



**Financial Action Task Force  
on Money Laundering**

Groupe d'Action Financière  
sur le Blanchiment de Capitaux

**Report on Money Laundering Typologies  
1999–2000**

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# **FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING 1999-2000 REPORT ON MONEY LAUNDERING TYPOLOGIES**

## **I. INTRODUCTION**

1. The Financial Action Task Force (FATF) held its annual meeting of experts on money laundering methods and trends on 18 to 19 November 1999. The group met under the chairmanship of Mr. James Sloan, Director of the U.S. Treasury Financial Crimes Enforcement Network (FinCEN) and took place at the International Trade Center in Washington, DC. The group of experts included representatives from FATF members and observer members: Australia; Austria ; Belgium; Canada; the European Commission; Denmark; Finland; France; Germany; Hong Kong, China; Ireland; Italy; Japan; Luxembourg; Mexico; the Netherlands; Norway; Portugal; Singapore; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States. The regional FATF-style bodies (see below) were represented at the meeting, as well as the following observer international organisations: the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund, Interpol, the International Organisation of Securities Commissions (IOSCO), the Organization of American States (OAS/ CICAD), the United Nations Office for Drug Control and Crime Prevention (UNODCCP), the World Bank, and the World Customs Organisation (WCO).

2. This year for the first time, FATF-style regional bodies were invited to send country representatives. Therefore, India and Thailand (member countries of the Asia Pacific Group), Trinidad & Tobago and Aruba (two member countries of the Caribbean FATF), and Slovenia (a member of the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures [PC-R-EV Committee]) attended the meeting in addition to the secretariats of those bodies. The newly formed regional body, the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), was represented by Tanzania. The presence of this last group was the first at any FATF meeting.

3. The FATF Typologies Exercise provides a forum for law enforcement and regulatory experts to identify and describe current money laundering methods and trends, emerging threats, and potentially effective counter-measures. Following last year's example, the discussions at the Washington meeting were led off with a series of presentations on specialised money laundering issues identified and agreed upon beforehand. Although the primary focus of this exercise was on money laundering developments within FATF member countries, with this year's participation of countries from outside the FATF membership, an attempt was also made to look at trends in other regions of the world. As in past exercises, delegations submitted written material to serve as the starting point for discussions at the experts group meeting and to provide additional information for this report. The current report, therefore, is divided into three parts. The first deals with the four major issues examined by the experts group. These include the vulnerabilities of Internet banking, the increasing reach of alternative remittance systems, the role of company formation agents and their services, and how international trade related activities can serve as a cover for money laundering. The second part of the report focuses on money laundering trends identified in FATF member countries. It is then followed by a third part that offers an overview of trends for other regions of the world.

## II. MAJOR MONEY LAUNDERING ISSUES

### (i) On-line Banking<sup>1</sup>

#### a. *General*

4. Increasing numbers of financial institutions are now providing retail banking services through the Internet. At the same time, other entities are using the Internet to offer money laundering services -- sometimes styling themselves as legitimate “offshore financial services” or “investment opportunities”. With the burgeoning of the all types of commercial activity through the Internet and the perceived potential for abuse of this medium, the FATF experts examined this subject more closely in an attempt to draw attention to the potential money laundering vulnerabilities. This topic falls within the larger FATF effort of identifying the key money laundering implications of the introduction of new technologies.

5. The presence of financial institutions on the Internet has shown phenomenal growth over the past several years -- in one member, growing tenfold in five years -- however, it is important to distinguish between merely being present on the Internet and offering “transactional” services<sup>2</sup>. In the United Kingdom, for example, most high street banks maintain a website. Services offered range from verifying account balances to transferring funds to accounts at other institutions, although not all of these services are offered by each institution. The United States reports that some 30% of its financial institutions have Internet sites, yet an informal count<sup>3</sup> of those offering transactional services revealed only 875 banking and thrift institutions or about 7% of all institutions.

6. Transactional services vary from one institution to another but may include such activities as opening new accounts (checking, savings, etc.); bill payment; debit, ATM, and credit cards; on-line lending; and deposit taking in some cases. Although some on-line banking is offered by “pure” Internet banks (that is, only offering services through the Internet), institutions offering transactional services are for the most part already established, traditional institutions that have moved into on-line banking as an additional customer service. Indeed, in the United States only eight institutions (of the 875 offering transactional services) provided their services exclusively through the Internet.

#### b. *Impact on Money Laundering*

7. The concern in respect to on-line banking is the obvious reduction in face-to-face contact between the customer and the financial institution. The customer would normally access his or her account from a personal computer using Internet browser software and world-wide web access through an Internet service provider (ISP). Access would be obtained when the customer provides his personal identification code to the bank’s web server, and, when encryption software is used, the appropriate key is generated by the browser software. Because this access is indirect, the financial institution would have no means of verifying the identity of the individual actually accessing the account. Moreover, with the increasing mobility of Internet access, a customer has the possibility of accessing his or her account from virtually anywhere in the world. Because the access is obtained through the ISP, however, the institution would have no way to verify the location from which the account was accessed. Essentially, an individual desiring to conceal his or her true identity -- including money launderers or other criminal elements -- would be able to have unrestricted on-line access to and control of his bank accounts in any location.

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<sup>1</sup> “On-line banking” in the broader sense includes accessing financial services indirectly, that is by telephone, automatic teller machines (ATM), and the Internet. For the purposes of this typologies exercise, the focus was limited to Internet banking since this appears to be the newest area and one in which the vulnerabilities to money laundering are least understood.

<sup>2</sup> The ability to conduct financial transactions, such as, for example, direct payments, electronic funds transfers, issue of cheques, purchase of securities, and opening / closing accounts.

<sup>3</sup> As of 10 November 1999.

8. At present, the FATF experts have seen few if any examples of on-line banking being used in money laundering. Denmark cited an example in which an Internet website in another jurisdiction was used to offer money laundering services and used the name of an established financial institution as a cover for this activity. Several other member countries also cited examples of Internet sites being used in fraud activities. Given the rapid development of on-line banking services in the near term, it is difficult to say whether the lack of money laundering cases involving on-line banking is due to its absence from the Internet or the inability thus far of law enforcement to detect such activity.

*c. Impact on counter-measures and potential solutions*

9. The FATF experts raised several potential weaknesses in current counter-measures regarding on-line banking. The obvious reduction in face-to-face contact between the customer and the financial institution -- often this is the very point where an initial suspicion arises -- is of real concern. Although comparisons have been made between on-line banking and similarly de-personalised telephone and ATM banking services, which in many cases have little additional requirement for identity checks and account monitoring, the crucial point with on-line banking is that the customer can conduct transactions without any employee interaction at all.

10. Current measures in FATF member countries focus on customer identification, as a minimum, when the business relationship is established (i.e., when an account is opened). Many of the experts stated that these measures would also apply for on-line accounts. In Japan, for instance, on-line transactions may only be conducted for accounts that have been opened in a traditional, face-to-face manner. In Belgium, anti-money laundering legislation makes no distinction on whether the initiation of the business relationship takes place in person or by letter, fax, e-mail or Internet. The financial institution must in each case establish the identity of the client by means of a probative document, a copy of which must be maintained by the institution. In the United States, the opening of an account may be initiated on-line; however, the customer must provide identification numbers that are subject to verification by the financial institution. This procedure is no different from that which would apply for opening a bank account by mail.

11. Identification of the customer at the beginning of the business relationship may be, according to some of the experts, insufficient for detecting serious or organised crime structures that develop after this initial step. The nature of on-line banking itself, with an elimination of personal contact between customer and the institution, will necessarily make it more difficult to know who is actually controlling the account and what constitutes normal business practices. Indeed, with on-line banking as currently conducted, the financial institution will routinely only be able to ascertain that a particular account was accessed at a particular time, the sum involved, and possibly the beneficiary (name or account number). The bank will only be able to assume that access took place by the nominal account holder and will have no way to verify the exact location from which the customer made the transaction. This means that a single individual could ultimately control a number of accounts simultaneously without necessarily drawing the attention of the financial institution or institutions in which those accounts are maintained.

12. Another concern expressed by the experts relates to the regulatory or investigative jurisdiction that might be involved in detecting and ultimately pursuing potential money laundering violations. Internet banking, as with other on-line commercial activities, has already been promoted as having the potential to break down the barriers of national borders. A quick browse through lists of financial services available on the Internet shows a number of these that claim to offer their services regardless of the location of the account holder. Several of the experts stated that licensing requirements for domestic financial institutions would apply equally to any institution offering financial services on-line to customers within its jurisdiction. Nevertheless, the nature of the Internet is such that a particular country may find it difficult, if not impossible, to prohibit its citizens from setting up accounts through the Internet with institutions offering on-line banking from other locations beyond its borders.

