**Transparency International (TI)** has been at the forefront of the anti-corruption movement since it was formed in 1993. TI is a non-profit making, independent, non-governmental organisation, dedicated to increasing government accountability and curbing both international and national corruption. TI(UK) is part of a network of 90 national chapters carrying out the TI mission around the world. TI works in a non-confrontational way with governments, companies, development agencies, NGOs and international organisations to seek a consensus to combat corruption. More information on TI(UK) can be found at [www.transparency.org.uk](http://www.transparency.org.uk).

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1 Introduction

The figures are staggering. According to the International Monetary Fund, between USD 500 billion and USD1.5 trillion, or between two and five percent of the world’s gross domestic product, are laundered every year through the global financial system. In the UK, the Home Office estimates that dirty money represents about two percent of gross domestic product or approximately £18 billion. This sum is equivalent to about a quarter of all of the UK Government’s revenue from VAT.

Money laundering subverts legitimate financial mechanisms and banking relationships by using them as protective cover for the movement of the proceeds of criminal and corrupt activities as well as for the financing of terrorism. Money laundering undermines the integrity of the global financial and trading systems upon which our prosperity and growth depend. As an organisation dedicated to fighting corruption by fostering transparency and good governance, Transparency International has already been much involved through the launch of the Wolfsberg Anti-Money Laundering Principles. Now, Transparency International (UK) has chosen to focus on the issue of money laundering because of the UK’s key role in the provision of international financial services and concern that money laundering is fuelling the growth of transnational criminal enterprises at a huge social and economic cost.

Transparency International (UK)1 is issuing this Report because it is particularly concerned with money laundering as it relates to the proceeds of corruption. When large sums of money change hands as a result of a corrupt transaction, the recipient of the funds risks immediate exposure if he does not conceal his windfall. Therefore the ability of the corrupt to launder the proceeds of their misdeeds is a vital part of the corruption process. The prevention of money laundering should be an essential part of any government’s ability to deter and detect corruption.

The UK, and in particular London, is faced with the issue of corrupt money laundering on two fronts. First, as the world’s largest international financial centre, the United Kingdom’s effectiveness in eliminating money laundering will have a direct and disproportionate effect on tackling international corruption. Second, and although it poses a more limited threat, the laundering of the proceeds of domestic corruption is also a concern. Whilst the UK is regarded as having comparatively low levels of corruption, it nevertheless exists and is facilitated by any weaknesses in money laundering controls.

Corruption is by no means the largest user of the laundering process. The trafficking of drugs and humans, fraud and organised crime all rely upon money laundering and increasingly money laundering techniques are being used to finance terrorism.

In recent years, the international community has made major strides in the fight against money laundering, most notably through the work of the Organisation for Economic Cooperation and Development (OECD)’s Financial Action Task Force (FATF) whose recommendations have strengthened the regulatory framework aimed at stemming the

1 The views and recommendations expressed in this Report are those of Transparency International (UK) and should not be regarded as representing that of any other body, which the author, editors, researchers or contributors are or have been part of.
flow of dirty money. The UK itself has long been at the forefront of legislation and regulation against money laundering. Indeed the International Monetary Fund (IMF) has recently confirmed that the UK complies well with most of the FATF recommendations.

Yet there remain shortcomings in the UK approach, including those which relate to corruption, and these form the basis of this Report. But regardless of the origins of the money, the laundering process remains similar and we therefore have provided comments that we would hope will be helpful in the general fight against money laundering and the financing of terrorism.

Given the complexities of the problem, it would be presumptuous to claim that our Report represents a definitive view on the way forward in the fight against money laundering but we are confident it will make a valuable contribution to the debate on this vital issue.

Laurence Cockcroft, Chair, Transparency International (UK)

John Drysdale, Chair, Transparency International (UK) Money Laundering Working Group
Key Findings and Recommendations

2.1 Overview

Despite unprecedented work, both in the UK and internationally, in the fight against money laundering and in the campaign against the financing of terrorism, the level of money laundering remains high.

It is our view that money laundering, and the underlying crimes it reflects, including corruption, pose one of the most significant threats to our future prosperity and growth, and that more fundamental action must be taken to bring its proliferation under control. Without decisive and immediate action, the ability of the UK, and governments internationally, to tackle this issue must be questionable.

The damaging consequences of money laundering may not be immediately visible to ordinary citizens but that does not mean that they are not adversely affected by it. The crimes whose proceeds are laundered raise our insurance premiums and our taxes and, in some cases such as robbery and extortion, put our physical safety at risk.

Tackling the threat of money laundering will require considerably more resources than are currently deployed. Additional resources will be required in every area, be it criminal investigations and prosecutions, the review of Suspicious Transaction Reports (STRs) and Suspicious Activity Reports (SARs), or the supervision by the Financial Services Authority (FSA) of adherence to the anti-money laundering (AML) requirements by the firms it regulates. To this must be added the cost of an increase in the level of awareness in sectors at risk from money launderers, particularly those which will become subject to the revised Money Laundering Regulations (MLR) 2003. The investigation and prosecution of money laundering must also be a made a priority for law enforcement bodies. Only in this way can the UK truly begin to close its branch of the money laundering machine.

Failure to do so will undermine much of the other work being done by the international community to promote democracy and the rule of law as the laundered monies will both encourage and facilitate the continuation of corruption and the financing of poor governance. Laws and regulations to fight money laundering, however effective on paper, will achieve little if the resources and prioritisation to implement them are lacking.

One cannot be “tough on crime and the causes of crime” whilst starving the fight against money laundering of resources and adopting a “light regulatory touch” in the enforcement of AML regulations.

We appreciate that funding of additional resources must be found and that this must compete with other claims for extra funds from different sectors of the economy. However, in the case of money laundering, the ability of the new Assets Recovery Agency (ARA) to recover laundered money, which, according to a Home Office estimate, amounts to £18 billion a year in the UK alone, means that there is every prospect of such funding being recouped in the longer term.

Above all else we recommend that this additional funding is found and found quickly.
We welcome the inclusion in the National Policing Plan 2003-2006, as one of the four priorities at local level, of the combat against serious and organised crime; also of the express inclusion of international corruption. This has to be translated into local policy on a multi-agency basis and needs to be backed by appropriate resources.

We have concentrated the detailed recommendations of our Report on three key areas: deterrence and detection; expanding the activities covered by the UK AML regime; and improvements in the UK AML regime.

2.2 To deter and detect

2.2.1 Customer identification

The fight against money laundering in the UK has focused too heavily upon the issue of initial identification. Identification, whilst essential, is, in reality, only one part of the Know Your Customer (KYC) process. Indeed it is this element of the AML regime that we consider to be the easiest to evade, given the potential for identity theft and the creation of false identities. We are concerned that the emphasis on identity has, wrongly in our view, been seen as a panacea in the fight against money laundering. In fact, it is only part of the fight. This weakness has been further exacerbated by a failure to identify the source of the funds which are being utilised to undertake the transaction or activity.

This focus has also resulted in insufficient attention being paid by financial institutions to an understanding of the motives and activities of their customers and to the need for close monitoring of activity to identify suspicion. It is our view that this part of the KYC process is the most important and the most likely to result in the successful identification of money laundering activity.

**Recommendation 1**

*That the FSA, and other bodies responsible for the monitoring of compliance with the UK AML regime, ensure that firms do not focus upon initial identification at the expense of the need also for a proper understanding of the source of funds, the need for effective monitoring of customers’ activities and a better understanding of their motives and intentions.*

In respect of Politically Exposed Persons (PEPs) we think it unlikely that, without Government or other help, a firm can gather sufficient information to ascertain that relatives and associates of a PEP located in a different country have been identified.

**Recommendation 2**

*That the UK Government investigate how it can assist firms in the identification of “Politically Exposed Persons” and their associates, either directly or by encouraging the provision of such information by private sector bodies.*

We are also concerned that the use of the term “Politically Exposed Person” itself does not accurately reflect the risk from this area, as many persons exposed to corruption are not “politically exposed.” We therefore suggest that this standard industry phrase be broadened to reflect more accurately the various categories of persons whose roles or personal relationships particularly exposes them to the risk of corruption.
Recommendation 3

That the definition of the term “Politically Exposed Person” be broadened to encompass all categories of persons at risk.

2.2.2 The monitoring of transactions and activities

The monitoring of millions of daily transactions to determine whether the making of STRs or SARs to the National Criminal Intelligence Service (NCIS) is justified, cannot, in our view, be undertaken without sophisticated automated systems. Such systems can detect variances in both a customer’s own activities and variances of one customer from another with the same ostensible profile. Whilst many of the larger banks utilise monitoring systems, other sections of the financial community appear to lag behind in their introduction.

Such transaction monitoring systems may involve considerable expense and firms need guidance on what is required to enable them to make such a financial commitment with confidence. We accept the desire of the FSA and others not to endorse specific providers and we are aware that the adequacy of any system in complying with the Money Laundering Regulations will ultimately be a matter for the courts. Nevertheless we consider that the FSA can do more to assist firms in selecting appropriate automated monitoring systems. We therefore await with interest their proposed Consultative Paper on this issue, which we understand is due out in the middle of 2003.

Recommendation 4

That the FSA adopt and publish a benchmark standard for all sectors of the financial industry for acceptable automated transaction monitoring systems and give confirmation to providers that meet this standard.

As already noted, it is important that suspicions are not simply confined to transactions; rather it is suspicious activity that is the key. Indeed many of the professions shortly to be brought under the remit of the revised MLR, such as lawyers, do few “transactions” as such. Rather they are more likely to become aware of suspicious activity such as tax evasion. Nevertheless, it appears that suspicious “transactions” remains the standard term. We consider that the term “activity” is preferable as it not only covers transactions but other suspicions as well. Such changes in terminology, whilst minor in themselves, help change the mindset of those covered by the MLR as to what is expected.

Recommendation 5

That emphasis be placed on the requirement to report suspicious activities rather than only suspicious transactions, and that any necessary changes to guidance should be introduced to reflect this.

2.2.3 Staff training and awareness

We consider that the current requirements for the training of staff in the identification of suspicious transactions and activities are an important starting point. However, as money laundering trends change, it is vital that staff training reflects this. For example, specific requirements for training relevant staff on issues such as identifying PEPs and Ultimate Beneficial Owners should be introduced.
It is also vital that those groups which will shortly become subject to the revised MLR, for example estate agents and dealers in high value items, are given access to adequate training in their new obligations.

**Recommendation 6**

*That the requirements and/or guidance in respect of AML training be made more explicit. There should also be a general obligation on institutions to test staff awareness and understanding.*

### 2.3 Expanding the net

#### 2.3.1 The new requirements

We consider that the extension of the MLR to cover a range of non-financial service activities, including estate agents, casinos, company and trust providers and, in certain circumstances lawyers and accountants, is a significant wake-up call to areas which, whilst vulnerable to money laundering, may hitherto have been regarded as a “soft touch” by launderers.

#### 2.3.2 The use of lawyers and accountants by money launderers

As David Lock, Chairman of the Service Authority for NCIS, has said:

> “There is a direct link between those who are prepared to turn a blind eye and launder profits - and organised crime and its victims.”

