



What is Money Laundering?

An analysis of the size of the problem in Australia, its impact on society together with the effectiveness (or otherwise) of the legislative responses to money laundering.

Ralph Lake

Managing Director

Contingent Events Pty Ltd

Introduction

Money laundering is the process of making illegally obtained money appear as if it came from a legitimate and legal source. Colloquially; the illegally gained money has been referred to as dirty money given it exists as a result of the proceeds of crime. Perhaps not surprisingly, the process of making the “dirty” money appear to come from a legal source became known as cleaning the money or laundering the money. This metaphor gives rise to the term “Money Laundering”. The Attorney-General’s Department describes money laundering as:

The goal of criminal acts is to generate a profit. To enjoy their ill-gotten gains, criminal commonly seek to disguise the illegal source of those profits. Money laundering is the processing of criminal profits to disguise their illegal origin (Attorney-General's Department, 2007b).

Money laundering is typically conducted in three stages (Australian Transaction and Reports Analysis Centre, 2008, p. 4; Madinger & Zalopany, 1999, pp. 7-11) as depicted in Figure 1 Stages of Money Laundering:

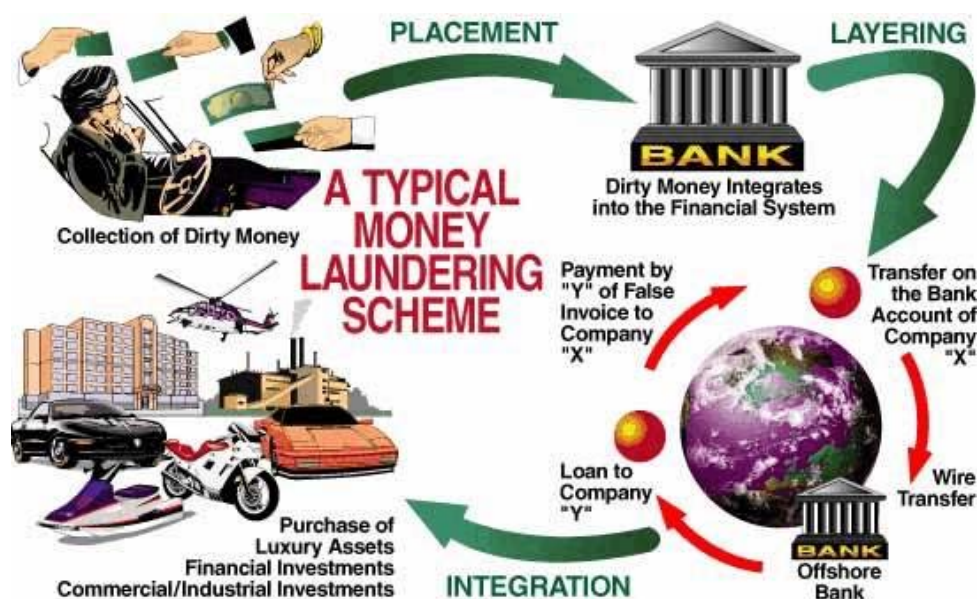


Figure 1 Stages of Money Laundering

1. Placement

This is the stage at which the illegal funds are first brought into contact with the financial system and is typically the riskiest stage of the process as it is when the money is closest to its criminal source. Typical placement includes: smurfing¹, electronic transfer, asset conversion, gambling and insurance purchases;

2. Layering

This is the stage in the process in which the illegal funds are moved, dispersed and disguised to conceal their criminal origins. Typically the more complicated the transactions the easier it is to hide the source of the funds. Layering can include: Electronic funds transfer, off shore banks, shell corporations, trusts and intermediaries; and

3. Integration

This is the stage in the cycle in which funds and or assets are successfully cleansed and appear to be legitimate in the financial system making them available for investment or other activities. Integration techniques include: credit and debit cards, consultants, corporate financing, asset sales and purchases and import/export transactions.

Brief History

According to the United Nations Office on Drugs and Crime (UNODC), the estimated amount of money laundered globally in one year is 2-5% of GDP, or \$800 billion - \$2 trillion in US dollars (United Nations Office on Drugs and Crime, 2009a).

It can be seen that the problem is not an insubstantial global issue.

¹ Involves the use of multiple cash deposits, each smaller than that minimum cash reporting requirements.