13. Some FATF member countries have begun to address these concerns through the establishment of working groups or conduct of special studies. Additionally, the Electronic Banking Group of the Basle Committee is examining the issue in the context of regulation of electronic financial services. The work of this last group is ongoing, and the FATF experts expressed the hope that this initiative would indeed address customer identification procedures in the on-line financial services area. A few of the specific suggestions offered by the experts for dealing with the potential vulnerability of on-line banking to money laundering include:

- Reinforce current customer identification requirements to ensure that what are essentially “anonymous” accounts are not being established.
- Establish new procedures that will facilitate the ability of financial institutions to truly know their customers over the life of the business relationship.
- Work toward uniformity of standards among jurisdictions.
- Develop new information technology capabilities that will permit both the detection of suspicious on-line transactions and verification of the customer.
- Limit the types of permitted on-line services or the amount of such transactions.
- Restrict on-line transactions only to those accounts that have been established in a traditional manner (i.e., with face-to-face contact between customer and financial institution).
- Prohibit financial institutions not licensed in a particular jurisdiction from offering their services in that jurisdiction on-line.
- Ultimately, oversight must be exercised by both the jurisdiction chartering the internet bank and by those jurisdictions where the internet banks has clients.

14. The experts group also recognised that there was a need within the law enforcement community to develop expertise in the detection and investigation of potential money laundering in the Internet environment.

(ii) Alternative Remittance Systems

a. *General*

15. Past FATF typologies exercises and similar exercises conducted by some FATF-style regional bodies consistently indicate the very significant role that alternative remittance systems appear to play in support of money laundering. Including alternative remittance systems in this year’s exercise represents an attempt to provide a clear world-wide focus to the issue.

16. Although there is not yet a broadly agreed upon definition for “alternative remittance systems<sup>4</sup>”, there is some agreement on the common characteristics of such systems. They generally have developed, for example, based on specific ethnic, cultural or historical factors and, in some cases, are a traditional method for moving money that pre-date the spread of Western banking systems in the 19<sup>th</sup> and 20<sup>th</sup> centuries. A key factor of such systems -- and one that they share with formal or “correspondent” banking -- is that value is moved from one location to another often without the physical movement of currency. Alternative remittance systems most frequently operate outside national financial regulatory systems. There are systems, however, that employ elements of the legitimate economy or even of regulated financial services, thus complicating detection by law enforcement authorities. As pointed out by the Swedish delegation, the one consistent element in each alternate remittance system is that all the systems rely upon some form of “netting” or “book transfer” procedure to transmit value.

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<sup>4</sup> The term “alternative remittance system” is used here also to refer to what are sometimes called “underground” or “parallel banking” systems.

17. Nearly all FATF members participating in this year's typologies exercise reported having seen some indicators of alternative remittance activity in their jurisdictions. It is not clear whether this observation means an increasing presence or a better detection of such activity by national authorities. The experts believed that some of the spread of these systems to new areas is due to immigration, and indeed, such systems often serve as the primary financial service to some immigrant communities. They are secure and less expensive than traditional banks and have sometimes serve as a means to circumvent restrictive currency exchange policies. They also offer a certain amount of anonymity to the user. This last characteristic has given additional incentive for others to make use of alternative remittances systems, including legitimate businesses as well as criminal elements.

*b. Black Market Peso Exchange*

18. The first of the three major alternative remittance systems discussed by the experts is a system operating primarily in the Western Hemisphere and now commonly referred to as the "Black Market Peso Exchange" (BMPE). This system originally developed in Latin America as a parallel financial system to support both legitimate trade and smuggling between North and South America. Its development was in response to foreign exchange restrictions and, in some cases, to financial systems that were unable to provided for reliable and timely funds movements. The system followed immigration patterns and then was exploited by the narcotics trade so that it reaches today in some cases beyond the Americas.

19. Although there is now a close association between BMPE and the narcotics trade, the system is still used by immigrant workers for sending funds back to their home countries as well as by some businesses seeking more rapid payment for goods (both legal and contraband). In the general scenario with illegal funds, the operation begins with US dollars in currency derived from narcotics sales and located in the United States. The narcotics trafficker needs to use these funds to pay the supplier in Colombia; however, he cannot use a financial institution to make an international funds transfer without drawing the attention of US authorities.

20. The trafficker makes use of a "broker" who takes the US funds in at a business (perhaps a bureau de change, some other type of non-bank financial institution, or another small business). Then he arranges for a partner business in Colombia to make the funds available to the suppliers in local currency. For this service, the broker may often charge a higher percentage for the "exchange" than the official dollar / peso exchange rate. At this point the broker has successfully transferred the funds abroad without physically moving them.

21. The money flow in this system is counterbalanced in the other direction (that is, from Colombia to the United States), when the broker sells dollars to Colombian merchants who plan to bring their purchases into Colombia and avoid paying Colombian taxes and tariffs. These importers make payments to the broker in pesos in Colombia and, in return, the broker makes dollar payments to their suppliers in the United States or in some other third country.

22. Because the broker has assumed the problem of the narcotics trafficker, that is, trying to cycle large volumes of US currency back into the economy without drawing attention to himself, he may use a number of ploys to make payments on behalf of the Colombian merchants. He might, for example, deposit the currency at a US financial institution through structured transactions or under the cover of a cash intensive business. Or else he may move the currency in bulk to third country where it might be deposited without question. The funds may in either case then be used as payment to the suppliers in the form of wire transfers, cheques, or bank drafts. Occasionally, financial institutions are bypassed entirely, and currency is delivered directly to the supplier. In all instances, however, none of the financial transactions may be traced directly back to the Colombian merchant.

c. *Hawala / hundi*

23. The second of the major alternative remittance systems dealt with by the FATF experts is the hawala or hundi system. This system originated in southern Asian but has now spread throughout the world following the immigration patterns from that region (to Europe, the Middle East, eastern and southern Africa, North and South America, and other regions of Asia). Hawala is a traditional method form moving funds in south Asia, and its use is known to pre-date the introduction of Western banking practices by hundreds of years.

24. Despite its prevalence however, hawala operations are illegal in a number of locations. In India, for example, some estimates conclude that up to 50% of the economy uses the hawala system for moving funds, yet it is prohibited by law. Hawala remains a significant method for large number of businesses of all sizes and individuals to repatriate funds and purchase gold. It is also in some cases linked to the movement of narcotics funds as well as transfers associated with smuggling (especially of gold), trafficking in human beings, terrorism, corruption, and customs and excise violations. It is favoured because it usually costs less than moving funds through the banking system, it operates 24 hours per day and every day of the year, it is virtually completely reliable, and there is minimal paperwork required.

25. In hawala, funds are moved between individual “hawaladars<sup>5</sup>” which collect funds at one end of the operation and other hawaladars that distribute the funds at the other end. The system is built on a relationship of trust that is not always strictly tied to kinship or other connections. Individual hawaladars usually operate independently of each other rather than as part of a larger organisation. They generally are merchants or small business owners that operate hawala activities alongside their normal business.

26. The system operates otherwise in a similar way to the BMPE. Funds which are to be moved from the United Kingdom to India, for example, will be provided to a UK hawaladar in UK currency or some other form. This hawaladar then contacts another hawaladar by phone or fax at the destination and requests that an equivalent sum (minus a small percentage charge) be paid out in Indian rupees or gold to the individual designated by the customer in the UK. The process can also move funds in the opposite direction. In instances where accounts become imbalanced between hawaladars over time, the accounts are settled through reciprocal remittances, trade invoice manipulation, gold and precious gem smuggling, the conventional banking system, or by physical movement of currency.

27. Hawala is considered by those that engage in it as an effective means of moving money. Gold often plays an important role in hawala transactions. Hawala operations are difficult to trace because of the lack of records or, when records exist, the fact that they are somehow coded. The ethnic connection of this system and its strong reliance on trust also make it also difficult to penetrate.

d. *Chinese / East Asian systems*

28. The alternate remittance networks known as the Chinese or East Asian system began in the Far East and, as with hawala, have spread throughout the world following immigration patterns. The system is a traditional one, again as with hawala, predating the introduction of Western banking practices. Originally, it was based on “chits” or tokens<sup>6</sup> -- thus it was often referred to as the “Chit system” -- today, however, most remitters no longer use chits. The Chinese / East Asian alternative remittance system is used for both legitimate (primarily business and repatriation of emigrant income) and illegal (especially organised crime and narcotics trafficking) money movements.

