

# The Complex Mechanics of Money Laundering

This four-part Anti-Money Laundering series is part of the larger GRC Illustrated Series presented by OCEG and Compliance Week periodically in the pages of this magazine and on the Compliance Week and OCEG Websites. To download a copy of the illustration on the facing page fold-out and for prior illustrations, please go to [www.compliance-week.com](http://www.compliance-week.com) and select "GRC Illustrated" from the "Topics" pull-down menu on the toolbar.

By Carole Switzer

In Hollywood, money launderers tend to operate in an audience-friendly way; viewers can easily peer into their clever but not overly complex schemes. In Steven Spielberg's movie "Catch Me if You Can," we watch raptly as Leonardo DiCaprio's phony pilot launders his ill-gotten gains by swiping a Pan Am logo from a toy model, affixing it to a check and then sweet-talking his deposit past the cute bank teller's initial suspicions.

Reality is far more unstable and complex, staggeringly so when it comes to money laundering. This poses major challenges to those responsible for anti-money laundering (AML) programs in companies that are required to comply with numerous AML rules and regulations.

The gritty reality is that the intense complexity and fluid nature of money laundering requires companies to implement and maintain an AML capability that operates as a finely tuned, powerful and efficient engine. A rigorous AML program that is flexible enough to adapt to new regulations and new threats, must have all of the key elements required and, equally important, must be designed with consideration of how these elements influence each other and should operate in concert.

## Not Just for Drug Dealers

Although the Bank Secrecy Act (BSA) and the USA Patriot Act represent the two primary U.S. sources of AML requirements (there are other domestic laws with AML rules, including the Intelligence Reform & Terrorism Pre-

vention Act of 2004, which amended the BSA; the Money Laundering and Financial Crimes Strategy Act; and the Money Laundering Suppression Act). The regulatory and enforcement agencies with domestic AML oversight are too numerous to mention here; they range from the U.S. Department of the Treasury and its Financial Crimes Enforcement Network (FinCEN), to the Security and Exchange Commission to the Dodd-Frank Act's Consumer Financial Protection Bureau (CFPB) to the New York Stock Exchange, IRS, FBI, and a number of federal banking regulators. Organizational AML capabilities must continue to evolve in response to an ever-expanding set of regulatory rules as well as the continually morphing, innovative, and modern methods by which criminals launder their money.

Money laundering is not just for drug dealers any more. The ways in which individuals and groups launder their money has expanded beyond the traditional boundaries of banks into methods that involve prepaid gift cards, mobile phones, peer-to-peer payments, precious metals, casino chips, virtual reality currency, other "new payment methods" (NPMs, in regulatory speak) and even laundry detergent. (No "cleaning" pun necessary: thieves actually have been robbing retail outlets for an expensive brand of detergent now used as black-market currency in some U.S. cities.)

## Stealing a Page From the Bad Guys

Money laundering describes the way in which criminals, often with the unwitting assistance of law-abiding organizations, disguise the identity, source, and destination of the proceeds of their illegal activities. Doing so requires that criminally generated cash be:

- » **Placed:** The introduction of ill-gotten cash into a legal financial system;
- » **Layered:** Related transactions used to camouflage the introduction of criminal funds; and

- » **Integrated:** The apparently (at least on the surface) legitimate transactions that return the cash to the money launderer.

Creating an effective AML program requires a parallel set of steps: A compliance capability must be implemented (or "placed"); layered with all of the expertise and knowledge necessary to track and respond to changing money-laundering tactics (by criminals) and rules (from regulators); and integrated with a company's overall GRC capability.

The integration also must occur within the AML program itself. Too often, fraud experts (from one of a company's numerous fraud units) are not sharing information with internal audit, which may not be aware of a potentially suspicious activity the compliance department has spotted.

Taking a page from the criminal's playbook in this way is hardly new. The real-world fraudster DiCaprio portrayed, Frank Abagnale, wrote a 2001 book, "The Art of the Steal," in which he shared fraud and money laundering tactics to help organizations bolster their defenses. If an updated version of the book were issued today, it might be retitled "The Quantum Mechanics of the Steal" to reflect the complexity in which fraud thrives.

Real life may not be as simple or glamorous as the movies, but it often tends toward the more practical. There's a highly practical reason why Abagnale, after serving his prison term, reinvented himself as a security consultant employed by the FBI. GRC professionals may not need to hire Abagnale to bolster their defenses, but they will need to roll up their sleeves and dig into the very real and practical work of creating an integrated, effective, and efficient AML program. ■

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AML Illustrated Series

## Building an Effective Anti-Money Laundering Program

A well-designed anti-money laundering program with balance, checks of power, and complete transparency can protect an enterprise from reputation damage, assist in legal compliance and ensure the organization is free from criminal wrongdoing.