We are concerned to note that the percentage breakdown by sector of STR disclosures has fallen in the case of solicitors, from an already low level of 1.97% in 1998 to 1.02% in 2001 and, in the case of accountants, from 0.74% to 0.35% in the same period.

In our view, professional bodies representing accountants and lawyers need to do much more to ensure that those amongst their membership who do turn a blind eye are speedily detected and removed from the profession. Additionally, the low level of reporting by solicitors and accountants has been a perennial problem and action to determine whether such limited reporting is justified or not is urgently needed. In the post-Enron world, simply relying upon self-regulation by professional bodies to achieve this is no longer justifiable or acceptable.

NCIS considers that disclosures from professionals frequently lead to impressive results. It is high time that this vital source of information for the investigation of money laundering is properly exploited.

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Recommendation 7

That there should either be a programme of independent on-site visits (for example by the FSA) to lawyers and accountants, specifically to review the quality of their compliance with AML requirements, or, if such inspection is to be undertaken by the relevant professional body, that the FSA approve the nature, rigour and frequency of such inspections.

2.3.3 Bureaux de change and money transmission services

As these activities do not fall under the regulatory purview of the FSA, the on-site inspections are undertaken by HM Customs and Excise. We consider that it would be preferable for a single body to be responsible for all inspections, so ensuring greater consistency in approach as well as making sure that the regulations are enforced across the industry, thus avoiding competitive disadvantage. We therefore believe that this responsibility should be transferred to the FSA.

Recommendation 8

That, ideally, legislation be introduced to bring bureaux de change and the provision of money transfer and cheque cashing services within the regulatory scope of the FSA. If such an approach is not considered feasible, then, at the very least, the providers of such services should be subject to licensing by HM Customs and Excise, with appropriate “fit and proper” checks on controllers and beneficial owners.

2.3.4 Non-financial institutions

As stated above, the UK Government will shortly be extending its MLR to cover non-financial institutions. These include antique dealers and auctioneers, casinos and other gambling businesses, dealers in property and high-value items and company and trust providers. This extension has been prompted by the second EU Directive on Money Laundering which comes into force in June 2003.

These measures have been driven, in part, by the realisation that the sophisticated use of non-financial markets, business entities and expert professional advice makes them potentially significant contributors to successful money laundering. These activities currently fall outside the scope of the current FATF Recommendations and this is now seen as a serious defect. The FATF is therefore consulting on an extension of their recommendations along similar lines.

Of particular concern to us is the issue of company and trust service providers. As the OECD has stated, “almost every economic crime involves the misuse of corporate entities.”

The Joint Money Laundering Steering Group Guidance Notes describe them as “the most likely vehicles for money laundering.”

Many offshore financial centres have introduced legislation to regulate those that form and administer companies and often trusts as well. Part of the aim of such legislation is to ensure that those conducting such activities are “fit and proper” and are subject to AML

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6 Paragraph 4.150.
regulations. The UK authorities intend to bring such activities within the scope of the revised Money Laundering Regulations 2003 but compliance will not be supervised by the FSA or any other public body.

We consider that such a failure to supervise is both regrettable and unacceptable. It seems to us unconscionable that the UK Crown Dependencies and Overseas Territories have been pushed to introduce improved regulation in this area, yet the UK itself still lacks definitive plans to do so.  

Recommendation 9

*That the UK bring those involved in the provision of company and trust services by way of business, such as company formation and professional trusteeship, within the regulatory scope of the FSA.*

From research conducted for this Report, it is evident that the non-regulated non-financial sectors, which are about to be brought within the revised MLR, are remarkably unprepared for the new regime. We are concerned that little appears to be being done to rectify this lack of preparation although the delay of around three months for the coming into force of the revised MLR may help. Unless urgent action is taken to put this hiatus to use effectively, many of those who will shortly become subject to criminal sanction for breach of the revised MLR will be wholly unaware of their new obligations.

Recommendation 10

*That the Government conduct a major exercise to ensure that those who will come within the revised MLR are made sufficiently aware of their new responsibilities and have been provided with adequate training to meet these responsibilities.*

Furthermore, many of the activities carried on by sectors such as antique dealers and auctioneers are of a wholesale nature in that the trade is on a dealer-to-dealer basis. The question then is one of how one can have an effective KYC policy on one’s customers’ customers.

As part of this we believe that, at least until the matter is resolved and the new AML regime is operating successfully, consideration should be given to seeking to place additional safeguards on the most vulnerable entry point in the laundry cycle, the placement of cash. This is logical as the draft MLR propose that a dealer in high value goods in excess of Euro 15,000 must first register with HM Customs and Excise.

Recommendation 11

*That consideration be given to requiring cash purchases of high value items above a certain level to be notified to NCIS, until such time as the MLR requirements are considered to be operating effectively.*

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2.3.5 **Correspondent banking**

We commend the considerable emphasis that is now being placed on the issue of correspondent banking. We consider that the risks posed by such relationships, particularly where a respondent bank is in a jurisdiction which has an inadequate AML regulatory structure, mean that additional formalised requirements should be put in place.

*Recommendation 12*

*That international pressure on correspondent banking be maintained and the UK authorities ensure that UK banks do not enter into or maintain correspondent relationships with respondents that do not have adequate AML procedures in place.*

2.4 **Taking the fight to the launderers**

2.4.1 **Assessment of reports of suspected money laundering**

According to the IMF, STR assessments by NCIS take an average of three months. This is significantly longer than its published target, and may enable launderers to avoid capture as they will already have left the jurisdiction before an assessment has even begun. Even more worrying, if the transaction is related to the financing of terrorism, the terrorist act itself may have occurred before the assessment is completed.

Whilst we note that NCIS does conduct an initial review on all reports within 24 hours and is able to “fast track” those it considers most urgent, the three month overall average is clearly unacceptable and needs urgent resolution.

This observation is not a criticism of NCIS, which has been faced with a more than threefold increase in reports over the past two years. It is, however, a reflection on the need to further increase its resources and enhance its systems.

We note that the Director General of NCIS recognises this and trust that the resources will be forthcoming.

*Recommendation 13*

*That the current speed of assessment of reports notified to NCIS be reviewed and an action plan developed and published on how and when it will achieve its review target.*

2.4.2 **Criminal prosecutions and regulatory action**

It is also important to remember that NCIS only provides an intelligence service and that the police and other law enforcement bodies are the ones which undertake the actual investigations of suspected money laundering. Therefore, regardless of the speed with which NCIS operates, unless sufficient resources and priority are given to the actual investigations, it is inevitable that the number of prosecutions will remain at a worryingly low level. Given the international dimension of much money laundering (particularly where it relates to corruption) such investigations are inevitably time-consuming, complex and expensive.

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Therefore, if the UK Government wishes to see a marked increase in the effectiveness of the UK AML regime, it must, in addition to new laws and powers, provide the resources for actual investigations and prosecutions. In this context, the formation of a national agency, specifically charged with the investigation and prosecution of major economic crime including complex money laundering cases, could be the way forward. It could be appropriate for such an agency to subsume the Serious Fraud Office in its activities.

Recommendation 14

That the UK Government allocate specific and adequate resources and structures to enable the investigation and prosecution of suspected money laundering offences and to commit to making judicial co-operation and mutual legal assistance effective.

2.4.3 Asset recovery

As NCIS has observed, “the simplest way to launder criminal cash is to buy assets or spend it on a lavish lifestyle.”

We therefore consider the recent introduction of the ARA, with its power to seek the civil recovery of the proceeds of unlawful conduct, to be potentially the most important recent initiative in the fight against money launderers and other criminals.

Provided sufficient resources are devoted to the development of the ARA, we consider the target of increasing the value of assets recovered to £60 million by 2004/2005 to be easily attainable, with the possibility of it being significantly exceeded.

The UK Government has confirmed that the Proceeds of Crime Act does enable the courts to confiscate the benefits which a UK citizen or a company obtain from winning a contract abroad through bribery as their benefits will be regarded as proceeds of crime.

TI(UK) is of the view that where assets were misappropriated from a specific country, the ARA should have the responsibility for their repatriation as appropriate through a trust fund administered internationally.

We are, however, concerned that the definition of “lifestyle offences” does not include the offence of corruption. Such offences will only include the proceeds of corruption where these proceeds have been laundered. Whilst this does not make the civil recovery of corrupt assets impossible, it does make it more difficult than for offences such as drug trafficking and prostitution.

Corruption can, in our view, constitute a lifestyle offence and should therefore have been included within the list of such offences in the Proceeds of Crime Act 2002.

Recommendation 15

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10 Ibid.
11 UK Government Home Office website.
12 This is consistent with the new draft EU convention on Mutual Legal Assistance.
13 Proceeds of Crime Act, Schedule 2.
That the “lifestyle offences” detailed in Schedule 2 of the Proceeds of Crime Act be extended to include corruption, perhaps using the proposed new Corruption Bill (now in draft) for this purpose.

2.4.4 Feedback on suspicion reports

In order to achieve a continuous improvement in the provision of these reports, it is important that reporting institutions are given adequate feedback on the reports they make. Whilst feedback that might imperil an ongoing investigation is clearly inappropriate, this does not preclude generic feedback to help firms in their determination of what should to be reported. Whilst NCIS does provide some feedback we believe that this can be improved.

In particular the lack of a detailed analysis of money laundering types and trends in the UK has been identified by the IMF as a weakness. Given the fixation of the UK on assessment using cost-benefit principles, we cannot see how effective cost-benefit analyses can be calculated without a deeper understanding of the nature and evolution of money laundering typologies. We welcome the comment from NCIS that it is planning to conduct further analysis in this area. We consider that work in developing such an understanding is needed and overdue.

Recommendation 16

That to facilitate continuous improvement in the quality of STRs and SARs, NCIS commit to providing regular feedback both to the finance sector as a whole and to specific institution, on the quality of reports made.

2.4.5 Training of investigators

The IMF has identified a weakness in the lack of training for UK enforcement agencies and the FSA in respect of money laundering investigations. We are aware of a number of initiatives in this area and note that a “Centre of Excellence in Financial Investigation” is already in operation as part of the ARA and designed to address this issue. There is a need to ensure that this Centre adequately covers the issue of corruption in money laundering.

Recommendation 17

That the ARA adequately cover the issue of corruption in money laundering in the “Centre of Excellence in Financial Investigation.”

2.4.6 The UK Crown Dependencies and Overseas Territories

The UK is unique in that it has, partly by design and partly by historical accident, an array of small dependencies over which it exercises varying levels of control. Many of these Dependencies and Territories have thriving financial centres, indeed some rank amongst

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15 Ibid, Paragraph 298.
16 Ibid.
the largest offshore centres in the world. Built on low (and sometimes zero) tax and historically weak regulation supplemented on occasion by strict banking secrecy laws, these centres have been traditional targets of accusations as money laundering centres.

However, at least in the case of some of the dependencies, such accusations in the 21st century would be seriously misplaced. For example Jersey, Guernsey and the Isle of Man have sophisticated AML legislation in place. In 2002, the AML regime in Gibraltar was commented on favourably by both the IMF and FATF, following on-site reviews.