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<sup>5</sup> The hawala “broker” or “operator”.

<sup>6</sup> A remitting agent would provide a chit to the customer desiring to remit funds to a distant location. The chit would then be sent to that location, and the recipient could then go to another remitter to redeem the funds.

29. The entities or agencies offering remittance services take various forms. Often the agent is located in a shop or office and provides the remittance service by itself or in combination with a variety of other services, such as foreign exchange and international fax facilities. Many trading companies and guest houses also operate remittance agencies alongside their main business. Since operating a remittance business requires little more than a fax machine, these agencies are frequently located in residences and operated by a member of the family as a part-time job.

30. A customer desiring to send money overseas from Hong Kong, for example, must first find a remittance agency that is able to remit money to the overseas destination. Normally a remittance agency will operate in parallel with a sister company or companies overseas. It will then specialise in providing remittance services to the country or countries in which their sister companies are located. To remit money, the customer deposits money into the Hong Kong bank account of the remittance agent and provides the details of the overseas person or bank account to which the money is to be sent. The remittance agent then contacts its sister company at the destination and instructs it to pay the money to the person or account designated by the customer. If money is sent to Hong Kong, the same process is used in reverse.

31. Legitimate customers normally use remittance agencies because their service is rapid and inexpensive. Remittance agencies usually charge customers less than banks for international funds transfers. These agencies also generally do not maintain extensive transaction records, require customer identification, conduct background checks on customers, or make reports of suspicious transactions to authorities. Such services are thus very attractive to individuals desiring to conceal the source or destination of their remittances. Persons using remittance agencies for these reasons include international criminals, notably narcotics traffickers, and those wishing to avoid overseas tax and currency regulations.

32. Remittance agencies make their profit by charging their customers more than the costs incurred in making the remittance. Costs are kept to a minimum when, during a given period, the total amount of money remitted from the agency is roughly the same as the amount remitted to it. In instances where there is a significant imbalance between two sister remittance services, the difference is settled by transferring money using such methods as low cost international transfer services or couriers. Remittance agencies make their money on very narrow profit margins; therefore, the volume of money dealt with must be high for business to be worthwhile.

*e. Other systems*

33. Besides the three major alternate remittance systems focused on during this typologies exercise, a number of FATF members mentioned cases or examples of similar but unrelated systems being used on a smaller scale in their countries. For example, France mentioned what appears to be a remittance network between it and North Africa. Spain also reported detecting such activity between Spain and the Spanish enclave of Melilla in Morocco. Italy cited an example in which representative offices of banks from a Southeast Asian country were providing remittance services to immigrants in Italy from that country. Immigrant populations from Turkey and from the former Yugoslavia also regularly use remittance services to move funds from Germany, and the Netherlands described a system providing this service for its immigrant population from Suriname. Although none of these systems fall into any of the larger schemes, they all share some of the same characteristics: lack of records, customer identification or regulatory oversight, and the potential for misuse by criminals.

*f. Impact on money laundering and counter-measures*

34. Alternative remittance systems appear to play a key role in a significant portion of international money movements for certain populations. Although particular schemes may use specific elements of regulated financial networks, alternative remittance systems are generally not dependent on those elements. These systems move large volumes of money in a more or less clandestine manner. Given this fact along with the number of instances where alternative remittance

operations have been related to suspect criminal activities, it is likely that such systems also are a key vector for laundering the proceeds of crime.

35. Law enforcement authorities that find connections to such systems have difficulty in tracing money flows and establishing necessary financial links to support their cases. With only a piece of the puzzle, they may not be able to separate legal from illegal money flows. This problem is further hampered by the cross jurisdictional aspects of alternative remittance systems, and law enforcement is often unable to penetrate these systems because of cultural and linguistic barriers or the close business or kinship ties of the participants.

*g. Potential solutions*

36. The experts agreed that alternative remittance systems should continue to be studied as they relate to money laundering. These systems should be examined individually to develop a better understanding of the role they play in the particular regions where they operate. They should also be looked at from a global perspective to find potential common measures that could be put into place to preclude their use in support of illegal business.

37. There are currently initiatives in some FATF member countries to address the problem of alternative remittance systems. The United States, for example, has focused part of its new national anti-money laundering strategy on seeking ways to deal with the BMPE. Interpol and the Asia Pacific Group on money laundering are engaged in projects that specifically examine hawala and the East Asian systems. Hong Kong has also conducted a survey of remittance systems operating from that location.

38. Some experts suggested that the problem of alternative remittance systems could be resolved by restricting such activity to authorised financial institutions, imposing a licensing requirement on remittance agents, or more thoroughly regulating the businesses involved in such activities. Such a system should of course also look into sanctions in case of non-compliance. While these solutions may have some merits, they do not address that fact that many of the systems have developed and flourished as “alternatives” to the formal banking system and as such have shown themselves resistant to attempts to impose record keeping and reporting requirements. As one of the experts observed, if the customers of alternative remittance systems wanted to use a “regulated” remittance service, they would already be using one. On the other hand, if regulations regarding the alternative remittance systems exist, law enforcement is essential in order to attack the illegal systems.

39. One of the experts also mentioned the possibility of looking for solutions in areas other than counter-measures. He stated that there was some evidence in his country that alternative remittance was becoming less attractive to regular customers as liberalisation of the banking system brought transaction prices down. Although the banking system still had not become competitive with such alternative remittance as far as swiftness and security (and obviously alternative remittance systems remain preferred method for tax evasion and money laundering), reforms to the banking system could draw customers away from alternative remittance systems. It follows logically, that the reduced volumes of legal moneys using BMPE, hawala and the East Asian systems might make these systems be less attractive as a cover for movements of illegal funds.

(iii) Company Formation Agents

*a. General*

40. One of the major topics of last year’s FATF Typologies exercise focused on the role of foreign legal entities in money laundering. The experts found that these legal entities, usually in combination with the barriers to obtaining information from some non-cooperative jurisdictions were a significant impediment to anti-money laundering investigations. A number of experts raised the issue of the individuals or agents that help to create such entities, the so-called “company formation

agents”, as being perhaps a key factor in an increasing number of complex money laundering schemes. This topic thus became an issue for this year’s exercise.

41. There is not yet an agreed upon definition for “company formation agent”. Based on the information from several experts and the discussions during the exercise itself, a company formation agent appears to be any agency that assists in the creation of juridical persons or legal entities -- specifically “shell companies”<sup>7</sup> -- that then may be used for various commercial purposes. Some of the types of activities seeking the services of a company formation agent might include: import / export trading companies, investment firms, holding companies, consultants, shipping firms, Internet trading firms, and individuals seeking to optimise their fiscal circumstances or protect assets.

42. A company or legal entity is formed by registering it at a national companies registry. The process varies from jurisdiction to jurisdiction but typically includes designating a director and other officers, selecting a registered office, providing for sale of shares for the company, and filing of appropriate incorporation forms at the registry. Because this process can be complicated and time consuming, individuals desiring to create such an entity have increasingly used the services of specialists in the area -- a company formation agent -- who performs the administrative task of establishing the company for the individual. The agent may be part of a law or accounting firm or may be a completely independent service.

43. As already mentioned, the procedures for company formation vary according to the jurisdiction. Company formation agents have thus taken on the role of advising clients on the best locations to establish a legal entity based on his or her individual needs matched to the appropriate jurisdiction. The agent may select a particular jurisdiction because it offers the advantages of rapid formation, low establishment costs, or minimal red tape; or else because it offers “off-the-shelf” companies. He might also choose a location because it does not include information about the owner of a company in public records, or it prohibits altogether the disclosure of such information. He then arranges for the provision of nominee directors and other company officers and registers the company in the optimum location. Increasingly, formation agents also offer other services such as mail / fax receipt and forwarding, telephone answering, administrative services, establishment and administration of bank accounts, or introductory services with particular financial institutions.

*b. Impact on money laundering and counter-measures*

44. Structures created by company formation agents to facilitate legitimate business activities might also be attractive as a cover for money laundering, particularly at the layering stage.<sup>8</sup> A launderer can, similarly to a legitimate client, seek the services of such an agent to set up legal entities in jurisdictions that do not require identification of the true owner or that refuse to disclose such information when available. The agent could arrange to further complicate the picture by establishing companies or trusts -- in still other jurisdictions -- as the owners of the company. The launderer then uses the company or series of companies in laundering operations simply by moving funds through the various company accounts.

