance is the transparency, accountability and integrity (Marazzi, & Schipani, 2014).

Ultimately, Money Launders use banks and other financial institutions to process the legitimizing of their illicit funds while they typically "hide behind corporate nominees and obscure the ownership and control of business[s]" (Rider 2009, p. 145). The most challenging fact to detect money launders and money trails are the financial institutions; secrecy of their corporate culture, corrupt and unethical business practice are arguably the most challenging issue to find the

origin of the illicit funds. According to a report issued by the United States Senate Subcommittee on Investigation, Criminal networks are using United State lawyers, real estate agents and bankers to hide and launder proceeds from the crimes ("United States Senate Permanent Subcommittee on Investigation", 2010).

According to the New York Times, there were occasions where the real estate sector in the United State failed to identify the buyers or their sources of income (Story, 2015). In the province of British Columbia in Canada, it was discovered that 112 out of 220 real estate companies had 'significant' levels of non-compliance, and five of the companies had 'very significant' non-compliance (Fumano, 2016). Transparency International indicates that self-governing law societies have published rules that include "Know Your Customer" requirements for lawyers and firms, but given their role in real estate closings, the lack of an anti-money laundering obligation is a major loophole (Martini, 2017).

Conflict with Individual Freedom and Right of State

Enforcing international laws universally is challenging. One of the challenges arises when taking actions against an individual, private entity or a State for not following AML/CFT standards. The FATF's "Forty plus Nine" Recommendations in 2000, FATF issued a list of 15 jurisdictions which are Non Corporative Countries or Territories (NCCT's). This list is known as a so-called Blacklist or "name and Shame System" ("The importance of the global network in suppressing the financing of terrorism", 2012):

> [.] this lack of cooperation manifested itself as an unwillingness or inability (frequently, a legal inability) to provide foreign law enforcement officials with information relating to bank account and brokerage records, and customer identification and beneficial owner information relating to such bank and brokerage accounts, shell company, and other financial vehicles commonly used in money laundering ("International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", 2016).

The effect of the 'name shame' system has significant impact on the State's financial system. "In reality, a jurisdiction placed on the FATF Blacklist often found itself under intense financial pressure ("International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", 2016).

Jackie Johnson, an AML/CTF expert, argued that the "blacklisting questions the legitimacy of the country or jurisdiction identified and its right to conduct financial business in the global environment (Sperling, 2014, p. 480). Also in a fair ground, money launderers has discovered the discrepancies among different legal systems of countries or jurisdictions in different parts of the world to gain access in the new markets (Johnson, 2004, p. 40) and therefore the enforcement mechanisms of international law in individual jurisdictions are largely non-existent (Roberts, 2005). The critics indicate that, the countries have advanced economic infrastructure and safer places to do business and trade will not be able to do usual business with other countries or lending money from the main international organizations such as World Bank or IMF due to not following FATF standards.

Anti-Money Laundering legislations also have been challenge by the national law, in different jurisdictions. As one of the world's largest financial sectors, the United Kingdom considers customer due diligence as essential to maintain its integrity of financial institutions. This is indicated by the Regulation 20 (1) of the "Money Laundering Regulations 2007" (2007):

> 20. — (1) A relevant person must establish and maintain appropriate and risk-sensitive policies and procedures relating to—
>
> a) customer due diligence measures and ongoing monitoring;
> b) reporting;
> c) record-keeping;
> d) internal control;
> e) risk assessment and management;
> f) the monitoring and management of compliance with, and the internal communication of, such policies and procedures,
>
> The Regulation 20 (2) includes a provision specifically to prevent activities related to money laundering and terrorist financing.
>
> [.] in order to prevent activities related to money laundering and terrorist financing.
> (2) The policies and procedures referred to in paragraph (1) include policies and procedures—
> (a) which provide for the identification and scrutiny of—
>
> i. complex or unusually large transactions;
> ii. unusual patterns of transactions which have no apparent economic or visible lawful purpose; and
> iii. any other activity which the relevant person regards as particularly likely by its nature to be related to money laundering or terrorist financing;

The British national law strongly indicates financial institutions to report suspicious clients or monitory transactions, "20 (1) a. customer due diligence measures and on-going monitoring;" (Money Laundering Regulations, 2007).

