

Chapter I

Money Laundering and Terrorist Financing: Definitions and Explanations

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For most countries, money laundering and terrorist financing raise significant issues with regard to prevention, detection and prosecution. Sophisticated techniques used to launder money and finance terrorism add to the complexity of these issues. Such sophisticated techniques may involve many different types of financial institutions; many different financial transactions using multiple financial institutions and other entities, such as financial advisers, shell corporations and service providers as intermediaries; transfers to, through, and from different countries; and the use of many different financial instruments and other kinds of value-storing assets. Money laundering is, however, a fundamentally simple concept. It is the process by which proceeds from a criminal activity are disguised to conceal their illicit origins. Basically, money laundering involves the *proceeds* of criminally derived property rather than the property itself.

The financing of terrorism is also a fundamentally simple concept. It is the financial support, in any form, of terrorism or of those who encourage, plan, or engage in it. Less simple, however, is defining terrorism itself,

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because the term may have significant political, religious, and national implications from country to country.

Money laundering and terrorist financing often display similar transactional features, mostly having to do with concealment. Money launderers send illicit funds through legal channels so as to conceal their criminal origins, while those who finance terrorism transfer funds that may be legal or illicit in origin in such a way as to conceal their source and ultimate use, which is the support of terrorism. But the result is the same—reward. When money is laundered, criminals are rewarded with disguised and apparently legitimate proceeds. Similarly, those who finance terrorism are rewarded by providing the financial support to carry out terrorist stratagems and attacks.

A. What Is Money Laundering?

Money laundering can be defined in a number of ways. Most countries subscribe to the definition adopted by the *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (1988) (*Vienna Convention*):¹

- The conversion or transfer of property, knowing that such property is derived from any [drug trafficking] offense or offenses or from an act of participation in such offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions;
- The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offense or offenses or from an act of participation in such an offense or offenses.²

1. <http://www.incb.org/e/conv/1988/>.

2. The *Vienna Convention*, Article 3(b).

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The *Vienna Convention* adds that money laundering also involves:

- The acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offense or offenses ... or from an act of participation in such offense or offenses.³

By its terms, the *Vienna Convention* limits predicate offenses (which is to say, the criminal activity whose illicit proceeds are laundered) to drug trafficking offenses. As a consequence, crimes unrelated to drug trafficking, such as tax evasion, fraud, kidnapping and theft, for example, are not defined as money laundering offenses under the *Vienna Convention*. Over the years, however, the international community has come to the view that predicate offenses for money laundering should go beyond drug trafficking. Thus, other international instruments have expanded the *Vienna Convention's* definition of predicate offenses to include other serious crimes.⁴ For example, the *United Nations Convention Against Transnational Organized Crime* (2000) (*Palermo Convention*) requires all participant countries to apply that convention's money laundering offenses to "the widest range of predicate offenses."⁵

The Financial Action Task Force on Money Laundering (FATF), which is recognized as the international standard setter for anti-money laundering (AML) efforts,⁶ defines the term money laundering succinctly as "the processing of...criminal proceeds to disguise their illegal origin" in order to "legitimize" the ill-gotten gains of crime.⁷ However, in its 40 recommendations for fighting money laundering (*The Forty Recommendations*), FATF specifically incorporates the *Vienna Convention's* technical and legal definition of money laundering⁸ and recommends expanding the predicate offenses of that definition to include all serious crimes.⁹

3. *Id.*, Article 3(c)(i).

4. See discussion at Chapter V, A., 1., Predicate Offenses.

5. The *Palermo Convention*, Article 2 (2), <http://www.undcp.org/adhoc/palermo/convmain.html>.

6. See Chapter III, B., FATF.

7. FATF, *What is money laundering?*, *Basic Facts About Money Laundering*, www.oecd.org/fatf.

8. *The Forty Recommendations*, Rec. 1, http://www1.oecd.org/fatf/40Recs_en.htm. *The Forty Recommendations* are reprinted in Annex IV of this Reference Guide.

9. *Id.*, at Rec. 4.

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B. What Is Terrorist Financing?

The United Nations (UN) has made numerous efforts, largely in the form of international treaties, to fight terrorism and the mechanisms used to finance it. Even before the September 11th attack on the United States, the UN had in place the International Convention for the Suppression of the Financing of Terrorism (1999), which provides:

1. Any person commits an offense within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willingly, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out:
 - (a) An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex; or
 - (b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking any active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing an act.
2. ...
3. For an act to constitute an offense set forth in paragraph 1, it shall not be necessary that the funds were actually used to carry out an offense referred to in paragraph 1, subparagraph (a) or (b).¹⁰

The difficult issue for some countries is defining terrorism. Not all countries that have adopted the convention agree on what actions constitute terrorism. The meaning of terrorism is not universally accepted due to significant political, religious and national implications that differ from country to country.

FATF, which is also recognized as the international standard setter for efforts to combat the financing of terrorism (CFT),¹¹ does not specifically

10. International Convention for the Suppression of the Financing of Terrorism (1999), Article 2, <http://www.un.org/law/cod/finterr.htm>. The conventions referred to in the annex in subparagraph 1(a) are listed in Annex III of this Reference Guide.

