MONEY-LAUNDERING TYPOLOGIES: A REVIEW OF THEIR FITNESS FOR PURPOSE

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PART 1: DEFINING AND CONCEPTUALISING TYPOLOGIES

INTRODUCTION

The aim of this section is to examine definitions of money laundering, the history of the three stage process typology and the conditions of its original application, followed by how the typology has been used by reporting entities, regulators, and law enforcement. Finally, some examples will be given of what academic research tells us about how laundering is accomplished.

The Oxford English Dictionary defines typology as "The study of classes with common characteristics; classification, esp. of human products, behaviour, characteristics, etc., according to type; the comparative analysis of structural or other characteristics; a classification or analysis of this kind." The aim of a typology ought to be to help practitioners/analysts to make better sense of the phenomenon by breaking it up into meaningful categories which they can then use to develop indicators, et cetera. The value of typologies for regulators is to enable them to benchmark how well the regulated bodies are identifying suspicions and processing them.

There is no predetermined model of how one arrives at a typology, but the construction of money laundering typologies has not been subjected to any particularly rigorous discipline to date – Fintrac (2012) is a rare example that discusses how it was done. In its original form within the FATF, 'typology' meant little more than 'some examples of'. Nor it is always clear who is the target audience for typologies, though practitioners have noted to this author that they give some needed reality to what are often quite abstract discussions of risk. Indeed, the *goals* of typologies of money laundering have not been fully articulated: they make sense as attempts to convey to those in the field a range of techniques used to launder money, depending on what data those constructing them have available and how plausible/valid that is as a representation of the underlying money laundering phenomenon (which may not be known). There is a tension between (i) communicating – and unconsciously reinforcing continued attention to - the 'known knowns' or, in this case, 'known suspecteds' (since neither the reporter nor often the analyst/investigator knows that whether the actor/activity is criminal cf. Fintrac, 2012) and (ii) seeking to abstract oneself from past patterns of detection and develop conceptually how money laundering *could* occur. This is analogous to the difference between writing an Organised Crime Situation Report and writing a Threat Assessment, at least a Threat Assessment that did not seek to analyse the capacities of threat actors.

However, a prelude to examining typologies is to deconstruct what is meant by laundering. There are at least 18 existing forms of definitions of money laundering (Unger et al., 2006; see Annex 1 to this report for a précis). The majority, however, mirror the broad conception introduced by the USA into the FATF founding meeting in Paris rather than restrict it to its essence. This broad construction amounts to the criminalisation of offenders doing anything to hide/store proceeds of crime; of knowing handling thereof; and (for specific ranges of third parties, which may vary between countries) of failing to report suspicions that funds are proceeds of crime or are intended to finance terrorism or WMD proliferation. It is understandable that practitioner bodies from the public sector try to avoid clear definitions that might restrict their scope for action. It is contended that the focus on 'true' laundering has been dissipated somewhat and that there has been some goal substitution in that process, with consequences yet to be fully appreciated.

CONCEPTUALISING AND DEFINING LAUNDERING

Etymologically, (money) laundering aims to achieve a misleading appearance of 'cleanliness', or legitimacy, related to illegally acquired money or illegally acquired property such as valuable objects that have been stolen or obtained by fraud. In other words, laundering takes place where "*someone constructs a pretended false legitimate origin of money or other illicit property. All other actions of concealment remain what they are: concealment, as long as they are not followed by that very step of false legitimation*" (Van Duyne and De Miranda, 1999: 262).

Thus stolen art and antiquities must be laundered by forging documents of provenance; stolen cars are laundered by tampering with the chassis and engine numbers, and with the registration details. Laundering, in other words, might more sensibly be viewed as a continuum of skill, whose success depends both on the knowledge and connections of criminal actors, the vigilance of third parties, and the knowledge, connections *and resources* of the analysts, investigators, prosecutors and judges. The 'whitening' and 'cleansing' component of laundering is also properly expressed in the German, Dutch, French, Italian and Spanish words: Geldwäscherei (or Geldwäsche), witwassen, blanchiment, riciclaggio, and blanqueo de dinero. Nevertheless, *legal* definitions of 'money laundering' vary widely and typically go beyond the initial semantic meaning. The expression usually conjures images of complex financial operations undertaken in several jurisdictions, most likely involving offshore jurisdictions: yet few prosecutions fit that image, especially since the FATF evaluations put pressure on countries to show that they are prosecuting for money laundering, which leads to the addition of self-laundering charges. Threat assessments usually refer to laundering (like 'organised crime') being increasingly complex. An IMF report by Aninat *et al.* (2002: para 3) notes:

> "*Money laundering involves transforming the proceeds of crime into usable form and disguising their illegal origins. After the criminal proceeds are introduced to the financial system, they are hidden – laundered – through a variety of transactions and financial vehicles and finally invested in financial and related assets. These operations often involve international transactions as a means of 'layering' – that is, of obscuring the source of the funds*."