There is a gradual recognition by the international community, if not by the media, that a clear distinction exists between well-regulated offshore centres and under-regulated ones. The well-run centres can set an example to a number of onshore jurisdictions such as in the regulation of company and trust service providers. The under-regulated centres such as Pitcairn Island, the British Virgin Islands and the Turks and Caicos Islands represent a threat to the fight against money laundering and continued pressure backed by appropriate sanctions is required.

Recommendation 18

We urge continuance of the international efforts to encourage jurisdictions to improve their AML regimes. To achieve this there must also be greater recognition of those who have done so, thereby providing a “carrot” to go with the “stick”. The UK should continue to actively monitor those who have not yet put in place effective AML regimes.
3 Corruption and Money Laundering: the International Context

3.1 Corruption

TI defines corruption as “the abuse of entrusted power for private gain.” Corruption has been defined by the World Bank as “the abuse of public office for private gain.” Whatever the definition, corruption invariably taints reputations and practices, infects political processes and economic stability, and generally deprives one person or group of persons to the benefit of another person or interest. Normally it is the poor and disadvantaged who become poorer and the criminals who become richer.

Poor governance, weak institutions, the lack of an independent and honest judiciary, a muzzled press and too much bureaucracy are often the primary causes of corruption. These lead to a lack of appropriate restraints on power, and to the lack of an independent ability to prosecute. If criminal justice and the rule of law are not upheld, then extortion and bribery cannot be tackled. Likewise, if the rule of law is inoperable, then the political élite will be beyond prosecution. Without the rule of law, the rule of fear and influence can take over. Anglo American plc expressed this very well: “Endemic and systemic corruption is most likely to thrive where state involvement is pervasive, where there is excessive regulation and where officials have a significant amount of discretion. The absence of parliamentary accountability, skilled law enforcement, an independent judiciary and scrutiny by the media and civil society make corrupt practices more likely.”

Corruption and the abuse of public funds by some government leaders and public sector officials has rightly become a subject of ever-increasing concern in recent years. Huge amounts of corruptly acquired wealth can, with seeming impunity, be transferred to foreign jurisdictions. The funds are then concealed through private anonymous companies, trusts or foundations, often in the names of relatives and close associates of PEPs. As a result, aid or private funds invested in such countries will rarely be used to best effect, as they will often be diverted to the benefit of ruling élites.

Corruption is thus not only a major disincentive to healthy economic growth, but is also a major disincentive to outside investment and long-term aid. The poor become poorer and the State is robbed of its ability to grow. Even a fleeting glance at many countries can provide us with all too many examples.

Many governments and international aid agencies are now making a great effort to encourage developing countries to combat corruption, initially through improved governance. Indeed, in some cases it is a prerequisite for continued support. The UK Department for International Development (DFID) provided support for the establishment of independent anti-corruption commissions in a number of countries. These bodies are required to have real political commitment, administrative autonomy, independence from the police, adequate financial resources, powers to investigate and prosecute, power to recruit directly, relevant laws and a functioning judicial system. However, no reform programme will be successful without support from a country’s political and administrative leaders.
While it is essential that every incentive is given to the fight against corruption in those low income countries where its effect is most devastating, it is very important to recognise that developed countries are often complicit in its promotion. In recognition of this, TI publishes both a Corruption Perceptions Index and a Bribe Payers Index. In that corruption is especially prevalent in the arms trade, for large public works contracts and in the extractive industries, and that all three of these are mostly provided by developed countries, the latter cannot escape the verdict that they can be part of the problem as well as of the solution.

It is a basic tenet of this report that the fruits of this corruption are often laundered to reach major financial centres and London in particular. Within the UK, the enactment of Part 12 of the Anti-Terrorism, Crime and Security Act 2001 will expand the UK’s ability to fight corrupt practices by British citizens and companies elsewhere. The new draft Corruption Bill will certainly assist in the prosecution of forms of overseas corruption which feed into the money laundering chain.

3.2 Money laundering

In recent years the issue of money laundering, both in the United Kingdom and throughout the world, has attained a far higher priority for governments. Money laundering\(^\text{17}\) involves the transformation of ill-gotten funds into a usable form, and the disguise of their illegal or illegitimate origins. John Carlson has aptly described this process:

“Because individuals or groups engage in corruption, organised crime, drug-trafficking and many other forms of serious criminality primarily to generate profits for themselves, they must find ways to use and benefit from them without attracting attention to the underlying criminal activity.”\(^\text{18}\)

These processes are as difficult to quantify as they are to investigate and bring to justice. After the proceeds are introduced into the financial system, they are hidden - laundered - through a variety of transactions and financial vehicles, and then finally invested in financial and non-financial assets. These operations often involve international transactions as a way of “layering”, or hiding, the source of the funds.

How does money laundering occur? Traditionally the process has three stages. It begins with the placement stage, where the launderer deposits the proceeds of his crime into the financial system. Examples of methods of placement include the use of many small cash deposits into bank accounts or the purchase of money orders. Once the funds have entered the financial system, the funds are layered through financial transactions designed to obscure the link between the funds and the placement stage, often using the correspondent banking system. This may involve movement of the funds across several locations and jurisdictions (including converting them into different currencies). It may also involve the use of business entities, which use the funds to make payments relating to the business, thus giving them a legitimate appearance.

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\(^{17}\) Aninat, Eduardo, Hardy, Daniel and Johnston, R. Barry, 2002, “Combating Money Laundering” in Finance & Development (September), p. 44.

\(^{18}\) Carlson, John, Money Laundering and Corruption: Two Sides of the Same Coin, No Longer Business as Usual: Fighting Bribery and Corruption p. 27.
Once the funds have been successfully laundered to the point where they look legitimate and their origins unknown, the criminal will then attempt the third and final stage of integrating the funds into the legitimate economy. He may invest in anything from property, pictures and antiques to cars, boats and businesses.\textsuperscript{19}

\section*{Corruption and the Money Laundering process}

\begin{center}
\begin{tikzpicture}
    \node (a) at (0,0) {Corrupt payment};
    \node (b) at (2,0) {The Boxes outlined in bold show where KYC should be operating};
    \node (c) at (4,2) {Local Central Bank};
    \node (d) at (6,2) {Correspondent bank London};
    \node (e) at (8,2) {A/C Discretionary Trust};
    \node (f) at (10,2) {A becomes beneficiary at later date};
    \node (g) at (2,1) {Lawyer};
    \node (h) at (4,1) {Client Money Account};
    \node (i) at (6,1) {Purchase property in name of company};
    \node (j) at (8,1) {Company borrows funds secured by property};
    \node (k) at (10,1) {Lends to B};
    \node (l) at (2,-1) {Agent in third country};
    \node (m) at (4,-1) {Auction House in UK};
    \node (n) at (6,-1) {Art bought};
    \node (o) at (8,-1) {Art transferred to third country and sold};
    \node (p) at (10,-1) {\$};
    \node (q) at (4,-2) {Sets up discretionary trust};
    \node (r) at (6,-2) {Provides trustees};
    \node (s) at (8,-2) {Company \(\text{shares} \text{\hspace{1em} (beneficially owned by discretionary trust)}\)};
    \node (t) at (2,-2) {Sets up company};
    \node (u) at (4,-2) {Provides nominee shareholdings \& directorships};

    \draw[->] (a) -- (g);
    \draw[->] (g) -- (h);
    \draw[->] (h) -- (i);
    \draw[->] (i) -- (j);
    \draw[->] (j) -- (k);
    \draw[->] (k) -- (p);
    \draw[->] (g) -- (l);
    \draw[->] (l) -- (m);
    \draw[->] (m) -- (n);
    \draw[->] (n) -- (o);
    \draw[->] (o) -- (p);
    \draw[->] (g) -- (q);
    \draw[->] (q) -- (c);
    \draw[->] (h) -- (r);
    \draw[->] (r) -- (d);
    \draw[->] (d) -- (e);
    \draw[->] (e) -- (f);
    \draw[->] (m) -- (u);
    \draw[->] (u) -- (s);
    \draw[->] (t) -- (h);
    \draw[->] (t) -- (l);
    \end{tikzpicture}
\end{center}

\section*{The Abacha scandal. Case Example \textsuperscript{20}}

In the late 1980s, a large multinational bank in London opened accounts for Ibrahim and Mohamed Sani Abacha, who represented themselves as “commodity and oil dealers.” While efforts were made to identify the individuals concerned, it was later learned that the Bank had recorded these men (who were brothers) as the sons of Zachary Abacha. Abacha Senior was recognised by the Bank as “a well-connected and respected member of the northern Nigerian community”. However through the process of identifying their clients and for whatever reason, the Bank failed to make note of the father’s position at the time as a General in the Army and Chairman of the Country’s Joint Chiefs-of-Staff. He was later to become the Head of State. By the late 1990’s it was determined that the two brothers had amassed and deposited, either for themselves or on behalf of others, approximately US $660 million with the London Bank.

On the face of it, US $660 million is not a very large amount for a large multinational bank and might be reasonably explained as being, for example, the profits of a successful business. However, it was later revealed that the Sani Abacha brothers and other members of the Abacha circle had allegedly stolen an estimated US $4.3 billion over a number of

\textsuperscript{19} OECD, op.cit., p. 127-128.
\textsuperscript{20} Levi, Michael, TI Global Corruption Report 2001, p. 204.
years. Half of this amount was reputed to be from the Nigerian Central Bank. Once the extent of the theft was uncovered, it was established that a number of bank accounts, trusts and other financial instruments were used across Europe to deposit large amounts of money. An estimated US $1.4 billion has been found (and subsequently frozen) in banks in Liechtenstein, Luxembourg and Switzerland.

The repercussions of this scandal, which made headline news around the world, were immediate. The Swiss Federal Banking Commission, the main regulator of banks in Switzerland, began to publicly list the leading banks that were involved in the scandal. They were criticised for “serious failures” that allowed the Abacha clan to amass US $660 million in deposits. However, in a shocking revelation to the UK banking industry, it was learnt that up to US $123 million of the funds had originally come from the UK. Incredibly enough, some were alleged to be bribes from UK companies. Additionally, Swiss investigators discovered that a further US $219 million had been transferred to British banks from Switzerland.

The Nigerian Government is still trying to recover funds looted by the late General Sani Abacha during the former President’s time in office.21

The FSA began its own investigation into the matter. One of its findings was that, despite the filing of STRs by some banks (as is the practice when unusually large sums are transferred), 15 of the 23 banks which had dealings with the Abacha family funds had “significant” control weaknesses. Unlike in Switzerland, none of the banks was named by the FSA, as this was beyond its statutory powers at that time. This has now changed, as the Financial Services and Markets Act 2000 has provided the FSA with greater powers to combat money laundering.22

3.3 The Link between global corruption and money laundering

Traditionally, money laundering was associated with the proceeds of drug-trafficking and other organised crime. However, it has come to be seen as a key element in the fight against corruption.23 In terms of value, it is now thought that money laundering from corruption ranks fourth behind drug-trafficking, organised and conventional crime, and fraud.