11. See Chapter III, FATF

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define the term financing of terrorism in its eight *Special Recommendations on Terrorist Financing (Special Recommendations)*¹² developed following the events of September 11, 2001. Nonetheless, FATF urges countries to ratify and implement the 1999 United Nations International Convention for Suppression of the Financing of Terrorism.¹³ Thus, the above definition is the one most countries have adopted for purposes of defining terrorist financing.

C. The Link Between Money Laundering and Terrorist Financing

The techniques used to launder money are essentially the same as those used to conceal the sources of, and uses for, terrorist financing. Funds used to support terrorism may originate from legitimate sources, criminal activities, or both. Nonetheless, disguising the source of terrorist financing, regardless of whether the source is of legitimate or illicit origin, is important. If the source can be concealed, it remains available for future terrorist financing activities. Similarly, it is important for terrorists to conceal the use of the funds so that the financing activity goes undetected.

For these reasons, FATF has recommended that each country criminalize the financing of terrorism, terrorist acts and terrorist organizations,¹⁴ and designate such offenses as money laundering predicate offenses.¹⁵ Finally, FATF has stated that the eight *Special Recommendations* combined with *The Forty Recommendations* on money laundering¹⁶ constitute the basic framework for preventing, detecting and suppressing both money laundering and terrorist financing.

Efforts to combat the financing of terrorism also require countries to consider expanding the scope of their AML framework to include non-profit organizations, particularly charities, to make sure such organizations are not used, directly or indirectly, to finance or support terrorism.¹⁷ CFT efforts also

12. http://www1.oecd.org/fatf/SRecsTF_en.htm. The *Special Recommendations* are reprinted in Annex V of this Reference Guide.

13. *Id.*, at Spec. Rec. I.

14. *Id.*, at Spec. Rec. II.

15. *Id.*

16. *Id.*, at introductory paragraph.

17. *Special Recommendations*, Spec. Rec. VIII.

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require examination of alternative money transmission or remittance systems, such as *hawalas*. This effort includes consideration of what measures should be taken to preclude the use of such entities by money launderers and terrorists.¹⁸

As noted above, a significant difference between money laundering and terrorist financing is that the funds involved may originate from legitimate sources as well as criminal activities. Such legitimate sources may include donations or gifts of cash or other assets to organizations such as foundations or charities that in turn are utilized to support terrorist activities or terrorist organizations. Consequently, this difference requires special laws to deal with terrorist financing. However, to the extent that funds for financing terrorism are derived from illegal sources, such funds may already be covered by a country's AML framework, depending upon the scope of the predicate offenses for money laundering.

D. The Magnitude of the Problem

By their very nature, money laundering and terrorist financing are geared towards secrecy and do not lend themselves to statistical analysis. Launderers do not document the extent of their operations or publicize the amount of their profits, nor do those who finance terrorism. Moreover, because these activities take place on a global basis, estimates are even more difficult to produce. Launderers use various countries to conceal their ill-gotten proceeds, taking advantage of differences among countries with regard to AML regimes, enforcement efforts and international cooperation. Thus, reliable estimates on the size of the money laundering and terrorist financing problem on a global basis is not available.

With regard to money laundering only, the International Monetary Fund has estimated that the aggregate amount of funds laundered in the world could range between two and five per cent of the world's gross domestic product. Using 1996 statistics, these percentages would approximate between US \$590 billion and US \$1.5 trillion.¹⁹ Thus, by any estimate, the size of the problem is very substantial and merits the complete attention of every country.

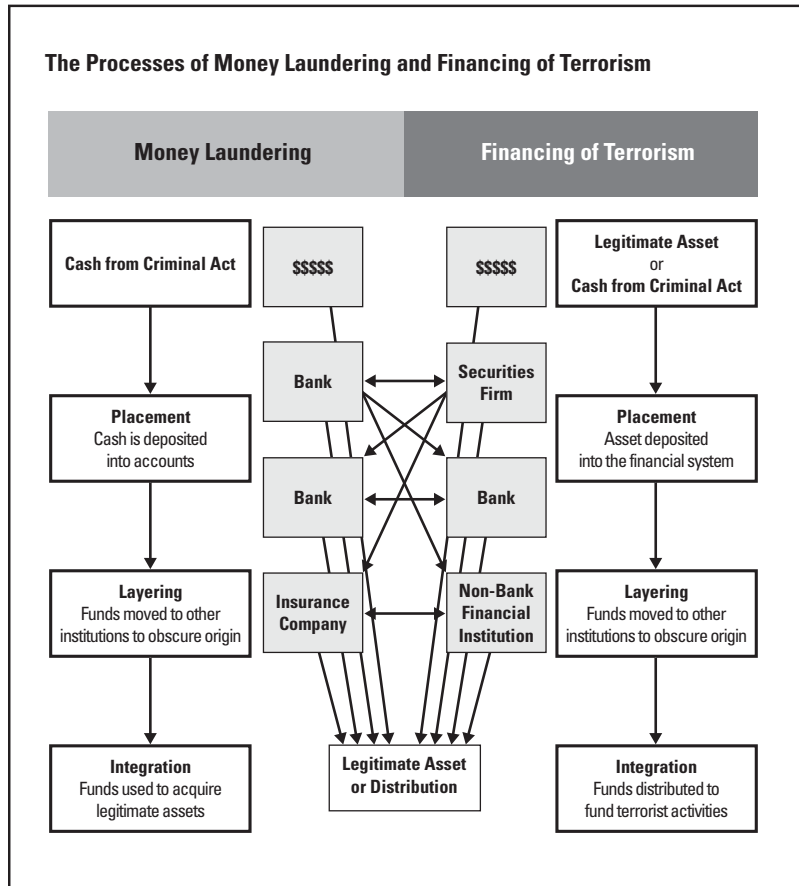
18. *Special Recommendations*, Spec. Rec. VI.