45. In situations where a particular jurisdiction may suspect the illegal nature of funds moved through such a network, investigation is complicated by the many jurisdictions potentially involved. Some jurisdictions may be unable or unwilling to provide information on the legal entities under its registry. Without the ability to determine the true owner of these companies therefore, government authorities investigating a particular money laundering scheme will be unable to establish the necessary links from the funds to the criminal. Besides money laundering cases described by the experts, a number of FATF members cited examples in which such structures have been used in international frauds and tax evasion.

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<sup>7</sup> A legal entity having no assets or operations in the location where registered.

<sup>8</sup> This is the second stage of laundering with the funds are moved through a series of transactions to further separate the funds from connection with the criminal act that generated them.

c. *Potential solutions*

46. Varying company formation procedures, along with a lack of transparency for the process in some jurisdictions, are factors of which the money launderer may take advantage through the company formation agent. The solutions to these problems then, according to the FATF experts, fall into two major areas: Increasing oversight of company formation agents and insisting on minimum standards for company registry and administration, as well as transparency for the process.

47. The company formation agent plays the key role in this process. His expertise is essential in setting up the legal entities tailored to the particular needs of the customer, otherwise this work would have to be done by the customer directly. The formation agent is therefore in an optimal position to know the identity of the customer, the nature of the business, and the goals in establishing the legal entity. According to the experts, the agent should ideally be required to obtain a license in order to perform such services and should likewise be subject to "know-your-customer" (identification of the beneficial owner) and suspicious activity reporting requirements. Some FATF members are considering such steps. The European Commission, for example, is considering extending the anti-money laundering requirements to professions engaged in company formation.

48. Bringing company formation agents under the similar anti-money laundering requirements as those for financial institutions presents some difficulties, however. There are large numbers of such agents; the United Kingdom estimates that it alone has close to 400 such businesses. These businesses vary in size and function and do not always involve lawyers and accountants. Thus there is the problem of adequately defining the company formation agent for the purposes of imposing regulatory oversight. Moreover, once these agents are subject to anti-money laundering requirements in one jurisdiction, the problem remains of how to deal with company formation agents offering their services from jurisdictions without adequate oversight of the activity.

49. With regard to implementing stricter company formation requirements to make these entities less attractive to money launderers, the experts made several suggestions of possible measures. Some of these measures include limiting the number of nominee directorships that may be held by one person, insisting on annual reports and periodic review of company information, and establishing provisions for striking companies off the register when found not to be in compliance with these procedures. Ireland reported that it was already taking these and additional steps to deal with perceived misuse of Irish registered non-resident (IRNR) companies, and Luxembourg has just implemented stricter legislation regarding domiciliary companies registered there.

50. As with extending anti-money laundering requirements to company formation agents, improved company formation procedures only deal with part of the problem. The issue must still be addressed of how to deal with those jurisdictions that choose not to implement stricter procedures. Several of the experts emphasised that these measures must be accompanied with increased transparency in the process of company formation and registry, that is, law enforcement, judicial and regulatory authorities should be able to obtain such information.

(iv) Trade Related Money Laundering

51. FATF member countries continue to observe cases in which international trade in goods and services appear to be used as a cover for money laundering or as an actual laundering mechanism. Specific cases have been seen in which import / export activities or various commercial transactions take place that do not correspond to usual business practices or are otherwise perceived as suspicious. Authorities are often unable, however, to determine whether illegal activity is involved and, if so, the nature of that activity. Although trade activity sometimes appears to serve as a cover for certain segments of alternative remittance operations, there are many other instances in which the trade activity is not part of such a larger operation.

52. One way that illegal funds may be laundered, according to an example mentioned by Germany, is through over or under-billing in cross-border transactions. In one case, a merchant was identified who had paid large sums of money for worthless goods. The payments made were in fact narcotics proceeds, and the goods, when received were either thrown away or sold as junk. The “trafficker” was thus able to move his illegal proceeds out of the country under the cover of a payment for goods received. In other instances, cash proceeds have been used to purchase high value items (automobiles, aeroplanes, yachts, etc.) which were subsequently exported to narcotics producing countries. In southern Africa, the transit trade in goods from the coast to landlocked countries frequently serves as a cover for proceeds of corruption.

53. In most jurisdictions, customs clearance officials (that is, the authorities responsible for inspecting incoming and outgoing shipments of goods) do not usually focus on import / export activities as a cover for money laundering. These officials have been trained for the most part to look for contraband, illegal narcotics or failure to pay appropriate customs duties. Goods shipments relating to money laundering would be more difficult to detect, as the perpetrators generally are willing to pay necessary duties so as not to draw attention to the operation. If an incoming shipment is declared at a value over its real worth, for example, customs officials might find this unusual; however, it would also be seen as a source of increased excise income.

54. As was suggested by some of the experts, customs officials can make a significant contribution in the detection of trade related money laundering given their key role in overseeing cross-border commerce. These officials review documentation that accompanies shipments and are thus in a position to differentiate between usual and unusual import / export business practices. One expert suggested establishing a system whereby suspicious trade activity could also be reported and then compared with disclosures of suspicious financial transactions. Since laundering activity may make use of legal appearing movements of goods, intensified sharing of information already available might be considered between customs clearance authorities and anti-money laundering authorities. The point was raised by one expert that increasing the amount of information available to anti-money laundering authorities could overwhelm the mission of detecting laundering activity in the financial network. Several other experts, however, cited their jurisdictions as examples where such co-operation is in place and appearing to be beneficial to the anti-money laundering effort.

55. At the end of the discussion of trade related money laundering, there was strong support among the experts for further study of the subject and especially how it might relate to alternative remittance systems. On an informal basis, member states who have a keen interest in this subject were encouraged to share experiences with each other.

### **III. MONEY LAUNDERING TRENDS**

#### **(i) Sources of illegal funds**

56. Narcotics trafficking remains the single largest source of criminal proceeds according to most FATF member countries. As reported last year, the next largest source of funds are the various types of fraud (bank / financial, value added tax, fiscal, mortgage, telemarketing, etc.), although the fraud category is the most important source of laundered money in at least two jurisdictions. Another jurisdiction has observed that the various types of fraud, if measured in the amount of money involved rather than the number of cases, would be the primary source of laundered funds in that country. Smuggling, casino gambling, and, increasingly in one case, trafficking in human beings are examples of other sources of laundered funds detected. A number of submissions also mentioned tax evasion as another source for laundered funds.

(ii) New methods or techniques and significant changes in trends

57. Continuing the trend noted in last year's exercise, FATF experts found that there were few truly new money laundering methods detected in their jurisdictions. New methods that were indicated generally were techniques that had been described in previous typologies studies but had not yet been observed in a particular country. For example, Australia reported detecting for the first time the use of fraudulent credit cards in money laundering schemes or operation of alternative remittance system "netting off" operations. Denmark cited a laundering scheme in which winning lottery tickets were sold for a sum above their nominal value. The purchaser (the money launderer) would pay for the ticket using criminal cash proceeds and would thus rid himself of the problem of disposing of the currency.

58. Other information furnished by the typologies experts and in the written submissions of FATF members reinforces the importance of the methods discussed in this year's specialised topics. This year saw additional members -- among them, Germany, Ireland, Spain, Switzerland -- report or provide specific cases examples of connections to the major alternative remittance systems. Interestingly, as indicated in the discussion on the specialised topic, France and the Netherlands reported evidence of remittance systems unrelated to these systems (with North Africa and Suriname respectively).

59. A number of FATF members also emphasised the role that legitimate remittance services still seem to have in many money laundering schemes. The Netherlands has seen an increased use of such services in schemes involving that country, although it recognises that this increased detection could also be due to the additional emphasis placed on bringing remittance businesses under anti-money laundering regulations. In other jurisdictions, however, ensuring that laws and regulations on customer identification, record keeping and suspicious transaction reporting are adequately implemented in the regulated money remittance sector is still perceived as a significant problem. As pointed out by one member, there is not much difference between international remittance companies and alternative remittance services as far as necessary infrastructure at the agent level. Usually, a fax machine, a telephone, or computer access is all of the technology necessary to be able to perform such a service.

60. Techniques that closely resemble other types of violations of laws -- usually involving various trade activities -- also remain high on the list of money laundering methods observed by FATF members. Several reports from members described schemes that involve trafficking in new or used vehicles (bought or stolen). The vehicles serve either as the source of illegal income laundered or else they serve as the means by which other illegal income is laundered. Similarly, tobacco, alcohol, textiles, and precious metals were also cited as being frequently related to such activity. The difference may seem subtle as to whether a shipment of a particular product is being used for money laundering or is simply to smuggled merchandise. However, determining the difference between money laundering and "ordinary smuggling" may indicate which law enforcement agency follows up on a lead or investigates a case and thus may be an important factor in combating this technique.