Given the global and growing nature of money laundering a number of major international initiatives were commenced beginning in the 1980s (Deitz & Buttle, 2008, pp. 8-10). Those initiatives included the following:

1. United Nations Convention Against Trafficking in Narcotics and Psychotropic Substances (the Vienna Convention) – Ratified by Australia in 1990;
2. The United Nations Convention Against Trans-National Organised Crime (the Palermo Convention) - Ratified by Australia in 2004;
3. The United Nations Convention Against Corruption (UNCAC) - Ratified by Australia in 2005;
4. The United Nations International Convention for the Suppression of the Financing of Terrorism - Ratified by Australia in 2002;
5. The United Nations Global Programme Against Money Laundering – a programme of the United Nations Office on Drug and Crimes; and
6. The Financial Action Task Force (FATF) – A policy-making body of which Australia is a member.

The FATF is perhaps the most important development in terms of Anti-Money Laundering (AML) and was created at the G-7 summit in Paris in 1989. The FATF is an inter-governmental body and is responsible for examining money laundering techniques and trends as well as reviewing actions that had already been taken at a national and international level. It was tasked with setting out measures that it believed still needed to be taken to combat money laundering. The following year the FATF issued a report which contained forty recommendations as its plan to further combat money laundering. In 2001 the mission of the FATF was further extended to include the fight against terrorism financing or counter terrorism financing (CTF) and

later that same year it made a further eight recommendations relating to the fight against terrorist financing. These eight additional recommendations became known as the “*Special Recommendations*”. Given the continuous evolving nature of techniques used by criminals the FATF issued another special recommendation in 2003 bringing the total FATF recommendations to forty with nine special recommendations. These recommendations are known as the international AML standards. As at the date of this paper, there are currently 34 member states and 5 associate members of the FATF. Whilst the FATF is predominately a policy-making body, it also monitors its members in their progress towards implementing its recommendations and publishes reports in relation to those evaluations (Financial Action Task Force, 2007).

Australia was a founding member of the FATF and as a member it has agreed to undergo periodic of assessments of its AML and CTF systems against the FATF recommendations. The FATF last published a report on its evaluation of Australia’s AML and CTF systems on 17 October 2005 (Attorney-General's Department, 2007a).

As a result of Australia’s membership and commitment to the FATF, the AML and CTF systems are principally driven by the need to comply with the FATF recommendations. Another driver has been the need to comply with the UNCAC which primarily focuses both on confiscation and return of property when requested to do so by another state and the provision of Mutual Legal Assistance (MLA) Treaties. Recommendations 36-40 of the FATF 40 recommendations also set out recommendations for strengthening international cooperation by requiring countries to adopt the widest possible range of MLA Treaties in money laundering and CTF investigations. MLA is the process available to countries to obtain assistance from

foreign jurisdictions. Australia presently has 25 MLA Treaties (Deitz & Buttle, 2008, p. 26).

The Global Response to Money Laundering

A number of organisations, in addition to the FATF, have been created and or assigned to deal with money laundering around the world.

The International Criminal Police Organisation (INTERPOL) which has its headquarters in France functions as an agency to exchange information about crime among its 168 member nations. Each member state coordinates activity with INTERPOL through a National Central Bureau (NCB). INTERPOL has developed model legislation for member states in relation to AML issues and providing training. It also works with private groups and banks so as to put effective AML measures in place (INTERPOL, 2008).

The Law Enforcement, Organised Crime and Anti-Money Laundering Unit (LEOCMLU) of the UNODC is that organ of the United Nations with carriage of responsibility of AML activities. The program was established in 1997 in response to the mandate provided for by the Vienna Convention and its mandate was further strengthened in 1998 by the Political Declaration and Action Plan against Money-Laundering of the UNGASS (United Nations General Assembly Special Session), which broadened its remit beyond drug offences to all serious crime (United Nations Office on Drugs and Crime, 2009b).

British Commonwealth countries, saving for Australia, have been involved in a series of initiatives where member nations have established a Commonwealth Scheme for Mutual Legal Assistance in criminal matters, including money laundering. Forfeiture has also become a major issue within the Commonwealth and the

provisions for the confiscation of the proceeds of crimes are now on the books in many Commonwealth nations (Madinger & Zalopany, 1999, pp. 99-100).

