

Money Laundering

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Observer oecd

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Introduction

The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardising their source.

Illegal arms sales, smuggling, and the activities of organised crime, including for example drug trafficking and prostitution rings, can generate huge sums. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to “legitimise” the ill-gotten gains through money laundering.

When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention.

In response to mounting concern over money laundering, the [Financial Action Task Force on money laundering \(FATF\)](#) was established by the G-7 Summit in Paris in 1989 to develop a co-ordinated international response. One of the first tasks of the FATF was to develop Recommendations, 40 in all, which set out the measures national governments should take to implement effective anti-money laundering programmes.

Members of the FATF include 26 countries and jurisdictions – including the major financial centre countries of Europe, North America and Asia – as well as the European Commission and the Gulf Co-operation Council.

The FATF works closely with other international bodies involved in combating money laundering. While its secretariat is housed by the OECD, the FATF is not part of the Organisation. However, where the efforts of the OECD and FATF complement each other, such as on bribery and corruption or the functioning of the international financial system, the two secretariats consult with each other and exchange information.

This *Policy Brief* discusses the phenomenon of money laundering, how it works and the reasons why it should be combated. It also describes the work of FATF in confronting the problem. ■

Financial Action Task Force on Money Laundering

Organisation for Economic Co-operation and Development

What is the scale of the problem?

By its very nature, money laundering occurs outside of the normal range of economic statistics. Nevertheless, as with other aspects of underground economic activity, rough estimates have been put forward to give some sense of scale to the problem.

The International Monetary Fund, for example, has stated that the aggregate size of money laundering in the world could be somewhere between two and five per cent of the world's gross domestic product.

Using 1996 statistics, these percentages would indicate that money laundering ranged between 590 billion and 1.5 trillion US Dollars. The lower figure is roughly equivalent to the value of the total output of an economy the size of Spain. ■

How is money laundered?

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

After the funds have entered the financial system, the second – or layering – stage takes place. In this phase, the launderer engages in a series of conversions or movements of the funds to distance them from their source. The funds might be channelled through the purchase and sales of investment

instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the globe. This use of widely scattered accounts for laundering is especially prevalent in those jurisdictions that do not co-operate in anti-money laundering investigations. In some instances, the launderer might disguise the transfers as payments for goods or services, thus giving them a legitimate appearance.

Having successfully processed his criminal profits through the first two phases of the money laundering process, the launderer then moves them to the third stage – integration – in which the funds re-enter the legitimate economy. The launderer might choose to invest the funds in real estate, luxury assets, or business ventures. ■

Where does money laundering occur?

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

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

case, in the country where the funds originate.

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

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

How does money laundering affect business?

The integrity of the banking and financial services marketplace depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is one of the most valuable assets of a financial institution.

If funds from criminal activity can be easily processed through a particular institution – either because its employees or directors have been bribed or because the institution turns a blind eye to the criminal nature of such funds – the institution could be drawn into active complicity with criminals and become part of the criminal network itself. Evidence of such complicity will have a damaging effect on the attitudes of other financial intermediaries and of regulatory authorities, as well as ordinary customers.

As for the potential negative macro-economic consequences of unchecked money laundering, the International Monetary Fund has cited inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers. ■

What influence does money laundering have on economic development?

Launderers are continuously looking for new routes for laundering their funds. Economies with growing or developing financial centres, but inadequate controls, are particularly vulnerable as established financial centre countries implement comprehensive anti-money laundering regimes.

Differences between national anti-money laundering systems will be exploited by launderers, who tend to move their networks to countries and financial systems with weak or ineffective countermeasures.

Some might argue that developing economies cannot afford to be too selective about the sources of capital they attract. But postponing action is dangerous. The more it is deferred, the more entrenched organised crime can become.

As with the damaged integrity of an individual financial institution, there is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organised crime. ■

What is the connection with society at large?

The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. Organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments.

The economic and political influence of criminal organisations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society.

In countries transitioning to democratic systems, this criminal influence can undermine the transition.

Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue. ■

How does fighting money laundering help fight crime?

Money laundering is a threat to the good functioning of a financial system; however, it can also be the Achilles heel of criminal activity.