61. A further example of the merging of techniques relating to other types of violations with those of money laundering is the often cited "Value Added Tax (VAT) carousel fraud". This type of fraud occurs in the European Union and functions by a series of invoice manipulations that take advantage of differences in VAT rates between EU member countries and the fact that businesses in one EU country may legally import goods from another EU country without reporting the VAT. The term carousel is used for this fraud because the goods involved may appear to move in a circle among several businesses generating illegal income with each cycle. The over and under invoicing that takes place in this scheme appears very similar to that which takes place with laundering. The primary difference, however, is that the invoicing in VAT carousel frauds is designed to avoid payment of VAT, while invoice manipulation for laundering is generally done in such a way that appropriate taxes and duties will be paid so as not to attract attention to the operation.

62. The use of professionals specialising in the creation of legal entities as mechanisms for money laundering has already been described in the discussion of company formation agents. FATF members continued this year to note that other professions -- solicitors, notaries, and accountants, for example -- frequently play a role in money laundering schemes. These professionals sometimes do act in the capacity of company formation agents. Indeed, in some jurisdictions, these professions may be the only ones who may perform such a function. According to one member, it has often been legal or accounting professionals, who, acting on their client's behalf, have liberally used "tax avoidance" as the explanation for what otherwise appears to be a suspicious financial transaction. The United Kingdom offered telling statistic related to this issue. Although some 300,000 legal professionals are subject to the same suspicious transaction reporting requirements as financial institutions, there were only 370 such reports filed by these professions in 1998.

63. Contributions to the typologies exercise also indicated that there may be a similar move to the use of other professionals for money laundering. Specifically mentioned were securities and commodities brokers. The financial services represented by these brokers would be attractive to launderers because the large sums involved would not necessarily draw attention as they might in a financial institution. In addition, there would be significant reasons that a broker might not report a suspicious transaction: the high volume of the transaction, the emphasis on potential commission rather than possible wrongdoing of the customer, and the reluctance in many cases to accept that the market or product is at risk of misuse by criminals. One member has also noted what increasingly appear to be attempts to co-opt employees of financial service providers either to participate in a money laundering scheme or be less observant regarding anti-money laundering rules.

64. Legal entities or other types of types of legal relationships (such as trusts) formed by these professionals remain ubiquitous in money laundering schemes described by FATF members. The FATF has in the past examined the role of shell and other forms of offshore companies in laundering schemes, including, most recently, last year's typologies exercise. The latter category of legal relationships -- in particular "offshore trusts" -- has not yet been the subject of any in-depth examination as to potential uses in money laundering, however. These relationships nevertheless appear to be another means by which an individual may dissimulate the true owner of an asset thus making them a potentially useful tool in money laundering.

65. Real estate, according to several FATF members, remains a vehicle for money laundering or a place for investing laundered funds. In some cases, mortgage loans on a property serve as the method when the launderer in essence loans himself the money, thus giving apparent legitimacy to the funds. Switzerland cited several cases in which real estate transactions were apparently used as a cover for suspect funds. Norway described a practice that may indicate a new effort among launderers to protect their real estate assets from potential confiscation. Specifically, a launderer rents his residence from a company registered in an offshore location. The company itself is owned by the launderer. If the launderer should be caught, the property would not be subject to confiscation if the authorities cannot establish the ownership link between the suspected launderer and the company that ostensibly owns the property.

66. Several FATF members also continue to provide examples in which insurance brokers or products play a role in laundering money. Life insurance policies purchased with a single cash payment or early encashment of the policy are two methods cited. Another technique is to use insurance policies as collateral security for the granting of a real estate loan, or, in one instance, an insurance broker used his access to high volumes of cheques and currency to carry out unlicensed banking activities and run a profitable money laundering operation.

67. Examples in which gambling plays a role in money laundering -- either as the source of criminal proceeds or as a means of laundering them -- likewise continue to be cited by many members. According to one submission, large scale regular betting is frequently preferred as a laundering method by some elements because it does not have the same risks as moving funds through financial institutions. The issue of Internet gambling raises concern among some members,

which see these services as offering a high degree of anonymity and secrecy to the potential money launderer. One member reported having detected what appeared to be a money laundering scheme through a virtual casino on the Internet. Though the site was ostensibly located in the country that reported the scheme, the server for the site was found to be in reality at a location in the Caribbean region.

68. Many of the so-called unsophisticated money laundering techniques have not disappeared and continue to be observed even as part of some of the more complex laundering schemes. Using accounts with false names is one such method reported by many FATF members. Structuring transactions represents another method that is used either as a primary laundering scheme or as part of a larger one. For example, Australia mentioned that structured account based transactions and purchases of international funds transfers continue to be commonly found in case studies received. In Belgium, structure transactions at bureaux de change are prevalent.

69. The United States has found what appears to be structuring activity through automated teller machines (ATMs). This activity was detected through a review of suspicious activity reports. Multiple cash deposits are made at the same or different ATMs in the United States or the account receives multiple wired funds from abroad. Subsequently, the funds are withdrawn from ATMs in countries with high risk for narcotics or money laundering. Other members also cited this method as one used for permitting an individual to gain access to assets ostensibly held by offshore trusts but in reality controlled by the individual.

70. Yet another laundering technique that shows no sign of abating is currency smuggling. In this method, criminal proceeds in cash form are moved across the border in an attempt to avoid the attention they might attract if deposited directly into a financial system. The intention is usually then to place them into the financial system of a jurisdiction where there will be less scrutiny. Interestingly, a number of the operations cited by FATF members this year seemed to go against this logic, with launderers moving cash proceeds from a vigilant jurisdiction across the border to another equally vigilant one. In at least one case, launderers even attempted to use currency import / export declarations as the ostensible justification for the import of what turned out to be criminal proceeds.

71. The United States included in their submission a section on attacking the funds of terrorist organisations. They explained that uncovering and interdicting the finances of terrorist organisations with existing anti-money laundering laws and FATF guidelines require that policy makers and law enforcement officials study the issue, recognising that terrorists' revenues, expenditures, and methods of moving funds may differ from profit-oriented organised crime networks. The United States suggested that anti-money laundering measures may therefore play a role in combating terrorism. It was recognised that there is a need to better educate law enforcement about the intricacies of terrorist financing.

(iii) Counter-measures (new or modified)

72. The nature of money laundering is such that it changes quickly in reaction to the various countermeasures arrayed against it. Despite the persistence of this problem, however, FATF member countries continue to re-examine, adapt and refine their anti-money laundering efforts when necessary.

73. The United States has established a comprehensive National Money Laundering Strategy that brings together a number of initiatives. It calls for the designation of high-risk money laundering zones which will permit co-ordinated law enforcement efforts and rules requiring the scrutiny of suspicious activity reported by a wide range of financial institutions, from money transmitters to broker-dealers and casinos. The strategy envisages the submission of the Money Laundering Act of 1999 to bolster domestic and international enforcement powers, including provisions to make a broader range of international crimes -- from arms trafficking to public corruption and fraud -- subject to criminal prosecution. It also envisions a review of measures that would restrict the use of

correspondent accounts in the United States by certain offshore or other institutions that pose a money laundering risk. Lastly, it seeks to intensify pressure on nations that lack adequate anti-money laundering controls.

74. In August 1999, Japan enacted legislation that will greatly reinforce its anti-money laundering system, the Anti-Organised Crime Law. This legislation will extend predicate offences to more than 200 serious crimes and establish a financial intelligence unit (FIU), the 'Japan Financial Intelligence Office' (JAFIO), under the Financial Supervisory Agency (FSA). The unit will receive suspicious transaction reports and disseminate them to law enforcement agencies. In order to facilitate the launching of the FIU, the FSA has engaged in extensive dialogue with the financial sector thus raising public awareness of the importance of STRs in combating money laundering. The law is to take effect in early 2000.

75. Other FATF members are also moving to enhance the legislative basis for their anti-money laundering programmes. Denmark, for example, is considering the possibility of replacing the receiving offences in the Penal Code (which cover money laundering) with an all crimes offence. The Netherlands likewise is studying a proposal to create a separate offence for money laundering rather than the current inclusion under the receiving provisions of the Penal Code.