DFID has stated that “corruption is aided and abetted by money laundering” and that corruption and money laundering “form a cycle of interdependent and illegal activity.”24 The easier it is to launder the proceeds of corruption, the greater will be the value and extent of extortion and bribery.

“Money deposited by looters and plunderers in the foreign banks was enough to repay Pakistan's debts. Pay our money and we will pay back our debts." These were the words of President Pervez Musharraf of Pakistan at the Inaugural Session of the National Anti-Corruption Strategy Workshop, on the 19th July 2002. President Musharraf urged the

22 Ibid.
23 Ofosu-Amaah, W. Paati (et al.), Combating Corruption, p. 53.
international community “to wage a war against corruption with the same resolve with which the menace of terrorism and narcotics were being addressed”.

He even went as far as to say that there had been collusion between the political and bureaucratic élite and financial institutions in Pakistan which had led to the corruption which plagues the country. To provide an estimate, he pointed out that approximately Rs 1.1 trillion, the equivalent to £10 billion today, had been earmarked for development purposes, but that to this day none of the projects intended had been realised.

To derive benefit from the fruits of corrupt acts an individual needs to disguise their source. In particular, a corrupt person will frequently wish to place ill-gotten gains beyond the sight, and hopefully beyond the reach, of his or her own jurisdiction. Such actions not only help avoid detection, but also provide a safe “nest egg” in case the person needs to flee. For this reason international financial centres such as London are seen as ideal locations. They have sophisticated financial services, are in politically stable jurisdictions and are large enough for significant sums of money to be placed without arousing undue attention. Money laundering, particularly trans-jurisdictional money laundering is therefore a vital part of the corruption process.

Because of this attractiveness all international financial centres, both on and offshore, must be alert to this threat, and London, because of its size and global reach, must be particularly vigilant.

Nor is the issue of corruption simply an “imported” problem, affecting only those financial institutions with an international customer base. In the context of the UK itself, corruption whilst less in scale is no less insidious. In the opinion of NCIS, “whilst it is difficult to estimate how many organised criminals use it routinely and systematically, over a quarter of organised crime groups identified in 2002 and 2001 were reported to have used it.”

3.4 International initiatives

Although early initiatives were specifically designed to combat money laundering related to drug-trafficking, the remit of the various directives and conventions has gradually expanded to cover money laundering related to serious crime including corruption.

The first major international initiative to co-ordinate efforts on a global scale was against drug-trafficking through the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention), signed by over 125 countries. In spite of its narrow remit, the Vienna Convention covered the early stages of financially related measures to combat money laundering. It imposed direct limitations on banking secrecy and financial privacy, and made drug-trafficking a criminal offence.

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26 With the exception for the M-2 Motorway, two international airports and a few buildings in Islamabad none of the allocated projects for Rs1 trillion given to the Public Sector Development Programme had been completed over the past ten years.
27 NCIS, UK Threat Assessment 2002: The threat from serious and organised crime.
The FATF, which is widely seen as the most important international initiative in the fight against money laundering, was established by the G7 Summit in Paris in July 1989 to examine measures to combat money laundering. In 1990 the FATF issued Forty Recommendations to address this problem. In 1996, the Forty Recommendations were revised to take into account the experience gained over the previous six years and to reflect the changes that had occurred in the money laundering problem. A further eight recommendations were added in 2001 specifically to cover the financing of terrorism.

All member countries of the FATF have made laundering the proceeds of a range of serious crimes a criminal offence and this extends to bribery at a national level as a predicate offence in almost all cases. The Forty Recommendations set out the basic framework for AML initiatives and are designed to be of universal application. They cover the criminal justice system and law enforcement, the financial system and its regulation and international co-operation. However, it was recognised from the start that FATF member countries had diverse legal and financial systems and so could not take identical measures. The idea was that countries would implement the recommendations according to their specific circumstances. The Forty Recommendations are widely accepted as the leading international AML standard.

The first EU Directive on Money Laundering in 1991 was a European initiative designed to prevent the use of European financial systems for money laundering. It sought to harmonise the various national laws and thus avoid the potential for regulatory arbitrage within the EU. The origins of customer identification, record keeping and the reporting of suspicious transactions can be found in this Directive. In December 2001, the European Union adopted the second EU Directive on Money Laundering. This amended the first directive by widening the range of predicate offences, and extends the obligations of the 1991 Directive, in particular customer identification and obligatory suspicious transaction reporting, to a range of non-financial activities and professions.

Also of note is the Basel Committee on Banking Supervision, which, in 1988, produced the Statement of Principles on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering. In simple terms, it provided the international financial community with a common standard for due diligence on customers through the KYC requirements.

Money laundering techniques constantly move on and new measures to combat them have been introduced. New technologies have also had an impact on both the regulators and the money launderers. This has resulted in further initiatives such as the UN Convention on Transnational Organized Crime; and, as already noted, the revised EU Directive on Money Laundering and the FATF Recommendations on Terrorist Financing. In October 2001, the Basel Committee issued its new guidance on Customer Due Diligence for Banks.

The FATF Forty Recommendations are themselves currently under review through a Consultation Paper to reflect, for example, the problems associated with PEPs, correspondent banking, electronic and other non face-to-face financial services, and non-financial services.

The FATF recognises that money laundering is not just a problem for the financial services industry. It has become increasingly clear that many non-financial businesses and
professions are deeply implicated. As a result, the extension of the Forty Recommendations to the following is under active consideration:

- Casinos and other gambling businesses
- Dealers in property and high value items
- Company and trust providers
- Lawyers
- Notaries
- Accountants and auditors
- Investment advisors

This review of the Forty FATF Recommendations has been spurred on by the fact that: “FATF members have noted increasingly sophisticated combinations of techniques, with increased use of legal entities and other corporate vehicles. FATF studies have shown that companies, trusts and other types of business entities are commonly used as part of the laundering process or to disguise the true ownership and control of illegally acquired assets. Another feature of money laundering schemes that has caused increasing concern has been the use of professionals, such as lawyers, notaries, and accountants, by organised crime and other criminals to assist them to launder their funds by acting as financial intermediaries or providing expert advice (so-called “gatekeepers”).”

The second EU Directive, which was due to come into effect in June 2003, also intends, among other points, to broaden the definition of “relevant financial business” so as to encompass professional intermediaries such as lawyers and accountants and those who deal in high value goods. It also widens the definition of money laundering to include “all serious crimes.”

A possible extension of the FATF Forty Recommendations, together with the second EU Directive, is likely to have a significant impact on the many non-financial businesses and professions which have, hitherto, not been statutorily regulated. This is of particular interest to our Report and makes it an opportune time to publish our recommendations.

### 3.5 Money laundering in the UK

“The UK is also an attractive target for money launderers. The attraction for the money launderer lies in the fact that London’s financial markets have the necessary breadth, depth and openness to be useful at all stages of the money laundering process, whether it be placement, layering or integration.”


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28 Review of the FATF Forty Recommendations, Consultation Paper.
It is for this reason that the UK, and London especially, is of concern to TI(UK). This concern is also felt by many other organisations and individuals who feel that the very features that have made London such a success could also encourage abuses of the system and a proliferation of money laundering. It is, however, difficult to assess with any precision the extent to which money laundering takes place in London. According to Home Office estimates, dirty money represents about 2% of the UK’s Gross Domestic Product, which is £18 billion.\(^{29}\) This figure must be supplemented by the laundering through London of the proceeds of criminal activity occurring outside the UK.

What are the main features which place London in such a vulnerable position? Without question, the UK is home to a huge financial services industry which makes a significant contribution to the UK economy. This position is partly due to the historical and political connections which the UK has built up as a trading nation over centuries, both with members of the Commonwealth and with many other countries.\(^{30}\) It is also due to the enterprise, skills and hard work which London still brings to the financial services industry. An ability to adapt and change has always been a hallmark of the “City”, aided, it has to be said, by a regulatory environment which has traditionally been robust, flexible and practical. The result is that London can claim a leading position in many financial services such as investment banking, foreign exchange and derivatives trading, securities and commodity exchanges, insurance and fund management, ship-broking and aircraft-leasing and legal, auditing and accounting services.

It is thus inevitable that launderers will seek to use London, given the range of financial services on offer and the size of its markets. London is, however, not unique in its attraction. New York, Hong Kong and every other major centre that provides significant international financial services face similar threats. Nevertheless, simply because it is not alone in its vulnerability, and money launderers certainly have access to other centres if London is made less attractive to them, this does not mean that London can relax its guard.

Legislation to control money laundering has developed in a piecemeal fashion but the key legislation is now the Proceeds of Crime Act 2002, which replaced the money laundering provisions in the Criminal Justice Acts 1988 and 1993. The Proceeds of Crime Act is, in our view, one of the most potentially effective pieces of legislation in the fight against money laundering. In particular, the creation of the ARA provides the authorities with a powerful new tool in removing the financial benefit from crime. It also introduces an objective test in determining whether a person should have had a suspicion. We do, however, consider that some improvements in relation to the issue of corruption are desirable and these are outlined later in our Report.

Other relevant legislation includes the Financial Services and Markets Act 2000 (FSMA) by which the Government gave to the FSA a statutory objective to combat financial crime.

As stated above, the first EU Directive on Money Laundering imposed a set of requirements upon the financial services industry (defined as institutions and

\(^{29}\) British Government Home Office website.

professionals having “relevant financial business”), which were later codified in the UK through the Money Laundering Regulations 1993.

This year, the UK Treasury will replace the existing regulations with the Money Laundering Regulations 2003, which will implement the second European Directive on Money Laundering.

The previous Regulations required that any person carrying out relevant financial business, either through a business relationship or a one-off transaction, must comply with the following procedures:

- Identification of all customers
- Record keeping relating to all identifications;
- Internal reporting as designated by the role of the Money Laundering Reporting Officer who receives all enquiries and reports relating to the suspicion of money laundering;
- Internal control and communication of the firm’s money laundering procedures and requirements to all relevant staff;
- Training of staff on the above procedures.

The revised MLR will extend the remit of the regulations to activities such as auctioneers, casinos and other gambling businesses, dealers in property and high value items, company and trust providers, lawyers (for certain activities) and accountants and auditors.

3.5.1 The FSA rules

The main regulator, the FSA, has a statutory objective to reduce the extent to which it is possible for a regulated firm to be used for a purpose connected with handling the proceeds of crime. The FSMA requires the FSA, in pursuing the financial crime objective, to have regard to the desirability of firms:

- Being aware of their financial crime risks;
- Taking appropriate measures to prevent financial crime, facilitate its detection and monitor its incidence;
- Devoting adequate resources to that prevention, facilitation and monitoring.

Through its powers under the FSMA, the FSA produces its own money laundering rules (Sourcebook), which are contained in the FSA Handbook. These were issued in December 2001 and operate in parallel with the banking industry’s Joint Money Laundering Steering Group guidelines. The purpose of the Sourcebook is to require “relevant” firms to have effective AML systems and controls, in order to reduce the opportunities for money laundering in relation to those firms. It also requires the firms to ensure that approved persons exercise appropriate responsibilities in relation to those AML systems and controls.
3.5.2 **AML guidance**

The Joint Money Laundering Steering Group has produced detailed Guidance Notes designed to assist the conduct of business on the basis of the MLR. Section 330(8) of the Proceeds of Crime Act requires the court to take into account Guidance that has been approved by UK Treasury.