In law enforcement investigations into organised criminal activity, it is often the connections made through financial transaction records that allow hidden assets to be located and that establish the identity of the criminals and the criminal organisation responsible.

When criminal funds are derived from robbery, extortion, embezzlement or fraud, a money laundering investigation is frequently the only

way to locate the stolen funds and restore them to the victims.

Most importantly, however, targeting the money laundering aspect of criminal activity and depriving the criminal of his ill-gotten gains means hitting him where he is vulnerable. Without a usable profit, the criminal activity will not continue. ■

What should individual governments be doing about it?

A great deal can be done to fight money laundering, and, indeed, many governments have already established comprehensive anti-money laundering regimes. These regimes aim to increase awareness of the phenomenon – both within the government and the private business sector – and then to provide the necessary legal or regulatory tools to the authorities charged with combating the problem.

Some of these tools include making the act of money laundering a crime; giving investigative agencies the authority to trace, seize and ultimately confiscate criminally derived assets; and building the necessary framework for permitting the agencies involved to exchange information among themselves and with counterparts in other countries.

It is critically important that governments include all relevant voices in developing a national anti-money laundering programme. They should, for example, bring law enforcement and financial regulatory authorities together with the private sector to enable financial institutions to play a role in dealing with the problem. This means, among other things, involving the relevant authorities in establishing financial transaction

reporting systems, customer identification, record keeping standards and a means for verifying compliance. ■

Should governments with measures in place still be concerned?

Money launderers have shown themselves through time to be extremely imaginative in creating new schemes to circumvent a particular government's countermeasures. A national system must be flexible enough to be able to detect and respond to new money laundering schemes.

Anti-money laundering measures often force launderers to move to parts of the economy with weak or ineffective measures to deal with the problem. Again, a national system must be flexible enough to be able to extend countermeasures to new areas of its own economy. Finally, national governments need to work with other jurisdictions to ensure that launderers are not able to continue to operate merely by moving to another location in which money laundering is tolerated. ■

What about multilateral initiatives?

Large-scale money laundering schemes invariably contain cross-border elements. Since money laundering is an international problem, international co-operation is a critical necessity in the fight against it. A number of initiatives have been established for dealing with the problem at the international level.

International organisations, such as the United Nations or the Bank for International Settlements, took some initial steps at the end of the

1980s to address the problem. Following the creation of the FATF in 1989, regional groupings – the European Union, Council of Europe, Organization of American States, to name just a few – established anti-money laundering standards for their member countries. The Caribbean, Asia, and Eastern Europe have created regional anti-money laundering task force-like organisations, and similar groupings are planned for Africa and Latin America in the coming years. ■

What role does FATF play?

The [membership](#) of the FATF includes the following countries, jurisdictions, and regional organisations:

Australia
Austria
Belgium
Canada
Denmark
Finland
France
Germany
Greece
Hong Kong
Iceland
Ireland
Italy
Japan
Luxembourg
Netherlands
New Zealand
Norway
Portugal
Singapore
Spain
Sweden
Switzerland
Turkey
United Kingdom
United States
European Commission
Gulf Cooperation Council

The FATF is a multidisciplinary body that brings together the policy-making power of legal, financial and law enforcement experts from its members. The FATF monitors members' progress in implementing anti-money laundering measures; reviews and reports on laundering trends, techniques and countermeasures; and promotes the adoption and implementation of FATF anti-money laundering standards globally. ■

What are the 40 Recommendations?

Drafted by the FATF in 1990 and revised in 1996, the [40 Recommendations](#) are a comprehensive blueprint for action against money laundering. They cover the criminal justice system and law enforcement; the financial system and its regulation; and international co-operation. Each FATF member has made a firm political commitment to combat money laundering based on them.

The 40 Recommendations have come to be recognised as the international standard for anti-money laundering programmes. A number of non-FATF member countries have used them in developing their efforts to address the issue. ■

How to contact FATF

Financial Action Task Force on Money Laundering (FATF)

■ *FATF Secretariat – FATF/OECD*
2, rue André Pascal
75775 Paris Cédex 16
FRANCE
Telephone: 33 (0) 1 45 24 79 45
Fax: 33 (0) 1 45 24 17 60
E-mail: fatf.contact@oecd.org
Internet: www.oecd.org/fatf/