The Organisation of American States (OAS) was formed in 1890 and is comprised of 32 nations in North and South America, including the Caribbean. A regional Inter-American Drug Abuse Control Commission (CICAD) was formed in 1986 to examine measures that could be taken against the drug trade, which includes measures to address money laundering activities. The CICAD has also made a series of recommendations to member states in relation to drafting model legislation on crimes related to money laundering (Madinger & Zalopany, 1999, p. 102).

The Egmont Group is an association of Finance Intelligence Units (FIU) from countries around the world and was founded in 1995 – The Australian Transaction Reports and Analysis Centre (AUSTRAC) is Australia's FIU and is a member of the Egmont Group. The FIUs act as collectors and analysts of information relating to suspicious financial transactions relating to money laundering and terrorist financing. At present there are about there are about 85 FIUs represented within the group (Madinger & Zalopany, 1999, p. 102).

Additionally, there are other regional international initiatives that have taken place with respect to money laundering. Some of those include: the Gulf Cooperation Council; The Caribbean Drug Money Laundering Conference; The Caribbean Community and Common Market; Basle Committee on Banking Regulation and Supervisory Practices; the Asian Development Bank Money Laundering Initiatives and the Asia/Pacific Group on Money Laundering (Madinger & Zalopany, 1999, p. 102).

The Australian Response to Money Laundering

In Australia “*Money Laundering*” is dealt with pursuant to the provisions contained within Division 400 of the *Criminal Code Act 1995* (“*The Criminal Code*,”) and were proclaimed in January 2003. That division of the Criminal Code criminalises money laundering and while not providing a specific definition of money laundering as such, it does make it a criminal offence to deal with money or property that is the proceeds of crime or when there is a risk that the money or property will become an instrument of crime².

The Criminal Code is not the only piece of Australian legislation designed to respond to the problem of money laundering. There also exists the *Proceeds of Crime Act 2002* (Cth), *Financial Transaction Reports Act 1988* (Cth), *Mutual Assistance in Criminal Matters Act 1987* (Cth) and more recently the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth). Additionally all states and the ACT, save for the Northern Territory, have enacted laws which create offences of money laundering at the State and Territory level.

Given the spread of legislation between the Commonwealth, States and Territories on AML there are a myriad of enforcement agencies involved in the detection and prosecution of AML offences. Such organisations include the Australian Crime Commission, the Australian Federal Police, The Australian Customs Service, State and Territory Police Services, the Australian Securities and Investments Commission, and of course AUSTRAC together with the relevant associated prosecutorial agencies.

² ss. 400.2 – 400.9.

Money Laundering in Australia

It seems that the first real attempt to quantify money laundering in Australia was conducted by Walker in 1995 (J. R. Walker, Australian Transaction Reports and Analysis Centre., & John Walker Consulting Services.). He suggested that around \$3.5b per annum were believed to be generated by crime in Australia and laundered either in Australia or elsewhere. In 2004 the issue was again revisited, this time by Walker and Stamp and by using survey methodology it was estimated that \$2.8b was laundered either within Australia or overseas from the proceeds of Australian crime (J. Walker & Stamp, 2004, p. 4). The results were derived from the respondents estimate that on average 80% of drug proceeds and around 70% of the proceeds of fraud were laundered. The 2004 report indicated that the total value of cases involving laundered money which were proceeded against was in the order of \$83m (p. 4) but the Australian law enforcement response was reported to have resulted in around \$100m in restrained proceeds of crime and over \$21m forfeited (p. 4).

Of the most recent estimate of \$2.8b laundered in Australia, Walker and Stamp concluded that it was believed that it was laundered through a range of industries including:

1. Real estate investment (23%) – \$651m;
2. Further crime activities (21%) – 600m;
3. Gambling (16%) – \$449m;
4. Luxury goods (15%) – \$424m;
5. Legitimate business (12%) - \$345m; and
6. Professional services (7%) - \$191m.

Walker and Stamp then considered the United Nations Office on Drugs and Crime (UNODC) World Drug report of 2005 in which it estimated the value of illicit

drugs around the world in 2002-2003 and combined this with the data from the AUSTRAC's 2004 survey based estimates of the percentages laundered. The result was an alternative estimate of money laundered generated by crime in Australia. The resultant figure was \$6.3b equally shared between fraud and drug offences (J. Walker & Stamp, 2004, p. 5).