It is important to note that the Guidance Notes are not mandatory and failure to comply does not mean an automatic breach of the MLR or FSA Rules. Nevertheless, as stated above, they do provide an indication of what the courts will take into account as being expected of firms.

According to the Joint Money Laundering Steering Group, the purpose of the Guidance Notes is to:

- Outline the requirements of the UK money laundering legislation;
- Provide a practical interpretation of the MLR;
- Set out the requirements of the FSA Money Laundering Rules, Evidential Provision and Guidance;
- Provide an indication of evolving international standards and good generic industry practice;
- Provide a basis from which management can develop tailored policies and procedures that are appropriate to their business.

Like the Regulations, the Guidance Notes are currently under review.
4To Deter and Detect

4.1 Verification of customer identity

It is our view that the fight against money laundering in the UK has focused too heavily upon the issue of initial identification. This identification, whilst essential, is in reality only one part of the KYC process. Indeed it is this element of anti-money laundering that we consider the easiest to evade, given the potential for identity theft and the creation of false identities. A Cabinet Office report in 2002 concluded that identity fraud is a serious and growing problem that costs the UK more than £1.3 billion a year.

NCIS has stated that there is “no comprehensive data on identity fraud.” However it has also stated that identity fraud underpins much serious and organised crime, including money laundering, and that serious and organised criminals have little difficulty in obtaining false identity documents. This means that whilst identification checks may provide some protection to firms - it is clear that when asked for identification some would-be money launderers do back off - they are unlikely to prove a fully effective deterrent to a determined money launderer and may even give false comfort to the firm that its identification checks provide sufficient protection.

This weakness has been further exacerbated by a failure to identify the source of the funds which are being utilised to undertake the transaction/activity. It appears that at least part of this is due to a reluctance to ask customers who may consider such questions an invasion of privacy. We therefore welcome the recent initiative to increase public awareness as to the rationale for such questioning.

Given this weakness, we are concerned that the focus on identity has been wrongly seen as a panacea in the fight against money laundering. In fact, it is only part of the fight.

This focus is likely to continue with the forthcoming exercise to verify the identity of customers with whom the bank already had a relationship prior to the introduction of the MLR.

Inevitably where a firm has limited resources there will be a risk that it will place emphasis on initial identification, and this in turn may result in insufficient focus by financial institutions upon understanding the motives and intentions of their customers and the subsequent monitoring of their activities. Yet it is our view that this part of the KYC process is the most important and most likely to result in the successful identification of money laundering activity.

Recommendation 1

That the FSA and other bodies responsible for the monitoring of compliance with the UK AML regime ensure that firms do not focus upon initial identification at the expense of the need also for a proper understanding of the source of funds, the need for effective

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31 In 2000, a group of leading international banks agreed a set of global AML guidelines aiming at strengthening KYC rules. These are available at www.wolfsberg-principles.com
33 Ibid.
monitoring of customers’ activities and the need for a better understanding of their motives and intentions.

In addition to this general issue, a specific problem arises in connection with corruption.

The Joint Money Laundering Steering Group Guidance Notes make specific reference to the handling of the proceeds of corruption. Specifically they deal with the issue of PEPs and the danger of the creation of constructive trusts in corruption cases. A definition of a PEP is provided and includes not only the individual but also his/her immediate family and close associates (defined as someone who is widely and publicly known to maintain a close relationship with the PEP).

In conducting the initial KYC review, the Guidance Notes advise use of the TI Corruption Perceptions Index to assess which countries are particularly vulnerable to corruption. Firms should also establish who the senior political figures are in the countries where they do business and seek to determine, so far as is practical, whether or not their customers have connections with them.

Whilst such guidance is laudable it is difficult to see how, without Government help, a firm can gather sufficient information to be able to be comfortable that relatives and associates of a PEP located in a different country have been identified. The Government, particularly the Foreign and Commonwealth Office, is well-placed to identify such persons. If, however, such provision is felt to be too diplomatically sensitive then encouragement should be given to the provision of such information by private bodies.

Recommendation 2

That the UK Government investigate how it can assist firms in the identification of “Politically Exposed Persons” and their associates, either directly or by encouraging the provision of such information by private sector bodies.

We are also concerned that the use of the term “Politically Exposed Person” itself does not accurately reflect the risk from this area, as many persons exposed to corruption are not “politically exposed”. We therefore think it is advisable that the definition of categories of persons whose role or personal relationship particularly exposes them to the risk of corruption be more broadly defined.

Recommendation 3

That the definition of the term “Politically Exposed Person” be broadened to encompass all categories of persons at risk.

4.2 The monitoring of transactions and activities

The Joint Money Laundering Steering Group Guidance Notes provide specific advice on detailed monitoring and due diligence.

The monitoring of millions of daily transactions to determine those that are suspicious and worthy of an STR cannot, in our view, be undertaken without sophisticated

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34 Sections 2.27-2.32.
automated systems. Such systems can detect variances in both a customer’s own activities and variances of one customer from another with the same ostensible profile.

These transaction monitoring systems are inevitably expensive and firms need guidance on what is required to enable them to make such a financial commitment with confidence. We accept the desire of the FSA and others not to endorse specific providers and we are aware that the adequacy of any system in ensuring a firm complies with the Proceeds of Crime Act and MLR will ultimately be a matter for the courts. Nevertheless we consider that the FSA should adopt a benchmark standard that it considers acceptable and give confirmation to providers that meet this standard. Any cost to the FSA can be met by charging providers for the assessment. We therefore await with interest their proposed Consultative Paper on this issue, which we understand is due out in the middle of this year.

Recommendation 4

That the FSA adopt and publish a benchmark standard for all sectors of the financial industry for acceptable automated transaction monitoring systems and give confirmation to providers that meet this standard.

As already noted, it is important that suspicions are not simply confined to transactions. It is suspicious activity that is the key. Indeed some of those businesses and professions shortly to be brought under the remit of the revised MLR, such as lawyers, do few “transactions” as such. Rather they are more likely to become aware of suspicious activity (e.g. a lawyer or accountant being asked to facilitate the making of non-commercial arrangements).

Nevertheless, it appears that suspicious “transactions” remains the standard term. We consider that the term “activity” is preferable as it not only covers transactions but other suspicions as well. Such changes in terminology, whilst minor in themselves, help to change the mindsets of those covered by the MLR, and what is expected. Otherwise there is a danger that money laundering activity will go unreported.

Recommendation 5

That emphasis be placed on the requirement to report suspicious activities rather than only suspicious transactions, and that any necessary changes to guidance should be introduced to reflect this.

4.3 Staff training and awareness

As we have stated in the introduction, money laundering is vital to the process of corruption. Nevertheless, the majority of AML documentation focuses upon other criminal activities, particularly drugs. Whilst some focus has, post-Abacha, looked at the issue of corruption, and the guidance on PEPs has been useful in this area, more work is still needed. For example, despite the pivotal role of money laundering in international corruption, the latest NCIS threat assessment35 does not specifically cover corruption as a significant threat. This could be because corruption is often seen as predominantly a

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“foreign” problem. However, as the Abacha case has shown, the international nature of the UK finance industry makes even “foreign” corruption a very real issue in the UK.

The question of staff training, both initially and ongoing, is therefore of considerable relevance in identifying suspicions of corrupt activity. The MLR requires that all finance sector firms must provide employees with training in the recognition and handling of transactions carried out by, or on behalf of, any person or persons who are, or appear to be, engaged in money laundering.\(^{36}\) However, without adequate training on corruption and how it may manifest itself, a firm cannot meet its AML obligations as staff will be unable to identify suspicious transactions or activity to ensure that they are meeting their and their firms’ obligations.

We do not consider that sufficient attention has been paid to the issue of corruption and the need for specific staff training on issues such as identifying PEPs and their immediate family and associates.

It is also vital that those groups which will shortly become subject to the revised MLR when they come into force such as estate agents and dealers in high value items are given access to adequate training beforehand.

Finally, there appears to be heightened concern by staff following the introduction of the Proceeds of Crime Act. This has expanded the culpability of failure to report as there is now an objective test of reasonable grounds for knowing or suspecting. Furthermore, there appears to be confusion as to what constitutes “tipping off.” Such concerns mean that training still needs to be made more explicit, for example in the handling of a transaction after a suspicion report has been made.

Finally there is a need for firms to be required formally to demonstrate that their staff know and understand their AML duties.

**Recommendation 6**

*That the requirements and/or guidance in respect of AML training be made more explicit. There should also be a general obligation on institutions to test staff awareness and understanding.*

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\(^{36}\) Regulation 3(1)(c).
5 Expanding the Net

5.1 Introduction

As highlighted by the FATF Consultation Paper,37 money launderers are moving into other areas in response to increased regulation in the banking and financial services industry. This in part reflects the good news that the deterrent effect of enhanced AML legislation and regulation is working, especially in the banking sector, but in part reflects the bad news that sophisticated and nimble money launderers will always stay ahead of the authorities.

5.2 Extension of the Money Laundering Regulations

5.2.1 Introduction

As a result of the second European Directive and the resultant changes to the MLR, a new range of activities will fall within the regulatory net.

This extension is a welcome wake up call to a number of areas which have previously been seen as “soft touches” for the purposes of money laundering. Nevertheless, we believe that, in a number of areas, the extension is insufficient to provide the level of protection needed to truly raise the bar in the fight against money laundering.

Additionally, we are concerned that this major change appears to be occurring without adequate awareness of its implications for those affected and without a clear programme for their training.

5.2.2 Lawyers and Accountants

The UK AML legislation applies to lawyers and accountants. Furthermore, the FSA has a statutory obligation to regulate those lawyers and accountants who undertake financial activities caught within the ambit of the FSMA. In addition, professional bodies such as the Law Society and Institute of Chartered Accountants, set their own requirements concerning their members’ AML work.

Despite the above, the number of STRs lodged with NCIS remains surprisingly few and concern has already been voiced at the “under-reporting of suspicious transactions by certain professional groups, in particular lawyers and accountants.”38 As far back as 1999, the DFID reported that the “Government is concerned to ensure that a wider range of professionals, such as lawyers and accountants, take seriously their responsibilities to report suspicious transactions.”

Indeed, Andy Blezzard of NCIS has commented that:

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“Solicitors and accountants continue to give concern with very few reports being made despite their relative attractiveness to launderers.” 

In 2001 accountants made only 0.35% of the 31,251 STRs reported to NCIS. Likewise, solicitors made 1.02% of STRs. The Law Society is aiming to increase awareness within the legal profession as a whole and as Louise Delahunty of the Law Society’s Money Laundering Task Force reported: “At present all efforts are being made to educate solicitors on this new area of concern for the financial services industry as a whole and to prepare them for the changes that they will need to adopt to accommodate the forthcoming regulations.” At the very least, there is clearly a need for lawyers and accountants to receive further training in AML regulations through Continuing Professional Development courses, to ensure that they appreciate the extent to which they must comply with the new regulations.