### Start with why

Every organization has a different set of reasons for building an anti-money laundering program. The primary reasons include legal compliance, reputation management, protection from criminal prosecution and just not wanting to handle dirty money.



#### KNOW THE LAW

Keeping up with ever-changing and often conflicting national laws, regulations, and treaties about financial transactions, money laundering and information privacy is critical.



#### What is money laundering?

It's not just for drug dealers anymore ...

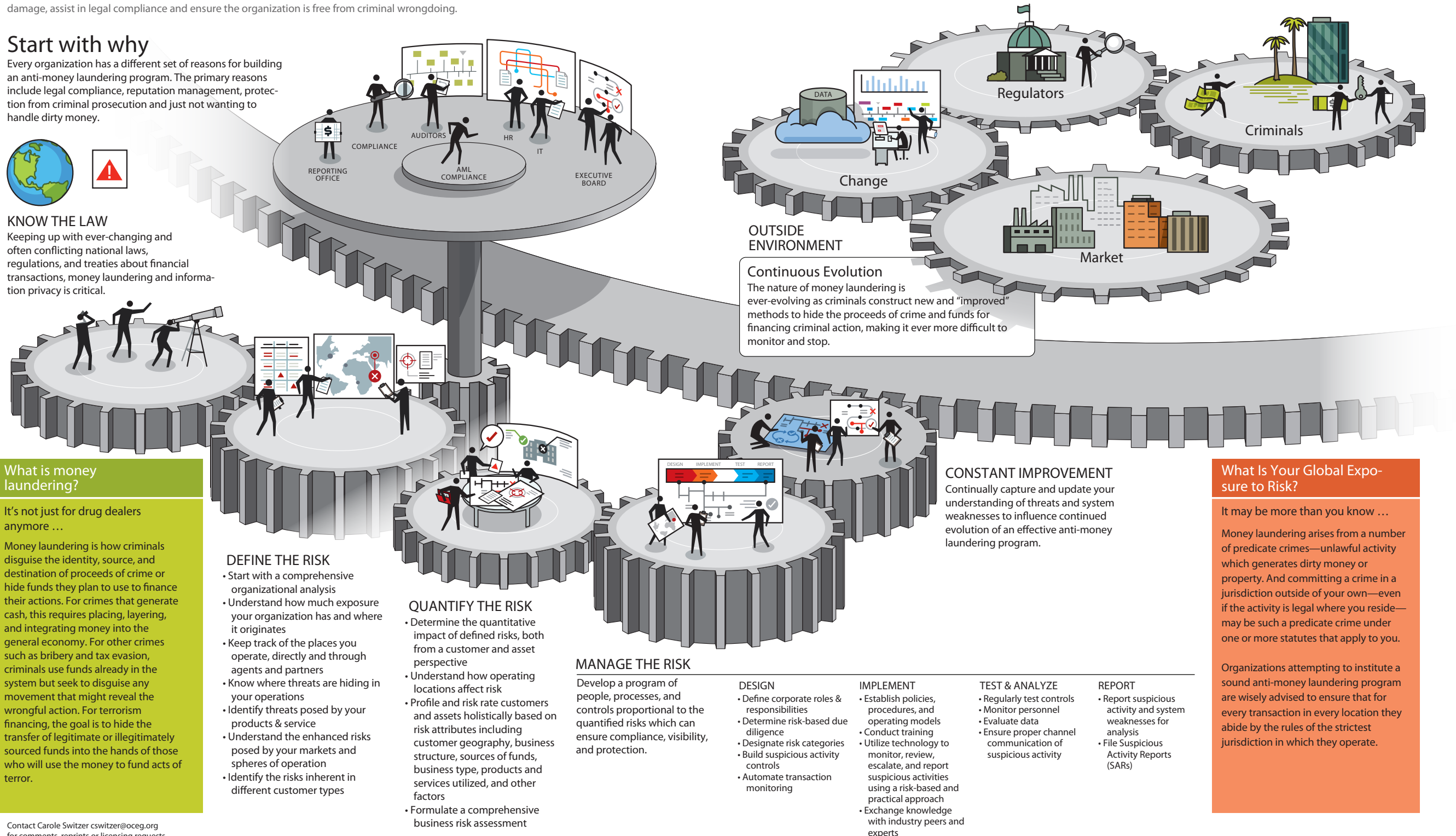
Money laundering is how criminals disguise the identity, source, and destination of proceeds of crime or hide funds they plan to use to finance their actions. For crimes that generate cash, this requires placing, layering, and integrating money into the general economy. For other crimes such as bribery and tax evasion, criminals use funds already in the system but seek to disguise any movement that might reveal the wrongful action. For terrorism financing, the goal is to hide the transfer of legitimate or illegitimately sourced funds into the hands of those who will use the money to fund acts of terror.

