Anti-Money Laundering (AML)

Marcos Roca
Tax and Crime Adviser, OECD
New Delhi, 19-20 July 2023

OECD
BETTER POLICIES FOR BETTER LIVES

Agenda for this module

- Today:

  - Conversation around AML: definitions and legal standards, techniques employed to detect the crime

- Tomorrow:

  - Real case of ML: initiating an investigation and challenges

What is Money Laundering?

"The conversion or transfer of property, knowing that such property is derived from any offence or offences […], or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions"

United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna, 1988)
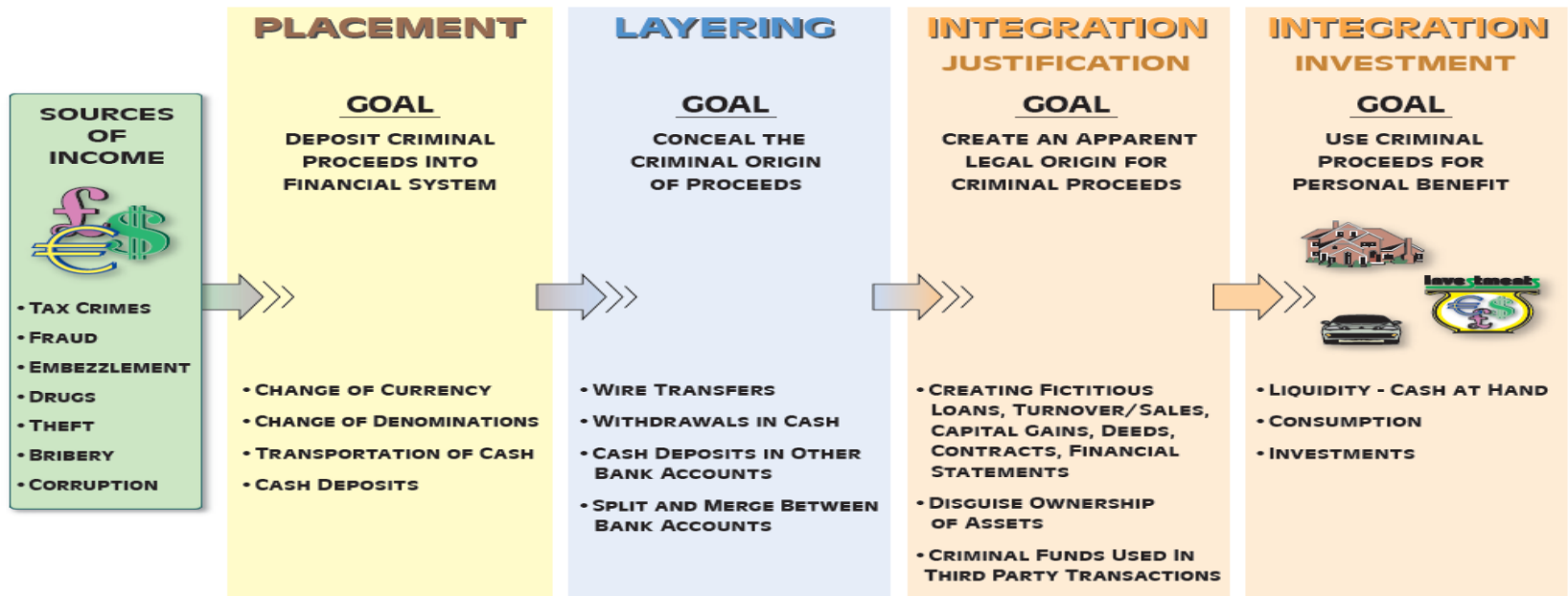
Dissecting the definition

- There must be a predicate offence: in order to launder money, it must have an illicit origin (Beware! The income must be illicit, the transaction not necessarily)

- By laundering the money, the offender seeks to hide its illicit origin in order to use it legally

- Historically, cash is king: difficulty tracing the origin of cash transactions (vs. credit cards, checks, etc.). 21st century: crypto currencies.