76. Faced with the continuing perception that its registered non-resident companies were somehow being misused money laundering schemes, Ireland introduced measures into the 1999 Finance Act to remedy some of these problems. The provisions made these companies resident in Ireland for fiscal purposes (subject to certain exemptions). Additional measures focusing specifically on company formation are also contained in an improved company law currently under consideration in the Dáil.<sup>9</sup> Luxembourg has likewise implemented legislation that limits certain types of financial transactions to financial institutions, other financial and insurance professionals, auditors, and accountants. It also enacted legislation that serves as the legal basis for international co-operation in the area of money laundering. Spain is considering measures that would restrict or prohibit the use of tax havens or offshore financial centres.

77. Since last year's typologies exercise, several FATF member countries have expanded the range of professions that is subject to anti-money laundering legislation (specifically, customer identification, record keeping, and suspicious transaction reporting). Belgium extended these requirements to accountants and fiscal advisors; France, to notaries and other real estate professionals; and Luxembourg, to auditors, notaries, casinos and other gambling businesses. Italy now has a series of non-financial professionals that are subject to these rules.

#### (iv) Information from FATF-style regional bodies

78. Money laundering activity is not limited to FATF member countries. As in past years, the FATF typologies has attempted, therefore, to provide a short overview of some of the money laundering methods and trends in other areas of the world as observed by FATF members. It should be noted that increasingly other voices are making themselves heard in providing this sort of information, in particular the FATF-style regional groups, which are starting or reinforcing their own efforts to examine the phenomenon of money laundering. Despite these efforts, however, countries involved in such efforts are the minority, and some regions have yet to begin looking at laundering as a problem at all. For this reason, the following paragraphs should be seen as, at best, a partial overview of money laundering trends for the rest of the world.

##### *a. Asia and the Pacific Region*

79. Sources of information for this vast region are limited but show signs of improving. A particularly positive development is the active participation of countries of the region in the

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<sup>9</sup> The Irish Parliament.

typologies exercise of the Asia Pacific Group on Money Laundering. The APG held its second exercise in March 1999 in Tokyo, and the typologies exercise now has become a regular feature on the APG calendar. Alternative remittance systems were the focus of the Tokyo meeting. A working group was established during the meeting to examine the money laundering threat of underground banking and alternative remittance systems. It was charged specifically with compiling and analysing cases on the subject. The final study will be presented at the next typologies meeting planned for March 2000 in Bangkok. This work will contribute greatly to understanding and ultimately better responding to the money laundering threat posed by hawala and the Chinese / East Asian alternative remittance systems.

80. Sources of criminal proceeds in the region are believed to continue to be such activities as trafficking in human beings and illegal narcotics, gambling, organised crime, and frauds (in one example, using a religious organisation). Among the most important laundering methods is most the use of alternative remittance systems as have been described elsewhere in this report. Indeed, the use of these systems appears to be reinforced in the two largest economies of the region as a means of evading foreign currency controls. Other methods used include real estate investment, commingling illegal funds with the proceeds of legitimate businesses, and other types of investments, as well as structuring and cash smuggling.

81. Some of the countries of the region are attempting to develop and put into place effective anti-money laundering programmes. Thailand, for example, recently enacted comprehensive anti-money laundering legislation and plans to have it implemented during the course of 2000. In India, a bill is being considered that will criminalise money laundering. In response to criticism of a lack of money laundering controls and abuse of company formation procedures in some South Pacific islands, an initiative has been launched through the South Pacific Island Forum<sup>10</sup> to examine some of these jurisdictions to determine what remedies may be warranted.

*b. Central America, South America, and the Caribbean Basin*

82. Narcotics trafficking continues to be the key source of and the determining factor for the money laundering of this region according to information and case examples provided by FATF members. A large portion of funds that are laundered in region come from outside the area. These funds are not all narcotics related; however, it is difficult to determine the specific criminal sources.

83. The CFATF is the FATF-style regional body for the Caribbean region. It too has a typologies programme to serve as forum for examining money laundering trends and patters. As reported last year, CFATF has completed its own study of laundering through international financial transactions that use domestic and offshore financial institutions as well as one on vulnerabilities of cyber crime. It plans to examine free trade zones and their potential money laundering role in the coming period. With regard to the whole region, including the Caribbean, the Organisation of American States (OAS) / CICAD money laundering working group now holds a typologies exercise that focuses on the 34 members of that organisation. The second such exercise was held in Washington in July 1999.

84. Examples of money laundering techniques for this region resemble many those already described throughout this report. According to one of the experts, the most important techniques include: structuring, casinos and other gambling activities, insurance agencies / products, mortgage or other types of loans, alternative remittance systems, commingling illegal funds with legitimate commercial deposits (or in some cases with the funds administered in trust accounts), etc. Most, if not all, jurisdictions in the region have criminalised money laundering; however, inadequate implementation of preventative measures remains common. Case examples provided by FATF members appear to indicate that launderers take advantage of bank secrecy rules and especially company formation rules that make determining links to the true owners of particular proceeds or assets difficult or impossible.

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<sup>10</sup> With the assistance of the APG, Australia, New Zealand, and the United States.

c. *Central and Eastern Europe*

85. The Central and Eastern Europe region continue to be cited as a significant source for what appear to be criminal proceeds. Law enforcement and judicial authorities in FATF member countries have been aware of this phenomenon for some time but media coverage – especially during the last year – of laundering operations originating from Russia have brought additional attention to the potential scale of the problem. In addition, capital flight from Eastern Europe and Russia in recent years has helped to create an environment in which the movement of criminal funds from out of the region has become even more difficult to detect. Obstacles to obtaining intelligence and evidence on individuals or proceeds from law enforcement or judicial authorities have added to the problems of authorities of other countries.

86. The Council of Europe PC-R-EV Committee, in addition to its work of evaluating the anti-money laundering systems of its 22 members, has also begun looking at money laundering trends and patterns from a regional perspective. As reported last year, the FATF-style regional body held its first typologies exercise in December 1998 and plans to hold another such exercise at its next meeting in February 2000. The focus of this exercise will be organised crime.

87. In Central Europe, one newly detected money laundering method involves the use of legitimate remittance agencies such as Western Union to move funds out of a particular country. This method is especially prevalent with funds derived from narcotics or human being trafficking. Other methods include using loans to legitimise funds embezzled from state-owned enterprises and the use of non-resident bank accounts by companies registered in offshore locations. According to one of the expert's at this years typologies exercise, this last method poses particular problems for investigators in determining beneficial owners and account relationships.

d. *Middle East and Africa*

88. Information for these two regions remains very limited. For the Middle East, FATF members offered little additional material beyond that which was provided last year. As reported then, a number of factors favourable to money laundering are known to be present, while few of the jurisdictions located there have comprehensive anti-money laundering programmes in place. In the Mediterranean area, there are some examples of alternative remittance activity to and from Morocco and Algeria. The activity in Morocco is believed to be related to narcotics trafficking and some smuggling and also involves the Spanish enclave of Melilla. Although an alternative remittance system has been detected relating to Algeria, at present, no criminal activity has yet been associated with it.

89. Africa south of the Sahara was characterised last year as vulnerable to money laundering. Corruption, smuggling, and arms trafficking are some of the sources of criminal proceeds generated in the region, although little is known about how, if at all, such proceeds are laundered there. Few jurisdictions have criminalised money laundering with the exception of the Republic of South Africa, and it has yet to enact and implement the preventative aspects of its anti-money laundering programme.

90. There are encouraging signs that the situation throughout Africa south of the Sahara is about to change with the creation of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) in August 1999, which, as the name suggests, is made up of countries in that region. The formal establishment of a similar FATF-style regional body for the countries of central and western Africa (the Intergovernmental Task Force against Money Laundering in Africa – ITFML / Africa<sup>11</sup>) took place in December 1999 at the Summit of the Economic Community of Western African States (ECOWAS). FATF welcomes these initiatives and hopes that they will be able as part

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<sup>11</sup> *Groupe Intergouvernemental d'Action contre le Blanchiment de l'Argent en Afrique* or *GIABA / Afrique*.

of their work to focus some attention on identifying and analysing money laundering methods and trends in their respective regions.

## V. CONCLUSIONS

91. This marks the third year that the FATF group of experts on typologies met to discuss a series of specialised money laundering topics. The Washington meeting focused on four major areas that had not previously been fully explored and thus further explained and supplemented information on the basic techniques and mechanisms of money laundering dealt with in previous exercises.

92. Given the rapid increase of financial services offered over the Internet, it is the ability to perform transactions on-line where the greatest vulnerabilities to money laundering lie at present. Transactional on-line services are already offered by a growing number of existing “high street” banks as well as a few pure Internet banks. The potential money laundering risks arise from the inability of financial institution to positively establish the identity of a particular transactor or even to determine the location from which he is making the transaction. The ability to access an account from a cross-border location raises the issue of how to determine regulatory or investigative jurisdiction when on-line transactions might have been for money laundering. Although there have been no money laundering cases detected using this mechanism thus far, on-line banking as a potential tool for the money launderer is here right now and not a future possibility. This technology thus deserves additional scrutiny, even if only from examining the implications on-line banking might have on customer identification. The FATF will continue to study the issue.