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#### OUTSIDE ENVIRONMENT

##### Continuous Evolution

The nature of money laundering is ever-evolving as criminals construct new and "improved" methods to hide the proceeds of crime and funds for financing criminal action, making it ever more difficult to monitor and stop.

#### CONSTANT IMPROVEMENT

Continually capture and update your understanding of threats and system weaknesses to influence continued evolution of an effective anti-money laundering program.

#### DEFINE THE RISK

- Start with a comprehensive organizational analysis
- Understand how much exposure your organization has and where it originates
- Keep track of the places you operate, directly and through agents and partners
- Know where threats are hiding in your operations
- Identify threats posed by your products & service
- Understand the enhanced risks posed by your markets and spheres of operation
- Identify the risks inherent in different customer types

#### QUANTIFY THE RISK

- Determine the quantitative impact of defined risks, both from a customer and asset perspective
- Understand how operating locations affect risk
- Profile and risk rate customers and assets holistically based on risk attributes including customer geography, business structure, sources of funds, business type, products and services utilized, and other factors
- Formulate a comprehensive business risk assessment

#### MANAGE THE RISK

Develop a program of people, processes, and controls proportional to the quantified risks which can ensure compliance, visibility, and protection.

##### DESIGN

- Define corporate roles & responsibilities
- Determine risk-based due diligence
- Designate risk categories
- Build suspicious activity controls
- Automate transaction monitoring

##### IMPLEMENT

- Establish policies, procedures, and operating models
- Conduct training
- Utilize technology to monitor, review, escalate, and report suspicious activities using a risk-based and practical approach
- Exchange knowledge with industry peers and experts

##### TEST & ANALYZE

- Regularly test controls
- Monitor personnel
- Evaluate data
- Ensure proper channel communication of suspicious activity

##### REPORT

- Report suspicious activity and system weaknesses for analysis
- File Suspicious Activity Reports (SARs)

#### What Is Your Global Exposure to Risk?

It may be more than you know ...

Money laundering arises from a number of predicate crimes—unlawful activity which generates dirty money or property. And committing a crime in a jurisdiction outside of your own—even if the activity is legal where you reside—may be such a predicate crime under one or more statutes that apply to you.

Organizations attempting to institute a sound anti-money laundering program are wisely advised to ensure that for every transaction in every location they abide by the rules of the strictest jurisdiction in which they operate.

## [AN OCEG ROUNDTABLE]

# Anti-Money Laundering Challenges

**SWITZER:** Criminals reportedly launder between \$500 billion and \$1 trillion worldwide every year. Is fighting money laundering necessary for more reasons than fighting crime?

**YUILLE:** Money laundering has an unfortunate economic impact especially in developing economies where weak institutions and a lack of regulation and oversight create an inviting environment for money launderers and the impact can be devastating for the local population. In developed economies the effects of money laundering is keenly felt by creating volatility in exchange and interest rates and facilitating high inflation. AML legislation also is vital in the fight against terrorist activities, which cannot survive without money laundering. Screening against sanction and watch lists alone doesn't work; after all, when was the last time that a designated terrorist walked into a high street bank to open an account? Only a systematic and sophisticated approach designed by experts can reveal risk across human networks so that effective action can be taken.

**PLATT:** Principally it's about fighting crime—including terrorism of course—but the AML rules also provide an opportunity for firms to think about their values. I like to think that some firms due diligence clients not only because the external rules require it but because

ethically they are opposed to the principle of helping criminals to enjoy their ill-gotten gains. With so much scandal surrounding the finance sector in recent years, it can be difficult to believe that all firms think about AML rules in this way, but I maintain that if they don't, they should. Firms that have been weak in this area need to shift from a consequentialist approach based upon calculations of the cost of remotely perceived enforcement action, toward a categorical, non-negotiable approach to AML compliance based on ethical principles.

**SWITZER:** What is the placement, layering, and integration" model of money laundering?

**BEATTIE:** The concept of "placement" has evolved within the perception of AML professionals to encompass the initial sourcing of funds into a particular region or financial institution rather than the basic injection of cash into the financial system. The original idea behind "placement" was related to lack of transparency of origin in cash which has expanded to monetary instruments, or even emerging products like pre-paid cards and phone-stored funds. Many current fraud activities like credit card skimming involve funds already in the system so the concept of "placement" has necessarily evolved to consider the initial step from the criminal activity with the "layering" or distancing the

funds from the original activity still taking place subsequently pending final "integration" of the funds into various financial systems.