Thee stages in the ML process

OVERVIEW OF MONEY LAUNDERING

SOURCES OF INCOME	PLACEMENT	LAYERING	INTEGRATION JUSTIFICATION	INTEGRATION INVESTMENT
	GOAL	**GOAL**	**GOAL**	**GOAL**
	DEPOSIT CRIMINAL PROCEEDS INTO FINANCIAL SYSTEM	CONCEAL THE CRIMINAL ORIGIN OF PROCEEDS	CREATE AN APPARENT LEGAL ORIGIN FOR CRIMINAL PROCEEDS	USE CRIMINAL PROCEEDS FOR PERSONAL BENEFIT
• TAX CRIMES • FRAUD • EMBEZZLEMENT • DRUGS • THEFT • BRIBERY • CORRUPTION	• CHANGE OF CURRENCY • CHANGE OF DENOMINATIONS • TRANSPORTATION OF CASH • CASH DEPOSITS	• WIRE TRANSFERS • WITHDRAWALS IN CASH • CASH DEPOSITS IN OTHER BANK ACCOUNTS • SPLIT AND MERGE BETWEEN BANK ACCOUNTS	• CREATING FICTITIOUS LOANS, TURNOVER/SALES, CAPITAL GAINS, DEEDS, CONTRACTS, FINANCIAL STATEMENTS • DISGUISE OWNERSHIP OF ASSETS • CRIMINAL FUNDS USED IN THIRD PARTY TRANSACTIONS	• LIQUIDITY - CASH AT HAND • CONSUMPTION • INVESTMENTS

Stage 1: Placement

- Financial sector 'gatekeepers' (designated authorities) play a vital role.

- Third party payments, short-time deposits.

- 'Refining' - currency exchange of small denominations.

- Use of false identities, dormant accounts and Informal Value Transfer Systems (IVTS).

- Cash mules, cross-border couriers, movements to high-risk jurisdictions

- Exchange for high value jewellery or goods.

Stage 2: Layering

- Concealment of fund's origins.

- Splitting funds, transferring them, removing from jurisdiction.

- Co-mingling of criminal money with legitimate money.

- Frequent transfers between individuals, companies and jurisdictions.

- Use of professional (financial) enablers, charities, alternative banking platforms, opaque trusts, shell and/or offshore companies.

Stage 3: Integration

- Stage 3 involves justifying and investing criminal proceeds.

- Doing business with yourself or falsifying income.

- Disguising the ownership of assets.

- Fraudulent and false documents.

- Fabricating loans and wealth.

- Price manipulation under/over invoicing.

The Three Stages in Real Life

Case A:

A drug-trafficking organisation in the United States sells drugs to street dealers in exchange for cash. The cash is accumulated in safe houses, where it is collected by associates who variously deposit batches of less than USD 10,000 in numerous bank accounts, and place it into cash-intensive businesses (taxi companies, restaurants, nightclubs…).

Once in the banking system, the money is wired to accounts of an off-shore company where it is used to invest in stocks and bonds. The securities are subsequently sold. The money is then transferred to the account of another company under cover of a loan, where it is used to pay the credit card bills of the wife of a senior member of the organisation.

Case B:

A corrupt politician wants to establish a corporate vehicle in which to park a bribe. He sets up a front company in order to disguise his control and beneficial ownership.

The front company's bank account receives a USD 10 million bribe through a wire transfer.