93. Alternative remittance systems frequently serve as the backbone of money laundering schemes throughout the world. Three major systems --Black Market Peso Exchange, hawala / hundi, and the Chinese / East Asian systems -- although different in regional, economic or cultural origins, share a number of common characteristics. The advantage these systems provide to money launderer is to ability to move funds rapidly over great distances leaving little audit trail -- or none at all. Remedies to this problem could include expansion and more thorough implementation of regulatory controls and licensing requirements, or, as in one expert’s suggestion, attempting to lure legitimate funds to the regulated financial sector. The current regional and national initiatives to study these systems and their use for money laundering should be encouraged.

94. The role that company formation agents may play in money laundering is becoming clearer. The launderer takes advantage of the agent’s expertise in varying company registration procedures. This expertise, together with the banking or corporate secrecy of in these jurisdictions, go to create a barrier of legitimate seeming corporate structure that further separates the beneficial owner (the launderer) from his illegal proceeds. Company formation agents are, for the most part, not specifically subject to anti-money laundering rules. Extending the rules to this sector might be a solution on a national level; however, this solution does not address the problem of services provided from locations outside of the jurisdiction. Another possible solution is to promote a minimum standard in company formation procedures -- perhaps limiting the number of directorships an individual may hold or striking companies off the register when they fail to comply with the procedure, etc. Again, however, these solutions will not work if standards are not adhered to by all jurisdictions.

95. Trade related money laundering elicited a great deal of interest as a specialised topic this year. The experts have observed an increasing trend for trade activities to be used both as a cover for money laundering and as an actual money laundering mechanism. Although it frequently appears in the context of alternative remittance systems, trade related money laundering is not exclusively tied to such systems. Indeed, several delegations provided examples of laundering through import or export of goods in operations that were obviously not tied the alternative remittance as well as those that were. Customs officials responsible for import/export controls have access to useful information on cross-border movements of merchandise, yet this information is not being exploited fully in most

jurisdictions from the point of money laundering investigation. The FATF will continue to study this subject and, in particular, examine the relationship between trade activity and alternative remittance systems, as mentioned in paragraph 92 in the context of the next typologies meeting.

96. Money laundering is a phenomenon that obviously involves countries and territories both within and outside the membership of the FATF. Anti-money laundering measures implemented over the past decade have helped FATF member countries in detecting and ultimately better understanding the problem within their jurisdictions. Until recent years, the FATF was virtually alone in attempting, on an annual basis, to develop a comprehensive view of money laundering trends and patterns. However, a certain number of non-FATF countries throughout the world, as they implement anti-money laundering programmes, have begun examining laundering methods and trends within their borders. They are also beginning to share this information, especially within the framework of typologies exercises held by FATF-style regional bodies. Regional typologies exercises can only be seen as a positive development, yet there are still some obstacles to making this a truly global effort. One of these is the lack of overall co-ordination among the various typologies exercises to permit, for example, a co-ordinated approach to specialised topics. Another perhaps more important issue, however, is the fact that there are still jurisdictions in some regions that do not see the value of examining money laundering methods and trends. Engaging these countries in this work should be a priority for the near term.

3 February 2000

# ANNEX TO THE 1999-2000 FATF REPORT ON MONEY LAUNDERING TYPOLOGIES

## Selected cases of money laundering

### Case N° 1: Alternate remittance system (Example 1)

#### Facts

This case involved a number of overseas remittance services. Common elements of these services were that they operated from retail shops selling clothes or fabrics and arranged the transfer of money to Country A (for a fee).

The largest remittance service among those investigated, 'Servicio Uno', operated as an incorporated company and had an annual turnover in excess of USD 3.3 million. It accepted money from individual customers and also received funds from smaller remittance services locally and regionally. These smaller services channelled money through Servicio Uno because it had an extensive family-based delivery network in Country A.

The general method used by Servicio Uno was as follows:

Cash was received from customers and sub-agents; a proportion of these funds was deposited in a bank, and some was kept on hand.

Funds were transferred to Country A in two ways: either by telegraphic transfer purchased with cash or cheque or by sending money to a trading company, 'Trans-Expedición SA', in Country B. This second company does business in Country A and has associates there that owe it money. Once Trans-Expedición received the money in Country B from Servicio Uno, it advised its debtors in Country A to pay a specified amount directly to another remittance business, 'Remesas-X,' in Country A.

Twice weekly, Servicio Uno faxes a list of required deliveries to a company it owns and operates in Country A, including details of the sender, the recipient and their address, and the amount and type of currency or gold bars to be delivered.

A fee of 5-10% was charged by Servicio Uno.

There was also evidence of substantial amounts of money flowing from Country A back to Servicio Uno. A fax was sent from Country A to Servicio Uno instructing it to provide a specific amount of money to an individual in Servicio Uno's country or to pay the funds into a particular bank account there. No funds were actually transferred from Country A. Instead, a method was used whereby the remittance services at either end of the operation paid off each other's liability with their assets.

#### Results

Investigations revealed that several legitimate businesses in Servicio Uno's country had also repatriated funds to Country A using this method. They also revealed that a previously convicted money launderer had on at least one occasion transferred USD 60,000 to Country A through Servicio Uno. Additionally, one sub-agent of Servicio Uno transferred funds on behalf of two active drug traffickers.

#### Lessons

This is the classic example of an alternative remittance system. The difficulties that an investigative agency might have if it were to detect part of the scheme would be able to determine the links to and

from the third country. The process would be further complicated by the high volume of legitimate business using this channel to move funds.

### **Case N° 2: Use of bank safety deposit boxes**

#### Facts

A law enforcement investigation centred on the suspicious behaviour of a bank customer who appeared to be exchanging old, outdated banknotes for a new series of banknotes. The suspect appeared to be storing the old banknotes in one of the bank's safety deposit boxes.

The suspect received a social security payments and had no other identifiable legitimate income.

Further enquiries revealed that the suspect had an extensive criminal history and had recently purchased a motor vehicle with a large amount of cash and owned a number of high value real estate properties.

#### Results

The investigation established that the suspect was involved in drug cultivation in the houses that he had purchased using the proceeds of his drug trafficking activities. The suspect was using the bank's safety deposit facilities to store cash obtained from the sale of the illegal drugs and also to store jewellery purchased with the same proceeds.

#### Lessons

This example was included to illustrate that a complicated money laundering scheme is not always necessary to insert illegal proceeds back into the circulation.

### **Case N° 3: Offshore companies used to establish the bona fides of a business**

#### Facts

A 'dormant' offshore company was bought by a company located in Country S using credit cards. The purchase was carried out by a lawyer acting on behalf of a criminal organisation. The registered office of the offshore company was an address in Country S, while the contact address for this company was simply a telephone with automatic voice mail facilities.

The articles of incorporation of the offshore company and reference documents for the new director were used in a Central European country to open a bank account. The account was then used for the cashing of thousands of stolen 'Eurocheques'. The proceeds were then transferred by couriers to Country C where it was exchanged for other foreign currency in several bureaux de change and used mainly for private purposes.

#### Lessons

Criminal organisations may use easily obtained incorporation documents as a means of establishing their bona fides for setting up accounts or other legal entities which may then be used for money laundering.

#### **Case N° 4: Laundering through temporary bank accounts**

##### Facts

An investigation revealed that the proceeds of a VAT evasion scheme were laundered through a series of temporary bank accounts. The launderer transferred the proceeds to a particular financial institution and requested that the funds be placed into a temporary account because he had not decided in which account to place them. A few days later, he instructed the bank to pay out the money in cash or with a bank cheque. The transaction was not registered on the books of the launderer. Investigators also discovered that, although not a usual action, the launderer used the temporary bank account for more than one transaction. Afterwards, he asked the bank to transfer the funds to accounts (at the same bank or another), which had been opened on behalf of companies controlled by the launderer. False invoices for fictitious deliveries to these companies were used to justify the transfers.

##### Lessons

Analysing and investigating transactions involving temporary bank accounts is very difficult. Often research must be done manually at the bank where the transactions occurred, thus there could be an extensive delay before the institution may be able to provide the information to authorities.

#### **Case N° 5: Alternative remittance system (Example 2)**

##### Facts

The difficulties experienced by the banking system of Country N (lack of foreign currency, lack of confidence in the system, high taxation and slowness of international banking transactions) have led the appearance of a parallel banking system.