In addition to this, the revised MLR will bring a number of activities undertaken by lawyers and accountants within the regulatory net. This is a welcome move yet, in our view, there is still work to be done.

The general duty of a professional such as a lawyer or accountant to keep the affairs of their clients confidential is clear. Nevertheless, it is not sacrosanct and professionals have other duties which may conflict with those owed to their clients. Managing such conflict may not be easy but it must be done. A professional’s duty to his or her client cannot be seen as an excuse for poor KYC assessments or for turning a blind eye to money laundering. A solicitor’s status as an officer of the Court ought to make his/her duty clearer. In many instances the professional will be in a well-placed position to identify suspicion as he or she will have a greater overall understanding of the activity. Such an understanding is often further enhanced by the professional having additional roles such as company secretary, trustee or director.

In our view, professional bodies representing groups such as accountants and lawyers need to do more to ensure that those amongst their membership who do turn such a blind eye are speedily detected and removed from the profession. This should be supplemented by a programme of independent on-site visits to professionals, specifically to review the quality of their compliance with the AML requirements. In the post-Enron world, purely to rely on self-regulation by professional bodies is no longer justifiable or acceptable.

It seems to us logical that the FSA is tasked with this additional work. Whilst the position of client confidentiality, particularly in respect of attorney-client privilege will need to be protected, the FSA is already under an obligation to preserve confidentiality and has a successful record in preserving confidential information reviewed during its on-site inspections. There is no reason to believe that it could not carry out its new role with similar discretion.

We understand that such work will result in extra demand upon the FSA’s resources, maybe necessitating new resources. Nevertheless we feel such resources will be eminently worthwhile. To find the required funding, the feasibility of utilising the proceeds of assets recovered by the ARA should be considered.

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Recommendation 7

That there should either be a programme of independent on-site visits (for example by the FSA) to lawyers and accountants, specifically to review the quality of their compliance with AML requirements, or, if such inspection is to be undertaken by the relevant professional body, that the FSA approve the nature, rigour and frequency of such inspections.

The use of lawyers in money laundering. Case Example 2

A solicitor who helped launder £30 million for a jailed smuggler of alcohol and tobacco was jailed for seven years in 2001.

According to the BBC, in an extensive operation that lasted several years the solicitor systematically set up companies and off-shore accounts to launder the money on behalf of his client.

He also prepared “utterly deceitful” letters of introduction for criminal colleagues of the smuggler so they could visit him in prison by posing as solicitors’ clerks making private legal visits.

Passing sentence the judge told the solicitor that “You entered into an agreement to put beyond the prying eyes of the authorities very large amounts of what should have been tax-payers money. On [your client’s] instructions you acquired properties and businesses with the proceeds of his criminal conduct.”

5.2.3 Money Service Businesses (MSBs)

MSBs include money transmission services, cheque cashing services and bureaux de change.

In respect of MSBs, our principal concern is that, unlike other financial service activities, responsibility for on-site inspection rests not with the FSA, but rather, since November 2001, with HM Customs and Excise.

Given the use that is made of MSBs by money launderers we consider that the simple registration of them and subsequent spot checks is an inadequate response. In particular, we are concerned that sufficient resources are not available and that the level of supervision is not consistent between MSBs which undertake no other functions (and so are subject to HM Customs and Excise supervision) and between those that do, such as banks, which are therefore subject to the FSA’s more stringent regime.

We consider that MSB activities should be brought within the FSA’s regulatory ambit. As a result of this, those that own and operate MSBs would become subject to “fit and proper” checks and the range of disciplinary action open to the FSA could be used against MSBs which fail to conduct themselves appropriately including compliance with the FSA

AML requirements. On-site visits to assess their level of compliance with AML requirements would therefore be undertaken by the FSA rather than by HM Customs and Excise.

Such an approach would overcome many of the concerns raised by the IMF regarding MSBs.\textsuperscript{41} There would be civil penalties (i.e. those imposed by the FSA) in respect of money laundering failings. Additional resources would be available for review and a “fit and proper” regime for MSBs would be initiated.

Recommendation 8

That, ideally, legislation be introduced to bring bureaux de change and the provision of money transfer and cheque cashing services within the regulatory scope of the FSA If such an approach is not considered feasible, then, at the very least the providers of such services should be subject to licensing by HM Customs and Excise, with appropriate “fit and proper” checks on controllers and beneficial owners.

The Use of Bureaux de Change in money laundering. Case Example 3\textsuperscript{42}

In June 2002, the BBC reported the jailing of thirteen people for a total of 60 years after HM Customs and Excise broke up one of Britain’s largest ever money laundering operations. This operation had funnelled profits of £50 million from the sale of cocaine in Britain to the Colombian drug cartels.

According to the BBC, the gang first aroused suspicions in 1998 when NCIS began to receive reports of large amounts of notes being bought by several bureaux de change from currency wholesalers.

Sterling from cocaine sales was taken to certain bureaux de change and exchanged for dollars which were then smuggled out of the country by couriers. Additionally, cash was taken to the bureaux, from there passed into accounts and then electronically transferred to other accounts abroad. Operators of some of the bureaux were amongst those convicted.

5.2.4 Company and trust management

As the OECD has stated,\textsuperscript{43} “almost every economic crime involves the misuse of corporate entities”. The Joint Money Laundering Steering Group Guidance Notes describe them as “the most likely vehicles for money laundering”.\textsuperscript{44}

The latest NCIS threat assessment\textsuperscript{45} also refers to the use of front companies.

The abuse of companies for laundering can take a number of forms. For example “front companies” where an actual business is carried on and illegal profits are commingled with revenues from the company’s legitimate activities, and “shell companies” which are

\textsuperscript{41} IMF, op.cit., Paragraph 294
\textsuperscript{42} BBC, 17th June 2002, “Money laundering ring smashed” Report
\textsuperscript{43} OECD, op. cit.
\textsuperscript{44} Paragraph 4.150.
\textsuperscript{45} NCIS, 2002, op. cit.,
those without substance but which are often incorporated to conceal the Ultimate Beneficial Owner of assets.

In addition to the use of such entities for the purposes of money laundering, the FATF has also reported that front and shell companies have been used in relation to terrorist financial activity.\footnote{FATF, Money Laundering Typologies 2002-2003.} In practice, they may also be used for concealing assets generated by fraud, tax and financial crime.

London is foremost in the world in the provision of those legal and accounting professional services essential to the establishment and operation of trusts and trust companies. The anonymity enjoyed by these structures makes them suitable for a number of legitimate purposes but also, in many cases, leads to their abuse through concealing and administering the proceeds of crime.

Many offshore financial centres have introduced legislation to regulate those that form and administer companies and often trusts as well. The aim of such legislation is to ensure that those conducting such activities are “fit and proper” and are subject to AML regulations. We understand that the UK authorities have considered bringing such activities within the scope of financial service regulation, but have no definitive plans thus far.

We consider that such a failure is both regrettable and unacceptable. It seems to us unconscionable that the UK Crown Dependencies and Overseas Territories have been pushed to introduce such legislation,\footnote{Edwards, Review of Financial Regulation in the Crown Dependencies and KPMG, Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda, op. cit.} yet the UK itself still lacks definitive plans to do so.

If the UK does not bring this area under regulatory control, ideally by the FSA, it is unclear to us who will be responsible for monitoring this sector’s compliance with the revised MLR on an ongoing basis. Such failure to monitor will, in our view, substantially devalue the benefit of bringing them within the revised MLR in the first place.

The bringing of this area within the regulatory scope of the FSA would also make the service providers subject to “fit and proper” checks and therefore further deter criminal control of such enterprises.

\textit{Recommendation 9}

That the UK bring those involved in the provision of company and trust services by way of business, such as company formation and professional trusteeship, within the regulatory scope of the FSA.

\subsection*{5.2.5 Other non-financial activities susceptible to money laundering}

The revised MLR will result in providers of many non-financial services being brought within the AML regulatory system. For example, estate agents, antique dealers, auction houses and other dealers in high value goods will be included and this will not be easy. In
addition to the issue of training discussed previously, there is a further major problem here.

The fact is that many of the activities of these businesses are of a wholesale nature. The question then arises of how is it possible to have an effective KYC policy on one’s customers’ customers? A great deal of the trade at auction houses and antique dealers, for example, is wholesale, with firms trading with each other. The auction process is continuous and brief, and auction houses have built up, over the years, relationships with an international network of dealers and their agents. These are, however, fiduciary relationships based on trust and an ability to pay. The auctioneer is not really interested in whether a dealer is acting as a principal or an agent. It is therefore not hard to understand why sophisticated money launderers, be they corrupt PEPs, drug-traffickers, fraudsters or terrorists, have been making increased use of these hitherto non-regulated non-financial sectors.

Bringing effective regulation and guidance into this area is, however, vital and we are not convinced that, at this stage, sufficient consideration has been given to the complexities involved. For example, how does one identify the Ultimate Beneficial Owner when dealers, particularly from overseas, do not have to disclose such details?

The UK is at risk here as so much of this wholesale trade takes place in London and the provinces. Firms outside London are especially vulnerable as they tend to be small and will lack the resources to implement effective KYC and STR/SAR policies. It will be difficult to implement AML regulations on these hitherto non-regulated sectors, which are, from research conducted for this Report, quite remarkably unprepared. We are concerned that little appears to be being done to rectify this lack of preparation. Unless urgent action is taken, many of those who will shortly be subject to criminal sanction for any breach of the revised MLR will be wholly unaware of their new obligations.

Recommendation 10

That the Government conduct a major exercise to ensure that those who will come within the revised MLR are made sufficiently aware of their new responsibilities and have been provided with adequate training to meet these responsibilities.

In addition, we question whether the simple reporting of suspicions over cash transactions above a certain value is adequate. As NCIS has stated,48 “cash is particularly important in the workings of most serious and organised crime.” As the placement of cash in the financial system has become more difficult, so the use of non-financial goods as part of the laundering process has grown in attraction. Virtually all high value items, from jewellery to high performance cars, from property to fine wine, can be used. Therefore, there is a need for purchases of such items for cash to be brought under greater scrutiny.

It must also be remembered that such purchases may not simply be part of the money laundering process but may also be the launderer enjoying the fruits of his activity. The purchase of such items by non-cash methods may also be suspicious and indicative of an unexplained lifestyle.

48 NCIS, 2002 op.cit.
The purchase of non-financial products for cash is the soft underbelly of the fight against launderers and greater emphasis on this area is long overdue. Such scrutiny will also provide assistance to the work of the new ARA.

*Recommendation 11*

That consideration be given to requiring cash purchases of high value items above a certain level to be notified to NCIS, until such time as the MLR requirements are considered to be operating effectively.

5.3 **Correspondent banking**

Our impression is that responsible banks in the City of London now take the issue of reputational risk very seriously, not least that related to money laundering. Indeed, recent events have demonstrated that reputation is a bank’s most valuable intangible asset. Banks have therefore, in their own enlightened self-interest, invested enormous sums, time and energy in developing effective compliance and AML systems. They now realise that these systems have become a major priority for management as they help to build and sustain reputation.