Canada, which has a similar common law Jurisdiction eliminated the due diligence process for lawyers. Therefore, lawyers are not obliged to conduct due diligence requirements drafted in the Proceeds of Crime Money Laundering and Terrorist Financing Act Section 7, PCMLTFA 2000, which indicates:

> *(7) Transactions if reasonable grounds to suspect*
> Subject to section 10.1, every person or entity referred to in section 5 shall report to the Centre, in the prescribed form and manner, every financial transaction that occurs or that is attempted in the course of their activities and in respect of which there are reasonable grounds to suspect that
>
> (a) the transaction is related to the commission or the attempted commission of a money laundering offence; or
>
> (b) the transaction is related to the commission or the attempted commission of a terrorist activity financing offence.

The high court ruling [(Federation of Law Society of Canada v. Canada (Attorney General) 2013 BCCA 147] indicates that the provision of the legislation is unconstitutional considering the appeal from the Law Society of Canada, which specifies that:

> [14] The Federation of Law Society of Canada (FLSE) served Canada with a notice of constitutional question and filed a petition in the Supreme Court of British Columbia on November 8, 2001, challenging the constitutional validity of the application of the Regime to lawyers and seeking immediate interlocutory relief. In its petition, the FLSC contended that the recording and related obligations imposed on lawyers pursuant to Part 1 of the *Act* violated s. 7 of the *Charter* by jeopardizing the liberty of lawyers and clients in a manner that failed to conform with the principles of fundamental justice, namely: (a) solicitor-client confidentiality and privilege; (b) lawyers' duty of loyalty to their clients; and (c) the independence of the Bar. A parallel petition was filed by the Law Society of British Columbia.

> [15] The FLSC also contended in its petition that the Regime requires lawyers to collect information from their clients and retain it so that the information can be available for law enforcement officials if they wish to review it. The FLSC argued that this requirement turns lawyers into state agents to collect information from their own clients for potential use by the state against those clients. The FLSC asserted that s. 8 of the *Charter* is also thus violated because state agents employed by the FINTRAC are authorized to conduct warrantless searches of lawyers' offices at any time.

Thus, the court dismissed the provision (S7) of the Money Laundering and Terrorist Financing Act (PCMLTFA) 2000 on the basis that it interferes with the lawyers/client privilege, which requires the information, is confidential (Martini, 2017). Therefore, each province of the country has drafted rules of conduct for its lawyers and firms.

However in Europe, identical cases occurred when the Belgian Constitutional Court had challenged some provisions of Directive 2001/97/EC (European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering [2001] OJ L344/76). This indicated that the provision violated the rights of lawyer/client confidentiality (Case C-305/05 Ordre des barreaux francophones et germanophone and Others v Conseil des ministres [2007]). The final ruling conducted that the CJEU did not find the directive and would be in breach of the right to a fair trial or a right of the defence (Pollicino, & Romeo, 2016).

With respect to the European Union Law, a normal commercial dispute, a host state does not have power to impose the full range of requirements on temporary service providers (Bernard, 2016). The European Law eliminated any barriers, which potentially challenged one of the fundamental principles of free movement of goods, and services. Article 28 of the Treaty on the Functioning of the European Union (TFEU) states that

> The Union shall comprise a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries.

However, in a sensitive manner the European Court of Justice has challenged this principle. In Jyske Bank Gibraltar Ltd v Administración del Estado (Case C-212/11), Spanish investigators required Financial Institutions operating in Spain, regardless of their country of origin, to inform the Spanish Financial Intelligence Unit (FIU) of any transfer of funds exceeding 30,000 euros to or from tax havens and uncooperative territories such as Gibraltar. (ECJ Press Release, 2013). The Spanish national law has been established against money laundering with respective to Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ, 2005).

The Jyske Bank, which is a credit union operating in Spain with Gibraltar origin, brought an action against the decision. The court found that the Spanish rule was a restriction on the free movement of service; however, the breach could be justified:

> [.] the directive does not expressly preclude the possibility of requiring credit institutions carrying out activities in Spain under the freedom to provide services to forward the required information in respect of the fight against money laundering and terrorist financing directly to the Spanish FIU. Therefore, the directive does not, in principle, preclude the Spanish legislation (ECJ Press Release, 2013)

With respect to the court's decision of the Jyske Bank', ECJ considered the interest of Spanish national law was to give an overall conclusion for the EU Directive (De Vido, 2015). Therefore, European legislators encourage the respect of the domestic laws and their interests when there is a conflict of interest.