The money remains in the account, and is used by the front company as a collateral to buy a house in Kensington, which the politician uses on occasional trips to London.
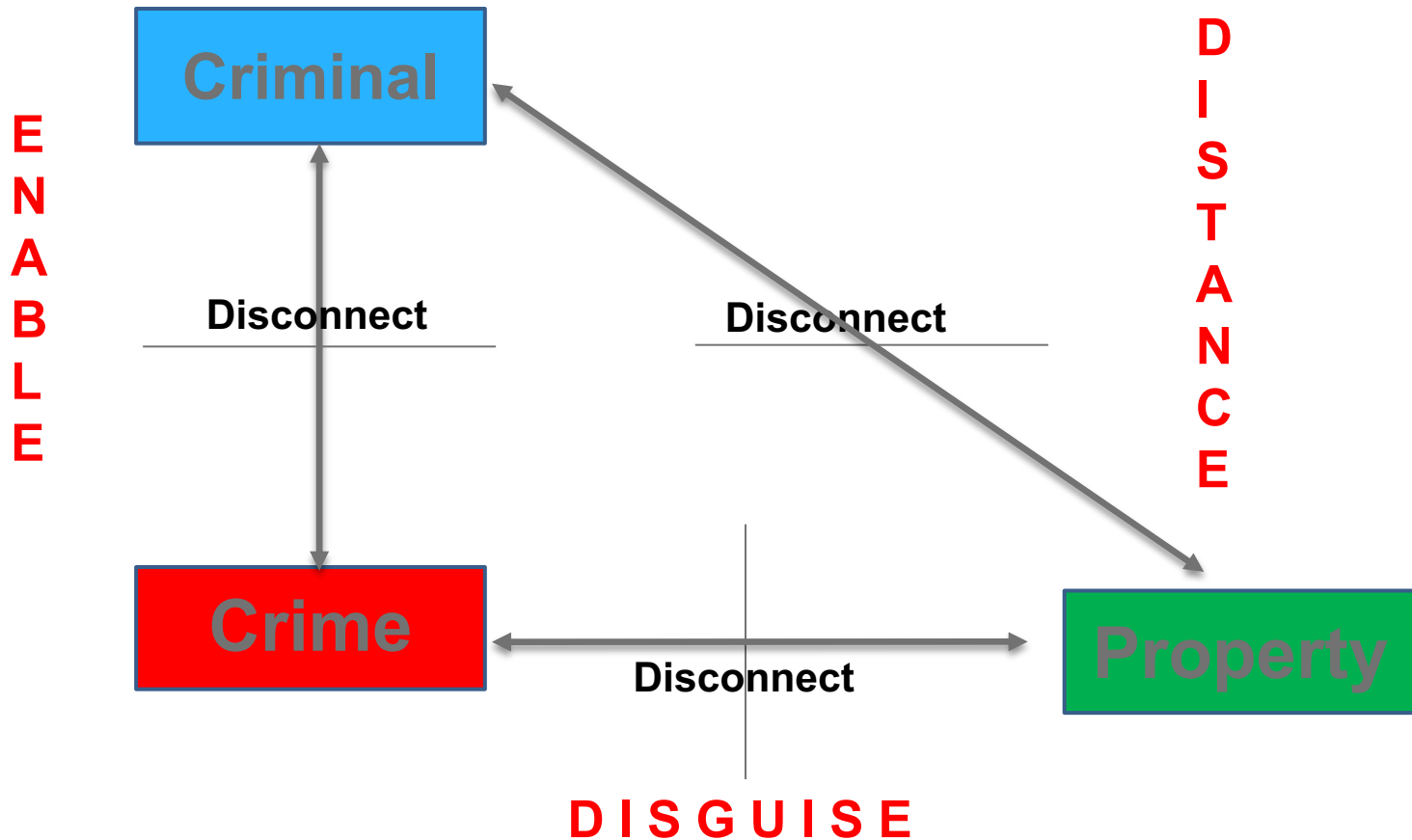
A newer model for detecting money laundering

- Place ourselves inside the mind of a criminal. Criminal's desires are:

    1. Succeed in perpetrating a crime

    2. Avoid detection

    3. Benefit from the crime

    4. Retain the benefit of crime

(Platt, Stephen (2015). Criminal Capital: How the Finance Industry Facilitates Crime, London, Palgrave-Macmillan)

The three Disconnects: Enable, Disguise, Distance

Criminal

Crime

Property

E N A B L E

D I S T A N C E

D I S G U I S E

Disconnect

Disconnect

Disconnect

Case B:

A corrupt politician wants to establish a corporate vehicle in which to park a bribe. He sets up a front company in order to disguise his control and beneficial ownership.