There is, however, an area of particular risk affecting banks in the context of money laundering and that is the issue of correspondent banking. Correspondent banking is the provision of banking services by one bank, the correspondent bank, to another, the respondent bank, usually in the form of inter-bank lending. By establishing multiple relationships worldwide, banks can, in effect, create international business for themselves and their customers in jurisdictions where they may not have a branch.

The main issue with correspondent banking is that once corrupt funds have entered the banking system, it is extremely difficult to identify those funds as they move from bank to bank. The problem is how to ensure that due diligence is extended beyond the respondent banks and through to their customers. This is not an easy problem to solve. As already noted, it poses the general question of how to enforce an effective KYC policy on the customers of your customers.

The FATF Consultation Paper on the Forty Recommendations found that: “The types of weaknesses that have been found in banks’ ongoing anti-money laundering oversight of their correspondent accounts are as follows:

a) Failure to ask respondent banks about the extent to which those respondents allowed other banks to use their accounts with the correspondent bank. In this way, the correspondent bank might find itself indirectly conducting business for a number of offshore or shell companies with which it would not even consider establishing a direct account relationship.

b) Variable degrees of due diligence on correspondent relationships, depending on whether credit was being granted. Extension of credit facilities necessitated an evaluation of the foreign bank’s management, finances, business activities, reputation, regulatory environment and operating procedures. But for fee-based services, e.g., wire transfers or cheque clearing, the same degree of due diligence was often not undertaken. Since the highest-risk banks were rarely extended credit, they often seemed to avoid banks’ anti-money laundering systems and controls.
Moreover, some correspondent banks did not always undertake periodic reviews of their relationships with respondent banks, even when there had been negative press reports about a particular bank, which if they had been reviewed, may have triggered a fundamental review.”

The recommendation from the FATF was greatly to increase due diligence in this sector, requiring far more background information and on-going reviews. Banks should train their staff to recognise irregular activity and to submit STRs where appropriate. Banks should also guard against establishing relations with respondent foreign institutions that permit their accounts to be used by shell banks.

Perhaps most noteworthy for London, the FATF advised that “Institutions should refuse to enter into, or continue, a correspondent banking relationship with a respondent where it has no physical presence (a so-called shell bank) and which is unaffiliated with a regulated financial group. Banks should also guard against establishing relations with respondent foreign institutions that permit their accounts to be used by shell banks.”

Given the sheer volume of international business passing through London and the number of foreign banks which operate there, it appears that London is more vulnerable than other major international financial centres.

The British Bankers’ Association has indeed expressed concern that there may be weaknesses in UK banks’ correspondent relationships, especially where one bank opens an account with another bank and uses that account to move a customer’s funds. It has also pointed out that it would not be unusual for corrupt PEPs in positions of power to use a Central Bank to launder funds. This was indeed the process adopted for a number of the Abacha transfers. Were a commercial bank in the UK to receive a telegraphic transfer from a Central Bank, it would be likely to treat it as a legitimate transaction.

The Guidance Notes require that “transactions conducted through correspondent relationships need to be managed on a risk-based approach.” Specifically the Guidance Notes state that:

- Firms should guard against passing funds through their UK accounts without taking reasonable steps to satisfy themselves that sufficient due diligence has been undertaken by the remitting bank on the underlying client and the origin of the funds.

- Firms should consider terminating the accounts of correspondents who fail to provide satisfactory answers to reasonable questions, including, where appropriate, confirming the identity of customers featuring in unusual or suspicious circumstances.

- The volume and nature of transactions flowing through correspondent accounts with firms from high risk jurisdictions or those with inadequacies or material deficiencies

49 Ibid, p. 15.
50 Paragraph 4.216.
51 Paragraph 4.218.
52 Paragraph 4.221.
should be monitored against expected levels and destinations and any material variances should be checked.\textsuperscript{53}

Overall, therefore, there is a need for greater KYC information from those respondent banks which are not so well-regarded. Assurances must be received from these banks that they comply fully with all the international directives and conventions on bribery, corruption and money laundering. Indeed, the leading multinational banks are beginning to enforce good banking practice on many smaller respondent banks which otherwise could be ostracised from the greater banking community. Where applicable, we also consider it is desirable that banks conduct regular visits to respondents located in non-FATF countries to confirm the adequacy of their KYC arrangements.

We consider that the above initiatives are highly worthwhile and go a considerable distance towards reducing money laundering in this area. Nevertheless we feel that certain additional prescriptive requirements should be put in place to help further prevent the abuse of correspondent relationships.

Recommendation 12

\textit{That international pressure on correspondent banking be maintained and the UK authorities ensure that UK banks do not enter into or maintain correspondent relationships with respondents that do not have adequate AML procedures in place.}

\textsuperscript{53} Paragraph 4.217.
6 Taking the Fight to the Launderers

6.1 The assessment of reports of suspected money laundering

Within NCIS there is an Economic Crime Branch which is the Financial Intelligence Unit for the UK. Its primary function is the receipt, analysis and dissemination of STRs, SARs and other disclosures. It is also involved in measures to improve the UK’s AML and asset recovery regime. In 2001, the Branch received 31,251 disclosures, an increase of almost 70% from the previous year. We have been advised that for 2002 the figure has nearly doubled.

The number of disclosures has resulted in a backlog in dealing with reports. The IMF has put this at 3 months.\textsuperscript{54} This is despite a staffing increase of over 100% between 2000 and the end of 2001. The target for turnaround times for fast track reports was to be 75% actioned within one working day and 90% of all reports within five working days.\textsuperscript{55}

The process whereby an STR or SAR is lodged which may lead to a prosecution, is lengthy. Once received, the report is assessed for any criminality associated with the suspicion and the persons involved. This assessment involves the use of a number of databases which contain all the disclosures made and which can be searched, based upon factors such as name, account number, branch code, etc. It also lists all known associates. These reports, which are reporting on the proceeds of crime rather than the crime itself, are then divided into three groups: drugs, terrorism and general crime. The consequence is that the basis of the suspicion may not be the basis of any investigation or prosecution. If information of sufficient merit is gathered from the database analysis, then the case is passed on to other Government agencies.

Once sent to law enforcement, it is up to them to decide what to do and how to do it. NCIS only remains involved through obtaining feedback from the law enforcement agencies so as to build intelligence. In a similar fashion, NCIS is committed to providing feedback and good customer service to the banks which lodge reports.

NCIS, in response to any allegations of inefficiency and ineffectiveness which their assessments of money laundering reports might provoke, points out that the nature of investigations into money laundering is different. While the financial services industry is required to provide reports of their suspicions, investigators are required to compile evidence for prosecutions, and the availability of the suspect, as well as of the evidence is key to any prosecution. As already noted, NCIS does not itself prosecute cases as that is left to the appropriate law enforcement agency.

It is at this point that the need for a joined-up criminal justice system in the UK becomes most obvious. The issues involved are beyond the scope of this paper. But it is sufficient to mention that law enforcement in the area of money laundering is the responsibility of 53 police forces, HM Customs and Excise, the Crown Prosecution Service and the Serious Fraud Office (SFO). Even in London there are two police forces. Outside

\textsuperscript{54} IMF, op. cit.
\textsuperscript{55} Home Office, Asset Recovery Strategy and Committee.
London, many forces do not have a fraud squad and still less the specialists required to deal with complex cross-border financial crime.

NCIS has been doing its best but the assessment of money laundering, especially related to corruption by PEPs, is often time-consuming and requires specialist skills. There is also the fact that reports which relate to drug-trafficking and terrorism take a higher priority, especially the latter after September 11th 2001. If money laundering is to be tackled with any real commitment, the Government must ensure that both the regulatory and investigatory bodies are adequately resourced. Despite a recent increase in staffing, NCIS would still appear to be seriously under-resourced. The provisions of the Proceeds of Crime Act may go some way to providing for more and better trained staff, but the whole system of STRs and SARs, and the passing of these to NCIS, requires refining.

We are aware of an independent report being undertaken to resolve these weaknesses and trust that its recommendations will be swiftly acted upon.

Furthermore, if, as a result of the second EU Directive and the revised MLR, NCIS is set to receive a further increase in reports from the professions and the previously non-regulated sectors, one must question whether it will be able to tackle these effectively. Without additional resources, both financial and skill-related, NCIS will be pushed to the limit and responses will be too slow to be effective.

This observation is not a criticism of NCIS which has been faced with a more than a threefold increase in reporting over the past two years. It is, however, a reflection on the need to further increase its resources and enhance its systems.

We note that the Director General of NCIS recognises this and trust that the resources needed will be forthcoming.

Recommendation 13

*That the current speed of assessment of reports notified to NCIS be reviewed and an action plan developed and published on how and when it will achieve its review target.*

6.2 Criminal prosecutions and regulatory action

It is important to remember that NCIS only provides an intelligence service but that the police and other law enforcement bodies are the ones which undertake the actual investigation of suspected money laundering. Therefore, regardless of the speed with which NCIS operates, unless sufficient resources and priority are given to investigations, it is inevitable that the number of actual prosecutions will continue to be low.

Historically there has been criticism of the small number of prosecutions for money laundering. Whilst arguments that simply looking at the number of such prosecutions provides a distorted picture, as STRs have resulted in prosecutions for a range of other offences, the criticism remains. This is not surprising given that the international dimension of much money laundering, particularly where it relates to corruption, makes such investigations inevitably time-consuming, complex and expensive. Law enforcement bodies endowed with limited budgets are therefore faced with the unenviable task of

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determining whether to commit considerable resources to such investigations or to use them for other activities which may be higher in the public perception of the need of action.

As for the number of prosecutions and convictions for money laundering offences, these are very few indeed. For 2001, there were only 175 of the former and 75 of the latter. The practical result of the laws and regulations in force in 2001 was very meagre, and it can only be hoped that there will be a considerable increase from now on. A lack of resources is one reason for these poor results. Another is, as already noted, the low priority assigned to cases involving major economic crime, including money laundering, which can be time-consuming, complex and expensive. There is also the fact that, in political terms, there is not much to be gained by tying up local police forces in these cases when there are more pressing local needs. There is indeed a strong argument for the creation of a national agency to handle these cases and which could subsume the Serious Fraud Office within its activities.

The Proceeds of Crime Act has increased the opportunity for prosecutions by introducing an objective test to determine whether a person should have been suspicious. In the case of regulations, the new role of the FSA through the FSMA also enables a more robust stance to be taken.

Evidence of such a robust approach by the FSA could be seen in December 2002 when the Royal Bank of Scotland was fined £750,000 following an investigation by the FSA. The FSA’s investigation revealed weaknesses in the bank’s AML controls across its retail network. The investigation found that, whilst there was no evidence of actual money laundering, the bank had failed either to obtain sufficient KYC documentation adequately to establish customer identity or to retain such documentation, in an unacceptable number of new accounts opened across its retail network in early 2002.