Considering above scenarios, it could be argued that the sensitivity of the AML legislation has some flaws.

Problems with Risk Management Strategies

Perfect Risk Management Strategies are essential in combatting money laundering and CTF. Therefore, FATF has developed a series of recommendations to combat ML/TF worldwide. National legislation recognizes these standards and introduces them into their AML legislations ("FINTRAC, Guidance on the Risk Based Approach to Combatting Money Laundering and Terrorist Financing", 2016). FATF defines The Risk Base Approach (RBA) as:

A RBA to AML/CFT means that countries, competent authorities and financial institutions, are expected to identify, assess, and understand the ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively." (FATF: Guidance for a Risk-Based Approach, 2014, p. 6).

Esoimeme (2015) identified three risk categories for the financial sector: Customer Risk, Product Risk, Country, or Geography risk. The first of three risks is the Customer Risk. Financial Institutions must recognize any type of business potentially vulnerable to money laundering by considering their nature of the business, transaction patterns. Existence of these Risks can be identified at the Customer Due Diligence stage.

The second risk is Product Risk. Certain product and services historically abused by the money launders should be identified by considering the nature of the customer relationship Customer Identification Program (CIP) and Customer Due Diligence (CDD) information. The Managers should follow identify, research, and report strategies when they encounter risk tolerance.

The third and final risk is Country or Geography Risk. The Jurisdictions, which subject to sanctions or Blacklisted countries by the FATF (Non Corporative Countries), could carry a greater risk. Therefore, financial institutions should identify the factors that could inherit risk from those countries.

Some scholars characterised The Risk Based Approach (RBA) as a "double edge sward" due to its nature of regulatory tolerance (Byrnes & Munro, 2017). The risk of applying wrongly and unreported procedures of any type of risks would have to be dealt with huge fines for non-compliance. The the same time, the regulators have unintended consequences from the compliance of fear spread across financial institutions. As result, over reporting and huge volumes of investigations looking into transactions and client accounts would occur (Byrnes & Munro, 2017).

Barriers of Customer Due Diligence (CDD)/ Know Your Customer (KYC)

In 2001, the Basel Committee on Banking Supervision (BCBS/BIS) issued guiding principles for Customer Due Diligence (CDD), (Customer Due Diligence for Banks, 2001) to combat and prevent money laundering and countering the financing of terrorism (AML/CTF). The due diligence practice from, "Know Your Customer (KYC) policies to procedures on new and existing customers" (Shahin & El-Achkar, 2017) will allow financial institutions to identify the clients they deal with and how to protect themselves.

Identification of the customers is an essential element of KYC Standards; it also includes guidelines for cross-border contexts, especially when dealing with 'Non-Face-to-Face customers (Customer Due Diligence for Banks, 2001, p. 48). In accepting business from non-face-to-face customers:

- banks should apply equally effective customer identification procedures for non-face-to-face customers as for those available for interview; and

- there must be specific and adequate measures to mitigate the higher risk.
  Examples of measures to mitigate risk include:
- certification of documents presented;
- requisition of additional documents to complement those which are required for face-to-face customers;
- independent contact with the customer by the bank;
- third party introduction, e.g. by an introducer subject to the criteria established in paragraph 36; or
- requiring the first payment to be carried out through an account in the customer's name with another bank subject to similar customer due diligence standards.

Keesoony argues that the KYC process takes a longer screening process and different stages of investigation strategies due to the strict legal requirements, which could prevent legitimate investors to enter in to financial products or services (Keesoony, 2016). Furthermore, KYC requirements for politically exposed persons (2.2.5) could violate the confidentiality of a diplomat, politician, or a leader who has strict secrecy.