The front company's bank account receives a USD 10 million bribe through a wire transfer.

The money remains in the account, and is used by the front company as a collateral to buy a house in Kensington, which the politician uses on occasional trips to London.

Goal is clear

- Money Laundering is **circular**: the money ends up landing with the individual who generated it.

- **ML Goal: to use dirty money in legal transactions.**

- This is the major difference between money laundering and terrorist financing. TF is **linear:** its goal is to move money, irrespective of its origin, to finance terrorist activities → in TF, we are not trying to disguise the origin of the funds, but to disguise its use/destination

QUESTIONS? COMMENTS?

ML is a major problem

- United Nations estimates that between USD 800 billion and 2 trillion are laundered around the world each year. This is equivalent to 2-5% of global GDP.

- (The figure is most likely an underestimate).

- But ML is not just a revenue problem: it affects the integrity of the financial system, of law enforcement and trust in government as a whole.

Examples of economic activities employed for ML purposes

- Cash-intensive businesses / Smurfing
- Real estate
- Gambling / Lottery
- Trade-based money laundering

Trade-Based Money Laundering (TBML)

"the process of disguising proceeds of crime and moving value through the use of trade transactions (both domestically and internationally) in an attempt to legitimise their illegal origin".

Financial Action Task Force

Main goal is to move money, not goods.

TBML Example

- Country A declares it **exported** bananas to Country B in FY 2022 for a total of **USD 10 million**.

- Country B declares it **imported** bananas from Country A in FY 2022 for a total of **USD 5 million**.

- The **missing** 5 million could indicate TMBL is taking place.

TBML Techniques

Goal: to create a difference between the value of the products exchanged and the amount paid for these products.

Some techniques:

- Fake invoicing: over-invoicing, multiple invoicing (invoicing several times for the same shipment), which makes it possible to launder the difference

- Under-shipment: Actual value of the goods does not correspond to the amount invoiced (or, similarly, shipment of defective goods but invoiced as being of good quality).

- "Phantom Shipping": Importer and exporter agree to fake an export transaction, which never actually takes place.

There will always be a misrepresentation of either a) price, b) quantity or c) quality of the goods.

TMBL in figures

- US NGO "Global Financial Integrity" compared official data of 171 countries over the 2008-2017 period, and found a gap of USD 8.8 trillion between imports and exports.
- This gap was mostly found in the following sectors:
  - Precious metals
  - Cars
  - Textiles
  - Electronic appliances

Informal Value Transfer Systems (IVTS)

❑ *Hawala / Hundi* (Middle East, India, Central Asia, Northern Africa)

❑ *Fei Ch'ien* ("Flying Money") (China)

❑ *Black Market Peso Exchange* (Latin America)

- Informal value transfer systems based on trust

- May be completely unknown to law enforcement

- For social and economic reasons, these systems are extremely popular in many regions across the world.

Black Market Peso Exchange

ML technique employed by drug cartels in South America. Cartels have sold drugs in the US market and need to "repatriate" earnings to South America. But how?

1. Cartel contacts a broker in South America asking to exchange drug-related USD to their local currency. USD are in the USA.

2. Broker makes sure that wholesale retailers in South America place orders for products in the USA.

3. Broker employs "Smurfs" in the USA who place the money in the financial system and makes a series of transactions to layer them.

4. Wholesale retailers pay for their US orders with the money placed in the USA by the broker.

5. US products are shipped to South America. Retailers sell them to the public in local currency and share profits with the broker.

6. Broker shares the profits, in local currency, completely laundered, with the cartel.

New trends

Criminals use new methods, which often are legal:

- Digital payment systems
- Prepaid debit cards
- Mobile transactions
- Crypto currencies

QUESTIONS OR COMMENTS?