The FSA further stated that there was insufficient evidence to show that the clients were who they had claimed to be, whilst in some cases the bank was unable to supply copies or details of the documents such as a valid passport, a driving licence or a recent utility bill, it had used to verify identity. Examples of inadequate verification of identity included where the bank only verified a client's name but not his address, or where the documents the bank obtained were not capable of verifying identity.

In mitigation, it was reported that the bank discovered the problems through its own testing in December 2001. Additionally, although the breaches revealed weaknesses in the bank’s AML controls, in most cases some attempt had been made to identify the customers. The bank devoted considerable resources at an early stage to correct the problem and has instituted group-wide monitoring of KYC compliance rates in an effort to ensure that a similar problem does not occur again. This action has caused the failure rate to fall significantly from April 2002 and the FSA has stated that it was satisfied that the bank had dealt with the issue effectively.

This case was not the first one where a firm was fined for lapses in its AML procedures. In 2001, Paine Webber International (UK) was fined £350,000. In addition to a number of other compliance failures, it had exposed itself to the risk of money laundering (although

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no instances of money laundering were identified). The firm failed to implement and maintain adequate account opening procedures and, in particular, failed to obtain and record sufficient evidence of customer details. It also failed adequately to train and supervise staff in the application of its AML procedures.

We welcome the introduction of these additional powers both for criminal prosecutions and regulatory action. Indeed the IMF recently concluded that the UK has a comprehensive legal, institutional and supervisory AML regime. Nevertheless, part of the perceived success of the UK’s enhanced approach will be based upon any increase in prosecutions for money laundering and the action taken by the FSA to deal with those within its regulatory scope that fail to meet the requirements.

With a crime as international as money laundering, efficient and effective judicial co-operation and mutual legal assistance are indispensable. The procedures currently in place seem designed more to safeguard national sovereignty than to facilitate the exchange and flow of information necessary to track fund transfers which disregard all national borders. Great strides must follow the enactment of the Crime (International Co-operation) Bill.

If the UK Government wishes to see a marked increase in the effectiveness of the UK AML regime, it must, in addition to new laws and powers, provide the resources for actual investigations and prosecutions.

**Recommendation 14**

*That the UK Government allocate specific and adequate resources and structures to enable the investigation and prosecution of suspected money laundering offences and commit to making judicial co-operation and mutual legal assistance effective.*

### 6.3 Asset recovery

“We can’t just go after the criminals themselves, we’ve got to try to dismantle the gang. An important part is taking away their ability to commit further crime with the wealth they have acquired. The message I want to get across to the criminal “Mr Bigs” operating in the UK – we are now coming after you and your ill-gotten gains.”

Bob Ainsworth - UK Home Office Minister.

In June 2000, a study by the Home Office Performance and Innovation Unit found that financial investigation and asset recovery were seriously under-utilised. For example, less than one fifth of drug-trafficking convictions, and even fewer convictions for other acquisitive crimes, resulted in a confiscation order. Additionally enforcement of confiscation orders was poor with confiscation receipts amounting to between 40% and 50% of the value of orders made each year.

In the light of this the Government endorsed a strategy to:

- Make greater use of the investigation of criminal assets in the fight against crime;

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60 UK Home Office, Asset Recovery Strategy and Committee.
Prevent criminals and their associates from laundering the proceeds of criminal conduct and detect and penalise such laundering where it occurs;

Use the proceeds recovered for the benefit of the community.

As part of achieving this strategy the subsequent Proceeds of Crime Act contained provision for the creation of an assets recovery agency.

The need for such a strategy was further evidenced by the IMF which stated that confiscation appeared not to have been a priority for the Crown Prosecution Service and that there was no government property management system. 61 As a result, the confiscation of perishable items like air and water craft was not pursued.

The ARA began life on 24th February 2003 and it is premature to judge the level of success it will have in its aim of investigating, seizing, confiscating and taxing criminal assets. The Home Office aims to recover £60 million in criminal assets between 2004/2005.62 Given the estimate of £18 billion in dirty money these hopes are eminently attainable. This compares with £29.5 million during 1999/2000.63

The ARA itself is similar to the Criminal Assets Bureaux in the Republic of Ireland. This was set up in 1996 following the murder of journalist Veronica Guerin. It has frozen assets worth £33 million and collected £27.6 million in taxes from criminals.

TI(UK) is of the view that where assets were misappropriated from a specific country, the ARA should have the responsibility for their repatriation as appropriate through a trust fund administered internationally.

We are, however concerned, that the powers of the ARA do not extend to recovering the proceeds of corruption as fully as it might. This is because the definition of “lifestyle offences” will only include the proceeds of corruption where these proceeds have been laundered.

As a result of this, recovering the proceeds of corruption, whilst not impossible, will not be as easy as for “lifestyle offences” such as drug trafficking and prostitution.

Corruption can, in our view, constitute a lifestyle offence and should therefore have been be included within the list of such offences in the Proceeds of Crime Act 2002.

Recommendation 15

That the “lifestyle offences” detailed in Schedule 2 of the Proceeds of Crime Act be extended to include corruption perhaps using the proposed new Corruption Bill (now in draft) for this purpose.

62 UK Home Office, op cit.
63 Ibid.
6.4 Feedback of suspicion reports

Financial institutions have indicated that even when a report is lodged, there is little rapid feedback, and that when this is finally received, it is often too late to ensure good customer relations.

In order to enable a process of continuous improvement to be developed in the provision of STRs and SARs, it is important that reporting institutions are given adequate feedback on the reports they make. Whilst feedback that might imperil an ongoing investigation is clearly unacceptable, this does not preclude generic feedback to help firms in their determination of what is appropriate to be reported.

Objective four of the United States Financial Crimes Enforcement Network is “To build new law enforcement resources through focused and sophisticated analysis of elements of major cases and of trends and patterns of money laundering and related financial crimes.”64 The lack of a similar detailed trend analysis in the UK has been identified by the IMF as a weakness.65

Given the fixation of the UK on assessment using cost-benefit principles66 we cannot see how effective cost-benefit analyses can be calculated without a deeper understanding of the nature and evolution of money laundering typologies, including corruption. We would therefore suggest that, as with the Financial Crimes Enforcement Network in the United States, the development of typology analysis is made formally a part of the objectives of NCIS. We welcome the UK’s comment that NCIS is planning to conduct further analysis in this area67 as we consider that work in developing such an understanding is needed and overdue. It is important that this analysis yields some concrete developments in this area.

**Recommendation 16**

*That to facilitate continuous improvement in the quality of STRs and SARs, NCIS commits to providing regular feedback both to the finance sector as a whole and to specific institution, on the quality of reports made.*

6.4.1 Training of investigators

The IMF has identified the lack of training in the UK for enforcement agencies and the FSA in respect of money laundering investigations as a weakness.

We are aware of a number of initiatives in this area and note that a “Centre of Excellence in Financial Investigation” is already in operation as part of the ARA and designed to address this issue. There is a need to ensure that this Centre adequately covers the issue of corruption in money laundering.

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65 IMF, op. cit., Paragraph 281.
66 Ibid, Paragraph 298.
67 Ibid.
Recommendation 17

That the ARA adequately cover the issue of corruption in money laundering in the “Centre of Excellence in Financial Investigation.”

6.4.2 The UK Crown Dependencies and Overseas Territories

The UK is unique in that it has, partly by design and partly by historical accident, an array of small dependencies over which it exercises varying levels of control. Some such as the Channel Islands and Isle of Man, are effectively independent in everything except foreign policy and defence. Others, like the Cayman Islands, still have the Governor playing an active role in their executive arm of government.

Many of these dependencies have thriving financial centres, indeed some rank amongst the largest offshore centres in the world. Built on low and sometimes zero tax and historically weak regulation supplemented on occasion by strict banking secrecy laws, these centres have been traditional targets of accusations as money laundering centres.

The dependencies themselves would admit that in the early years of the growth of offshore finance the quality of regulation was not adequate and that, as a result, the reputation of the jurisdictions suffered. However, at least in the case of some of the dependencies, such accusations in the 21st Century would be seriously misplaced. For example Jersey, Guernsey and the Isle of Man have sophisticated AML legislation in place and in 2002 the AML regime in Gibraltar was commented on favourably by both the IMF and FATF, following on-site reviews.

There is a gradual recognition by the international community, if not by the media, that there is a clear distinction between well-regulated offshore centres and under-regulated ones. The well-run centres can set an example to a number of onshore jurisdictions such as in the regulation of company and trust service providers, which we discussed earlier in the Report. The under-regulated centres represent a threat to the fight against money laundering and continued pressure backed by appropriate sanctions is required.

By way of example, in December 2000 the regulators in Guernsey, Jersey and the Isle of Man issued a consultative paper entitled “Overriding Principles for a Revised Know Your Customer Framework” (the Overriding Principles). This paper, which addressed issues such as the undertaking of due diligence on customers which were taken on before the introduction of all crimes AML legislation, can be seen as being more proactive in this area than the UK had been by that point.

In respect of its dependencies, the UK can do more in particular by defending the well-regulated dependencies from unjustified criticism. It must also do more to separate the arguments on money laundering from those on “unfair” tax competition. These two issues are not linked nor should they be permitted to be so. Tax is only relevant to money laundering when tax evasion is concerned.

We welcome the work of the FATF in its exercise to identify “non co-operative countries and territories”, which began in 2000 and has resulted in a number of countries (not by any means all offshore) improving their AML regimes. We also welcome the ongoing review of offshore centres by the IMF, which includes a review of AML amongst the general assessment of financial service regulation and international co-operation.
We are, however, concerned that the IMF review has, to date, produced a limited number of reports and that there is a significant delay between the on-site work and the publication of the subsequent report, in some cases of many months. In a rapidly changing environment such delays can lead to the report being significantly out of date even at the time of publication. Similarly, concern has been expressed as to consistency between reports and the IMF needs to ensure that its methods of assessment and its process for ensuring consistency are sufficiently transparent.

Recommendation 18

We urge continuance of the international efforts to encourage jurisdictions to improve their AML regimes. To achieve this there must also be greater recognition of those who have done so, thereby providing a “carrot” to go with the “stick”. The UK should continue to actively monitor those who have not yet put in place effective AML regimes.
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AML</td>
<td>Anti-Money Laundering</td>
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<tr>
<td>ARA</td>
<td>Assets Recovery Agency</td>
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<td>DFID</td>
<td>Department for International Development</td>
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<td>FATF</td>
<td>Financial Action Task Force</td>
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<td>FSA</td>
<td>Financial Services Authority</td>
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<td>FSMA</td>
<td>Financial Services and Markets Act</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>KYC</td>
<td>Know Your Customer</td>
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<td>MLR</td>
<td>Money Laundering Regulations</td>
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<td>MSBs</td>
<td>Money Services Businesses</td>
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<td>NCIS</td>
<td>National Criminal Intelligence Service</td>
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<td>OECD</td>
<td>Organisation of Economic Cooperation and Development</td>
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<td>PEP</td>
<td>Politically Exposed Persons</td>
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<td>SAR</td>
<td>Suspicious Activity Report</td>
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<td>SFO</td>
<td>Serious Fraud Office</td>
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<td>STR</td>
<td>Suspicious Transaction Report</td>
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Appendix

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