In this chapter, I have discussed the barriers to enforce AML, namely, the difficulty of achieving uniformity, which creates conflict between domestic laws and international AML laws. This chapter also analysed the issue of how money laundering could affect individual rights, democracy and freedoms, the comparative approach with case studies analysis, the AML legislations, and policies in different jurisdictions and their applications. Finally, I explained other challenges facing AML/CTF and some procedures used to protect financial institutions for exposure to money launders. In Chapter Four, I will conclude and list recommendations to help combat Money Laundering and Terrorist Financing.

CHAPTER FOUR: CONCLUSION

In the final chapter of this thesis, I will provide recommendations and conclude with my thoughts about money laundering and terrorist financing.

Recommendations

Money Laundering and Terrorist Financing could be the main challenge for financial institutions today. It is important to seek practical efforts to combat ML/TF universally. Recent political and economic climates around the globe discussed above, are clear signs that there should be different strategies to combat ML and TF as it is clear that launderers find loopholes to get around current AML laws.

While less developed jurisdictions are enacting many AML legislations into international standards, the real problems arise when they are enforcing those legislations with limited resources. In addition, there are many limitations within the inter-governmental organizations to access the accurate information when assisting money laundering in developing nations.

Therefore, it is important to use a doctrine approach to analyse the International AML laws, and then consider the comparative approach with case studies of money laundering which examine the law enforcements agencies and how they exist in different jurisdiction. In addition, risk management strategies must be used as tools to combat money laundering by harvesting large amounts of information and processing the information to identify suspect activity. The most

important factor to combat money laundering is to provide up to date training and education for law enforcements agencies.

A State or an institution may risk losing its reputation, enforce sanctions against, and pay huge penalties by failure to cooperate with AML standards. It can be concluded that money laundering cannot be fully eliminated at a domestic level due to its intercontinental nature and the weakness of the law enforcement in different in various jurisdictions. However, failure to achieve uniform nature of the international law is the greatest challenge facing AML today.

Implementing international laws into domestic laws is a long and drained out process and it can be very costly (Zweigert & Kotz, 2011). The possibility of implementing laws depends on the suitability of the domestic judicial system, which allows foreign laws to replace or amend domestic laws (Bianchi, 2016). There are some possibilities where incorporation of foreign laws might not easily allow merging into domestic laws due to institutional culture and individual tendencies of the judge (Higgins, 2010). In addition, the true purpose of the international law could be lost in practice.

Therefore, it should investigate the effectiveness of the International laws in different jurisdictions on the ground of development of their jurisdiction, and consider a common ground for incorporation of international laws. The ratification of the Vienna Convention can offer to facilitate some ground of uniformity. Article 14 of the Vienna Convention (1986) states that:

Consent to be bound by a treaty expressed by ratification, acceptance or approval

1. The consent of a State to be bound by a treaty is expressed by ratification when:

(a) the treaty provides for such consent to be expressed by means of ratification;
(b) it is otherwise established that the negotiating States were agreed that ratification should be required;
(c) the representative of the State has signed the treaty subject to ratification; or
(d) the intention of the State to sign the treaty subject to ratification appears from the full powers of its representative or was expressed during the negotiation.

2. The consent of a State to be bound by a treaty is expressed by acceptance or approval under conditions similar to those, which apply to ratification.

When a conflict of interest occurs between the State and an International Organization, it is difficult to compare international organizations to States, therefore, "international organizations cannot in this matter be treated on an equal footing with States" (Olivier Corten, Pierre Klein, The Vienna Conventions on the Law of Treaties: A Commentary, Volume 1, p. 305).

Moving forward, I have discussed that the FATF system of Blacklisting or 'name shame' process will isolate the countries for doing usual business with other financial institutions or States overseas. In directly, this could hurt the economy of individual states and will have a negative effect on global economy. The "Blacklisting" of a state is a serious action, similar to enforcing sanction or trade embargo by the United Nations Security council. It could be argued that this gives greater power of inter-governmental organization over the faith of a State or Global

economy overall. Even though Money Laundering has a historically long standing crime and different jurisdictions has different laws and processes for dealing with them.