Country N expatriates who have worked in Country G prefer for the most part to maintain their bank account at an institution in Country G upon retirement even if they leave the country at that time. In this way, their social security pension can be deposited directly to their account in Country G currency.

When these retirees are in Country N, either to live or to spend their holidays, they have the problem of converting their money into local currency. Since they usually do not have any confidence in the banks or postal money orders in Country N, they will write cheques in the currency of Country G that they will then give to individuals who specialise in this sort of transaction. These money converters then provide the retiree with the equivalent in Country N currency. The transactions take place for the most part in the street, as the money converters are apparently very easy to find.

The cheques are gathered and returned by courier to Country G where they are deposited in collector accounts that have been set up in Country G banks by non-residents from Country N.

These collector accounts, essentially fed by the deposit of retirees' cheques, then are used to finance the purchase of goods and merchandise that will be sent back to traders in Country N. These purchases take place in Country G and elsewhere in the world, which explains numerous international wire transfers from these accounts.

The Country N traders, having made their orders abroad and used the collector accounts to make their payments, then reimburse the money converters in Country N currency. This money never leaves Country N and thus serves as the funds that will be used for cashing the retirees' cheques.

## Results

This system is thus based on compensation, that is, the funds are not moved by wire transfer between Country N and Country G. Only the cheques in Country G currency written in Country N move physically to Country G to be deposited. Huge sums of Country G currency circulate through the collector accounts each day. Fees or commissions on the conversions or transfers are not yet known.

## Lessons

Such a system runs the risk of being used for money laundering, hidden in the masse of funds movements. An investigation is ongoing. At present, no money laundering has yet been detected. The only violation so far has been conducting banking operations without a license.

### **Case N° 6: Money laundering through purchase of luxury items**

#### Facts

The financial intelligence unit of Country R received a suspicious transaction report on large purchases of Country F currency totalling USD 263,000 and carried out by that a citizen of Country R.

The funds in Country F currency were used for the purchase of new motor vehicles in Country F. However, the transactions detected appeared to include only a part of the funds moved by the individual and his associates.

Indeed, the organisation to which the individual belonged regularly acquired new motor vehicles in Country R for payments in cash from a large dealership – either in collusion with the organisation or turning a blind eye to the activity.

The purchased vehicles (for around USD 30,900 each in the verified cases) were delivered and then driven to a neighbouring country where they were received by a close relation of the main individual in the scheme and known by authorities to be involved in narcotics trafficking. The vehicles were then exchanged for large quantities of drugs that were to be resold in Country R.

#### Results

The case was turned over to the prosecutor for investigation. Since the case was turned over, the total amount of money involved in the scheme has risen to USD 355,000.

#### Lessons

The scheme used in this case made it difficult to detect the funds placed in Country R because of the use of a large scale business (a motor vehicle dealership) and the transactions carried out in the currency of Country F which is generally considered an unlikely currency for narcotics related money laundering.

### **Case N° 7: Use of a bureau de change, accounts under false names**

#### Facts

A current drug trafficking investigation has established that cash collected from the sale of drugs was taken to a bureau de change at the border where large sums of money in small denominations were exchanged into denominations of a foreign currency. This money was then moved in bags of cash across the border and abroad to purchase a further supply of drugs.

Further investigation identified a scheme in which illegally obtained funds were deposited under a false name into a holding account within the bureau de change, which was controlled by the money launderer. During a search of the premises, it was also established that the bureau de change did not maintain detailed records of cash transactions.

### Results

At present, there are three individuals charged with money laundering in this investigation.

### Lessons

Although this bureau de change was required to identify customers and maintain records, it did not do so. A money laundering operation was uncovered through the police investigation; however, this example shows that laundering activity can continue in supposedly regulated financial institutions if preventive measures are not enforced.

### **Case N° 8: A good reputation created under false pretences through business contacts**

#### Facts

A national of Country M opened an account at a bank in Country H. After winning the trust of the bank the customer asked the bank to recommend and introduce him to an attorney in Country H. The attorney, assuming that the bank had performed all the necessary checks on the background of the customer (the bank itself was also a client of the attorney), accepted the customer without performing any checks of his own. The attorney created a structure of multiple companies for the customer. The customer then asked to be introduced to other banks, giving as a reason that he wanted to diversify his investments. The attorney affirmed to these banks that his client had initially been recommended to him by a local bank. The new banks likewise trusted the customer from Country M...

#### Lessons

Although the jurisdiction that contributed this example did not provide information on the outcome of this case, this example clearly shows the risk of relying solely on the recommendation of a “trusted” associate when establishing a business relationship.

### **Case N° 9: False loans scheme**

#### Facts

The individual involved in this scheme was the director of finances in a shipbuilding yard, a subsidiary company of one of the biggest companies in the country. In his capacity as finances director, he had a meeting in his office with two Russian nationals, one of whom already had business relations with the company. The finances director was asked to open two bank accounts in the name of the company, to receive two amounts of money (USD 65,000 and USD 100,000) from the Russians, and to deposit these sums into the bank accounts. He was promised a commission of 1-2% which would be paid to him directly.

The finances director agreed to this arrangement and received the money in cash in plastic bags on two occasions: the first, in his office; and the second, at a private residence. Subsequently, he was asked to sign a fictitious loan contract with the Russians on behalf of the company. According to the contract, the Russians would receive loans for the same amounts that had been deposited into the accounts opened by the finances director. This money was transferred to the Russians.

After receiving additional instructions from the Russians, the finances director wrote a letter -- using company letterhead -- stating that the loans had been transferred to a company by the name of Verimer

International SA and that payment should take place to this company. Verimer was registered in the Bahamas; however, the company had the same address as the finances director and a local bank account in his name. One of the Russians was an owner of Verimer; he had bought the company through a company formation agent in Moscow. The Russians then paid their own company.

### Results

Investigation determined that the USD 100,000 were the proceeds of a gross breach of trust committed by two or three Russian nationals in Murmansk. The second sum could never be linked to a specific crime; however, it was established that the sum did represent criminal proceeds of some sort. The finances director was convicted for money laundering over a period of two years. The judgement became final and enforceable by June 1999.

### Lessons

This example is included to illustrate the way that a legitimate business may be used as a cover for a laundering operation.

### **Case N° 10: Launderers recruit individuals for the use of their bank account**

#### Facts

The FIU received suspicious transaction reports from three financial institutions concerning international funds transfers. Through police investigation, it was discovered that several individuals were acting as the money collectors for a cocaine trafficking organisation. These individuals were to identify and “recruit” professionals already established in various trades and services who might be amenable to earning some extra money by allowing their bank accounts to be used in a laundering scheme. These professionals would place cash in their accounts and then transfer the sums to accounts indicated by the money collectors.

The professionals who became involved in this activity were active in several types of business, including travel agencies, and import / export in commodities and computers. In return for their services, they received a commission on the funds transferred through their accounts. The transfers out of the accounts were justified by fictitious invoicing that corresponded to their particular business.

#### Results

This investigation uncovered an organisation that was laundering the proceeds of cocaine trafficking that is believed to have laundered USD 30 million. Several members of the group were identified and are currently on trial in two countries.

#### Lessons

This scheme illustrates how additional safety measures will be put into place to further remove the money from the narcotics trafficking operation. Cash is collected from the drug dealer; the collector passes the funds to the launderer; the launderer then passes them to the recruited business professional who transfers the funds abroad for further processing.

### **Case N° 11: Alternative remittance system (Example 3)**

#### Facts

Cash from the sale of narcotics was brought to shops and bureau de change (controlled by a single organisation) in a town located in an overseas territory of Country P. The shops provided specially validated coupons in return for the deposits. These coupons were then used as bearer instruments that

permitted the holder to obtain funds to purchase more drugs or to make investments. The controlling organisation also owned several real estate agencies.

The laundering network converted currency from other countries through middlemen that were paid a commission for the use of their identities in the depositing of these currencies at financial institutions. An employee at one of these institutions was also involved in the scheme. Other funds processed through this system originated in the local black market in consumer goods intended for smuggling operations into the neighbouring jurisdiction.

### Results

The law enforcement investigation of this case brought about charges against 73 persons, and the seizure of 10 tonnes of narcotics, 11 boats, and USD 4.7 million in foreign currency. Suspicious transactions submitted by local financial institutions during the scheme reported transactions totalling more than USD 400 million.

### Lessons

This scheme is yet another example of an alternative remittance scheme. It is interesting in the issuance of coupons for the deposits of cash proceeds.