**MCCARTHY:** The Eddie Antar story is a good example of the use of money laundering processes. In the 1980s, the owner of Crazy Eddie's Electronics skimmed millions of dollars from the company to hide it from the IRS. Subsequently, he decided he could make better use of the money if it went back to the company disguised as revenue to inflate reported assets in preparation for an IPO. In a series of trips to Israel, Antar carried millions of dollars strapped to his body and in his suitcase. He "placed" the money by making a series of deposits to a bank in Israel, then he "layered" the funds by having the Israeli bank wire transfer everything to Panama, from where he could make anonymous transfers to various offshore accounts. Antar then "integrated" by slowly wiring the money to the Crazy Eddie's Electronics bank account, where it got mixed in with legitimate dollars as revenue. Overall, he laundered more than \$8 million and boosted the initial offering stock price so that the company ended up worth \$40 million more. Antar sold his stock for \$30 million in profit but was caught in Israel in 1992, extradited, and sentenced to 8 years in prison.

**SWITZER:** With electronic fund transfers

and new forms of currency, it seems that money laundering may now be harder to detect. What might present an exceptional challenge for those seeking to discover the schemes?

**BEATTIE:** One interesting method involves securities-based money laundering. Since many exchanges, particularly foreign exchanges, have limited requirements for listing a security for trading, a sophisticated money launderer can set up a company (or buy an already listed company at very low cost) and either launder money through wash sales, for example selling securities from one account to another at either a premium or a discount, or have the company issue a dividend to all shareholders which the launderer can collect as "clean" funds.

**SWITZER:** What is most difficult to do right in an AML program?

**PLATT:** Whether it is the most difficult aspect is moot but certainly one aspect that many firms get wrong is setting the appropriate tone toward AML at the top. A firm can have the most sophisticated AML control framework but if staff don't think senior management are fundamentally committed to the prevention of laundering they will follow that lead. It is vital that firms recognize that they are biologies in which staff will display the behaviors and characteristics, including toward risk taking, that they believe will lead to the greatest rewards. If an aggressive risk taker is more highly prized than the meeker risk manager who says 'is taking on that East African government minister a really good idea?' then the firm is heading for a train crash. Senior management get the behavior toward AML compliance they deserve.

**BEATTIE:** AML programs are highly dependent on a broad view where everyone within the organization has a role. Many organizations struggle with building a "culture of compliance" primarily because they set up AML programs as ivory towers or black boxes that are not very well tied into the actual business

and are not well understood outside of AML compliance. In order for an AML program to succeed, and moreover be cost efficient, AML compliance groups must work closely with the business, operational, and technology groups, drawing on their expertise, to better understand and choose options that fit best within and across the organization. Often, AML compliance groups produce policies and procedures that impose burdens on the rest of the organization that could be better managed through alternative methods that may not be evident without this interaction.

**YUILLE:** A very challenging task for organizations today, and one that will become increasingly burdensome, is the management of data. Compliance departments struggle with the overwhelming volume of information. The value of decision making is greatly reduced if data is raw, unchecked, unrefined, and devoid of analysis. There's a critical need for highly structured intelligence that offers a degree of analysis and has been checked for quality, as well as carefully prepared client data. And while the task of collecting and collating the right information is onerous, the task of keeping it updated is next to impossible without considerable resources. An integrated and intelligent risk-management program, properly implemented and maintained, greatly increases the effectiveness leading to stronger controls and substantially better informed decision making.

**SWITZER:** What is in the future for efforts to prevent or detect money laundering?

**YUILLE:** Expect far more complexity in compliance and look for an increase in the level of co-operation between authorities around the world. As the battle between money launderers and authorities intensifies, governments will continue to step up their AML efforts and sectors targeted by money launderers (not just financial services) will be increasingly tasked with legislative obligations. For example the Financial

Action Task Force on Money Laundering (FATF) of the G-7 is pushing to strengthen the implementation of some of the more difficult legislative requirements, to ensure transparency about the beneficial ownership of legal persons and legal arrangements.

**MCCARTHY:** The increasing use of semantic technology in financial services will bring benefits to the prevention and detection of money laundering. It allows a common understanding of the structure of information among people or software agents, providing for better reporting and data analysis. It also establishes a common definition of some set of terms, such as definitions between banks and the bodies regulating them for money laundering, so if there is a change in the set of terms for anti-money laundering, instead of error prone updates of programming code, just the ontology will be updated.

**PLATT:** The external AML rules environment is going to become even more onerous for firms, and geographical arbitrage opportunities in the developed world will be exploited. On the first point, the United Kingdom in particular has to begin to take meaningful enforcement action against firms that fail to implement tough AML controls. The FSA fine levels are so low that they are simply factored in as a cost of doing business. I believe that we will begin to see that change, and whilst the U.K. enforcement environment will never become as tough as that in the United States, it will harden. I am less optimistic about Europe where levels of AML enforcement are pitiful. Nevertheless as enforcement environments in developed economies do evolve, developing economies will become even more attractive to money launderers. That will present a big challenge for the international community because, through bodies like the FATF, it has to convince countries hungry to attract international capital that their long-term economic interests will not be served by attracting short-term criminal money. ■

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