HOW TO DO WE FIGHT AGAINST MONEY LAUNDERING?

Whole-of-Government Approach

- According to the FATF, most ML cases begin from a referral from civil tax auditors.

- **What is the role of tax auditors in the fight against money laundering? Please discuss with your group (15 minutes).**

The role of tax auditors in the fight against ML

- Identifying and reporting unusual or suspicious transactions, in accordance with the laws and procedures in force in their country.

- Tax auditors are often well placed to spot the first signs of possible money laundering or terrorist financing activity. Their skills and training enables them to detect suspicious transactions quickly.

- Also: collaboration with law enforcement (joint investigation teams)

ML risk indicators

- How to identify possible ML in the course of a tax audit
  1. Physical movement of cash (transportation, currency exchanges, deposits, purchases)
  2. Use of well-known ML schemes
  3. Unexplained increases in income or capital (unrelated to declared turnover)
  4. Unusual loans

- Detection should focus on what is unusual.

ML risk indicators (cont.)

- Unclear origin of funds
- Unclear identity of involved parties
- Transaction does not match financial profile or declared income
- Transaction has no economical or logical explanation

OECD (2019). *Money Laundering and Terrorist Financing Awareness Handbook for Tax Examiners and Tax Auditors*. Paris, OECD Publishing.

Tax and FIU co-operation

- **FIU**: "a central national agency responsible for receiving (and, to the extent possible, requesting), analysing and disseminating financial information in order to combat money laundering and the financing of terrorism"

- **Suspicious Transaction Report (STR/SAR)**: Tax auditors should familiarize themselves with them in order to be able to file them.

- **Tax crime as a predicate offence for ML**: allows investigating both crimes simultaneously. Use of enhanced international cooperation mechanisms.

QUESTIONS? COMMENTS?

SEE YOU TOMORROW

Challenges for ML investigators

1. **Complexity**: ML is very complex, involving multiple individuals and corporate vehicles in several countries → traceability of financial flows.

2. **Lack of inter-agency co-operation**: ML investigations require co-operation from different agencies (both domestically and cross-border) → legal barriers, lack of co-operation culture.

3. **Resources**: ML investigations are long and time-consuming and require lots of human resources and information-sharing.

Follow the Money

"You follow drugs, you get drug addicts and drug dealers. But you start to follow the money, and you don't know where the f... it's gonna take you."
Detective Lester Freamon, HBO TV series 'The Wire'.

Following the Money Trail

- **Locard's Exchange Principle: Every contact leaves a trace.**

- Applied to criminal investigations: The perpetrator of a crime will bring something into the crime scene and leave with something from it.

- And in financial crime investigations this means:

1. Physical changes (assets move, are transferred, etc.)

2. Changes in ownership and/or controlling entity

Everybody leaves a trace

Simple Principles:

- Check and assure – <u>never</u> assume.
- Use <u>all</u> the information.
- <u>Every</u> contact leaves a trace.
- <u>Follow</u> the (money / value) trail.

Understand what's normal to recognise what's abnormal

- Origin of the funds is not clear.

- Identities of those involved are not clear.

- Transaction does not fit the person's background or reported income.

- No economical or logical explanation.

- The 'reasonable person' test.

Create a Financial Profile

For each suspect, a financial profile should be created.

As a living document, it should aim to set out not just linkage to that which is suspected to be **the proceeds of crime** but also the subject's **lifestyle and assets**.

Treated as a living document, the profile supports the investigator by:

- Setting out that which has been established (a one-stop reference point);
- Highlighting knowledge gaps and next step actions;
- Providing a means of communicating intelligence and tasking to others

Sources of information

In your groups, discuss and list available sources of information that may assist with developing a financial profile.

Sources of information (cont).