It will be recalled that UNODC estimated money laundering to be between 2-5% of GDP. According to the Australian Bureau of Statistics, the Australian GDP in 2004 was \$655b (Australian Bureau of Statistics, 2004). These figures would tend to indicate that according to UNODC estimates, the amount of money laundered in Australia should sit somewhere between \$13b and \$32b.

It can be seen that studies as at 2004 of estimates of money laundering in Australia indicate that the amount of money laundered falls just below 50% of the estimates expected of a country as expressed in terms of its GDP. On this basis then, it would appear that Australia is doing better than expected in terms of the amount being laundered. Whether this can be attributed to active AML enforcement actions or not does not clearly emerge. What is clear though is that the sum of \$100m in restrained proceeds involving money laundering and \$21m forfeited falls far short of the estimated \$6.3b estimated to be laundered through Australia and more work needs to be done restraining and forfeiting the proceeds of money laundering.

Impacts of Money Laundering on Society

With the introduction of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) there was, for the first time, a requirement for professionals such as lawyers and accountants to be subject to reporting requirements that some would argue are onerous. The act places similar obligations on a number of other business sectors including: Real estate agents, jewellers, some finance brokers,

gaming machine venues, life insurance policy products, Companies that sell managed investment schemes, organisations providing non-banking financial services and some other sectors. The reporting obligations relate to customer identification procedures and reporting suspicious matters. To enable them to meet their reporting obligations they will be and have been required to implement a compliance program so as to ensure compliance. As a matter of pure business economics, these businesses will pass these costs onto the consumers of their products and services.

According to Mark, NSW Legal Services Commissioner, (2007, p. 9) many affected professionals have begun to question whether the obligations are really proportionate to the perceived AML/CTF risk. Indeed he indicates that one of the greatest concerns voiced by all affected professions is the economic and practical cost of implementing a compliance program and that overseas experience has shown that implementing such programs is costly.

The banking sector had at that time, already forecast that compliance costs associated with the new legislation would surpass \$200m whilst the superannuation industry believes that costs could amount to \$900m (Mark, 2007, p. 11).

Examples provided across NSW for sole legal practitioners, financial planners and real estate agents where solus practitioners constituted more than 80% of the market indicated that most of them were not in a position to economically or practically comply with the requirements. Mark argues that the impact of complying on the sole practitioners is an “*absolute cause for concern*” (2007, p. 11).

It can be seen that the impacts of this legislative response to money laundering has been costly to a range of business sectors across Australia. Those smaller businesses that cannot afford to comply may well fall by the way side; and this subjects the market to less competition forces. The net result on this basis alone will

be that consumers of these products and services will pay more. There should be a balance between commitment to AML and the operation of small business in the market place.

Effectiveness of Australian AML Framework

Australia has chosen to take a risk-based approach to AML/CTF compliance. It is in fact one of the first jurisdictions to enact such an approach. Ostensibly this is an approach of leaving it up to the individual organisation to determine what risk there is and then apply the principles according to that identified risk. This translates into those that have the least risk have to do the least to comply which is backed by tough penalties for failing to comply. It seems that the risk based approach is what industry wanted (Drummond, 2008).

The figures quoted above in this paper relating to \$100m restrained and \$21m forfeited as at 1994 indicate that, relative to the estimate of the money laundering through Australia, the legislative response may not be as effective as it otherwise might be. However; since that date the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) has been proclaimed and implemented in stages. The last remaining stage came into operation on 12 December 2008. The true effect of this legislation is yet to be determined. The FATF last conducted a mutual evaluation of its AML/CTF framework against the published FATF international standards in 2005 with the report being published on 14 October that same year. The report indicated, inter alia, that:

...[T]he low number of money laundering prosecutions at the Commonwealth level (ten dealt with summarily and three on indictment since 2003, with five convictions), indicat[e] that the regime is not being effectively implemented (Financial Action Task Force, 2005, p. 7).

It is to be noted that the report precedes the enactment of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth).

The report contained numerous recommendations to improve compliance with FATF recommendations and standards (Financial Action Task Force, 2005, Table 2). All of this would suggest that Australia's response to AML still has some way to go to be effective.

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