19. Vito Tanzi, "Money Laundering and the International Finance System," IMF Working Paper No. 96/55 (May 1996), at 3 and 4

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E. The Processes

The initial concern over money laundering began with its early connection to illegal trafficking in narcotic drugs. The objective of drug traffickers was to convert typically small denominations of currency into legal bank accounts, financial instruments, or other assets. Today, ill-gotten gains are produced by a vast range of criminal activities—among them political corruption, illegal sales of weapons, and illicit trafficking in and exploitation of human beings. Regardless of the crime, money launderers resort to placement, layering, and integration in the process of turning illicit proceeds into legal monies or goods.



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1. Placement

The initial stage of the process involves placement of illegally derived funds into the financial system, usually through a financial institution. This can be accomplished by depositing cash into a bank account. Large amounts of cash are broken into smaller, less conspicuous amounts and deposited over time in different offices of a single financial institution or in multiple financial institutions. The exchange of one currency into another one, as well as the conversion of smaller notes into larger denominations, may occur at this stage. Furthermore, illegal funds may be converted into financial instruments, such as money orders or checks, and commingled with legitimate funds to divert suspicion. Furthermore, placement may be accomplished by the cash purchases of a security or a form of an insurance contract.

2. Layering

The second money laundering stage occurs after the ill-gotten gains have entered the financial system, at which point the funds, security or insurance contract are converted or moved to other institutions further separating them from their criminal source. Such funds could be used to purchase other securities, insurance contracts or other easily transferable investment instruments and then sold through yet another institution. The funds could also be transferred by any form of negotiable instrument such as check, money order or bearer bond, or transferred electronically to other accounts in various jurisdictions. The launderer may also disguise the transfer as a payment for goods or services or transfer the funds to a shell corporation.

3. Integration

The third stage involves the integration of funds into the legitimate economy. This is accomplished through the purchase of assets, such as real estate, securities or other financial assets, or luxury goods.

These three stages are also seen in terrorist financing schemes, except that stage three integration involves the distribution of funds to terrorists and their

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organizations, while money laundering, as discussed previously, goes in the opposite direction—integrating criminal funds into the legitimate economy.

F. Where Do Money Laundering and Terrorist Financing Occur?

Money laundering and the financing of terrorism can, and do, occur in any country in the world, especially those with complex financial systems. Countries with lax, ineffective, or corrupt AML and CFT infrastructures are also likely targets for such activities. No country is exempt.

Because complex international financial transactions can be abused to facilitate the laundering of money and terrorist financing, the different stages of money laundering and terrorist financing occur within a host of different countries. For example, placement, layering, and integration may each occur in three separate countries, one or all of them removed from the original scene of the crime.

G. Methods and Typologies

Money can be laundered in a number of ways, ranging from small cash deposits in unremarkable bank accounts (for subsequent transfer) to the purchase and resale of luxury items such as automobiles, antiques, and jewelry. Illicit funds can also be transferred through a series of complex international financial transactions. Launderers are very creative—when overseers detect one method, the criminals soon find another.

The various techniques used to launder money or finance terrorism are generally referred to as *methods* or *typologies*. The terms methods or typologies are referred to interchangeably, without any distinction between the two. At any point in time, it is impossible to describe accurately the universe of the different methods criminals use to launder money or finance terrorism. Moreover, their methods are likely to differ from country to country because of a number of characteristics or factors unique to each country, including its economy, complexity of financial markets, AML regime, enforcement effort and international cooperation. In addition, the methods are constantly changing.

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Nevertheless, various international organizations have produced excellent reference works on money laundering methods and techniques. FATF has produced reference materials on methods in its annual reports and annual typologies report.²⁰ The various FATF-style regional bodies also provide information on the various typologies seen in their regions. For the most up-to-date information on money laundering methods and typologies, please consult the websites for these entities.²¹ In addition, the Egmont Group has produced a compilation of one hundred sanitized cases about the fight against money laundering from its member financial intelligence units.²²

20. See, for example, 2002–03 FATF Report on Money Laundering Typologies, http://www1.oecd.org/fatf/pdf/TY2003_en.pdf, and prior reports, http://www1.oecd.org/fatf/FATDocs_en.htm#Trends.

21. See Chapter IV for a discussion of the FATF-style regional bodies.

22. <http://www1.fincen.gov/fiuinaction.pdf>. See Chapter III, The Egmont Group.