- Intelligence databases (domestic / international)
- Criminal / Court (including civil) / AML + TF Supervisor records
- Tax Records / Benefit claim records / Border cash declarations
- STRs / SARs / Bank account registers
- Company registration records
- Land Registry / Utility records / Driver + Vehicle registration
- Credit profile
- **Open source**

Caveat: The following is not exhaustive and accesses may vary from country to country, and in-country, from organisation to organisation.

Open Sources (OSINT)

With individuals and businesses being increasingly exposed in the 'virtual world', open source research can be invaluable to financial profile development.

(Material obtained from Facebook profiles, enabled the Italian authorities to seize criminal property worth EUR 500 million from the Sicilian Mafia).

Remember your own <u>digital footprint</u> when conducting open source research. "Every contact leaves a trace." When accessing the internet in an official capacity, it is advisable to use an account that is non-attributable to you and/or your organisation.

Case Study

In your groups, consider the following and produce a research action plan in support of developing a financial profile:

Intelligence received states that John EDWARDS, a building contractor who is reachable on mobile telephone number +33 6 09 29 11 12, is money laundering. He has received 10 cash payments, totalling EUR 300 000 (no further details).

He has used a business, EDWARSBUILD LIMITED, to hold the money, mixing it with business income. The business operates a bank account (IBAN: FR76 4061 8803 0406 1958 993, BIC : BOUS FRPP XXX), and is registered at an office in Paris, France.

Case Study (review).

- **John Edwards**: common first and last names. Difficult to establish without more information.

- **Building contractor**: Building organisations (federation, etc.) / Local government (town hall, region, etc.) / Business directory (open source)

- **Tax administration**: does EDWARDSBUILD LIMTIED have a TIN? VAT/GST registration? Did it receive any government assistance? The information may identify the beneficial owner (individual), turnover, address, telephone. If tax returns were filed online, IP address.

- **EDWARDSBUILD**: (in addition to above): Company registries, banks, credit agencies

- **Bank account**: IBAN/BIC identifies the bank and the branch (Boursorama in Boulogne-Billancourt, France). Analyze how to speak informally with the bank before requesting formal information.

- **Office**: Companies Registry / Land Registry / Who else is registered at this address? Is the address continuous from law enforcement / FIU?

- **Phone**: Ask mobile phone companies. What name is the line registered to?

- **And more**: Twitter, Facebook, Instagram, Snapchat, Tiktok, newspapers... Google!

Red Flag Indicators

- Unusual income.

- Unusual rise in net worth.

- Unusual possession or use of assets.

- Unusual debt.

- Unusual transactions (standalone / patterns).

- Unusual timelines (quick turnaround of funds).

Tax Returns and Tax Audit Information

- Unusual balance sheet items (e.g. cash injections).
- Unusual profit and loss items (compare with the economic sector)
- Upon questioning, owner/responsible person shows poor knowledge of their business and business sector.
- Transaction in goods or services not fitting company's profile, no commercial basis, lack of supporting documents.
- Offshore company transactions / high risk jurisdictions / opaque corporate structures.
- Business associates share common addresses / have criminal linkage.
- Asset sales not substantiated.

Unusual Financial Flows

- Payments to third parties not involved in the transaction.

- Company bank account used as a cash flow-through account.

- Non-verifiable origin of the money.

- Denominations and currency unusual in the business sector.

- Bank deposits not declared.

- No economically viable reasons for money flows.

- Unusual use of credit cards.

Unusual Turnover/Sales

- Significant increase in anonymous cash turnover/sales.

- Large cash payments received for goods never delivered (fictitious buyer).

- No economical basis for transaction and missing paperwork.

- Sales invoiced by non-transparent businesses.

- Costs incurred not leading to turnover/sales.

- Business transacted with entities suspected of criminal links or association.

QUESTIONS? COMMENTS?

THANK YOU!

Marcos.Roca@oecd.org
http://www.oecd.org/tax/crime

OECD
BETTER POLICIES FOR BETTER LIVES