With respect to combatting crime and bringing up the national legislations in to global standards, countries declare war on drugs, and money laundering. In a statement, the Governor of New Mexico, Gary Johnson, wrote in the *New York Times* (Dec. 30, 2000):

> I am neither soft on crime nor pro-drugs in any sense. Yet when I ask whether our costly, protracted war on drugs has made the world safer for our children, I must answer no. The federal anti-drug budget in 1980 was roughly $1 billion. By 2000, that number had climbed to nearly $20 billion, with the states spending at least that much. Yet according to the federal government's own research, drugs are cheaper, purer, and more readily available than ever before. (Johnson, 2000).

He refers to the existing philosophy of legalizing drugs by the Nobel Prize winning economist, Milton Friedman and former Secretary of State George Shultz. The debate explains that decriminalization is not denying that drugs destroy the lives of many people and cause serious harm to society. Similar, to war on drugs, war on money laundering is more negative than positive (Gray, 2012). On August 4th 2006, Swiss Banking Institute of the University of Zurich issued a study report, which indicates that:

> ….the goal of AML efforts, namely the prevention of drug trafficking and organized crime, has not been achieved, although significant effort has been contributed by the financial sector. Therefore, the AML activities of the Banks have become a sole requirement to conduct successful business locally and abroad. They generate however considerable expenditure (Friedman et al., 1993).

Walter H. Muller argues that the finding of the research "gives the impression that implementation of AML/CTF regulations has become a marketing tool rather than an effective mechanism to combat ML/TF" (Muller et al., 2007, p. 9). Muller (2007) also argued that the as long as bribery and corruption exits, it is difficult to assess the real impact of the AML regulations in certain jurisdictions. Rather than forcing the State to implement international laws and standards, elimination of some level of money laundering laws, which create complexity of the legal system while improving or developing individual laws to combat money laundering, could achieve a greater impact on AML/CTF. This process will be less expensive, more efficient and give more powers to national state to exercise on AML legislations to combat crimes within their geographic boundaries.

I also indicated that, customer due diligence (KYC) process and Risk Management Strategies (ARB) has greater impact on efficiency of financial institutions. The longer screening process could prevent investors to invest on certain States and choose different place to invest. The reporting requirements could lead to huge volumes of information to analyse by both the financial institutions and law enforcement agencies. Therefore, legislators will spend time understanding and validating how far the information are correct, catch criminals, money launderers will operate freely while finding different methods to launder money. For that reason, it is vital for establishing a freedom of financial market. Financial Freedom is the pre-requisite as it involves the freedom of capital in and flows in and out of the market. Although, in the term of rules and regulations, it is

essential to build up international trust and transparency, in a way the financial centre for investors, both foreign and local, to make money, which will in turn, facilitate economic growth (Li, 2012, p. 438) This is the goal of every country; therefore, any kind of AML legislation recommendation should facilitate ultimate freedom for financial institutions while there is some level of AML standards in place. The legislators should be looking into case-by-case scenarios when making laws for different jurisdictions instead of complete financial markets in the world as a single market.

Martini (2017) recommends that in order to combat money laundering, the governments should amend the current regulations for reporting standards for sectors, which exposes money laundering. The governments should require that real estate agents and other entities such as as lawyer, law firms, accountants, notaries, mortgage lenders and other corporate service providers who engage in the buying and selling of real estate must identify and keep records of the beneficial owners of customers before they purchase or invest in real estate properties (Martini, 2017).

Finally, I would like to conclude that, over the past two decades, the world is more aware of money laundering as one of the biggest global problems in the 21st century. While hundreds of legislations were created, the money-laundering problem does not go away easily. The more money laundering laws could mean more police task forces will be implemented. However, the task should be educational. As long as the State can reduce crime, corruption, and terrorism at

the domestic level, the criminals will always make a profit and will be moving their proceeds from one place to another. Therefore, the world should take action to combat crimes, which could lead to control the money from getting into the financial industry at any level.

While the Vienna Convention was used to achieve some unification of international laws, the Palermo Convention can be used as the main international instrument in the fight against transnational organized crime (Restrepo, 2017). Especially the later, amended with three protocols including punishing human traffickers, smuggling migrants and illicit manufacturing and trafficking firearms (Restrepo, 2017) can be used to reduce significant levels of crimes. Therefore creating new inter-governmental bodies similar to the FATF but to combat organized crimes could be an ideal platform for war against money laundering.

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