Yet in reality, criminal proceeds are often hidden from the start rather than simply after they have been introduced into the financial system. It is not even necessary to perform a *variety* of financial transactions: a fictitious loan or a forged inheritance document may suffice to 'show' legitimate origin unless due diligence is high. Owning/running a casino or an online gambling firm could also offer large scale opportunities to launder. Hence, money laundering can entirely be carried out domestically. What is important to crime-entrepreneurs is to purge the crime money of its criminal smell to the extent necessitated by controls, e.g. the objective and/or expected probability of publicly accountable sniffing, in order to enjoy the fruits of their crimes at some (usually unspecified) future date.

Spending crime-money can create evidence against the spender. For instance, spending on registered goods, like cars, houses and boats, creates direct evidence, especially if due diligence is performed on the purchaser as it should be under the DNFBP provisions of AML recommendations. Spending on other objects can also leave traces that allow investigators (including tax officials) to conduct a net-worth analysis. Risk-averse criminals have to counter this by:

- placing the assets in the name of a nominee natural or legal person;
- spending their money in an undetectable manner by avoiding invoices and the consumption of those services, such as air travel and cruises, that have to be documented;
- additionally, resorting to forgery, misrepresentation of facts, documentary fraud, et cetera.

Policy makers define all these manoeuvres as 'disguising' crime assets. FinCEN has provided the following definition:

> "*Money laundering involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Through money laundering, the criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source*."[1]

Disguise is good enough only if it makes the origin of the crime proceeds look legitimate. Even if funds are moved through a series of transactions, obscuring their source and the beneficial owner avoids leaving traces when spending money, any visible increase in wealth that exceeds declared income may have to be accounted for later *if and only if the financial investigation is thorough enough*. Therefore, definitions which suggest that blurring the paper trail suffices to make the criminal proceeds usable and untouchable are not wholly correct, especially where civil forfeiture independent of prosecution is available and is actually used.[2]

If the late Jose Gonzalez Rodriguez-Gacha, a doyen of the Medellin cartel, had ensured that his funds had been both well hidden and well justified, his family would most likely not have kept his assets totalling millions of dollars. The money went through a series of transfers to various accounts in the USA, Luxembourg, Switzerland, Austria and the UK, but was eventually

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1 FinCEN - http://www.fincen.gov/about_fincen/wwd/faqs.html

2 We do not know the extent to which funds from obscure offshore vehicles are easily accepted *today*, *i.e.* some blurring of the paper trail may well suffice for corrupt or wilfully blind bankers or government officials to accept such funds without questioning their origin to the extent necessary to stop them. However recent experiments have shown the susceptibility of financial intermediaries to willing participation, at least from people claiming that the prospective account-holder has a legitimate occupation: see Findley et al., (2012).

tracked down and frozen by the US Department of Justice in 2001.[3] He had not laundered sufficiently deeply to defeat diligent investigation by a major power.

FINTRAC's website more subtly states as follows:

> "*Money laundering is the process whereby 'dirty money', produced through criminal activity, is transformed into 'clean money' whose criminal origin is difficult to trace. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. The money earned from criminal activity (proceeds of crime) can originate from all kinds of designated offences. These include, but are not limited to illegal drug trafficking, bribery, fraud, forgery, murder, robbery, counterfeit money, stock manipulation, tax evasion, and copyright infringement.*"[4]

It is conventional wisdom that making crime-money completely white is the prime concern of crime-entrepreneurs. Nevertheless, the majority of existing money laundering definitions goes no further than to describe money laundering as hiding the source of the illegal wealth, although this can be expected from any sensible profit-oriented criminal. The money laundering theme was placed on the political agenda during a time – the 1980s - when significant attention was paid to the *cash*-based drugs economy. Therefore the approach was (and still is) mostly centred on the movement and concealment of crime money in the form of large quantities of bank notes.

THE ELASTIC DEFINITION OF LAUNDERING

As noted earlier, global definitions of money laundering go far beyond legitimising funds in the light of intensive investigation. Interest group pressures and law-makers' responses typically are to have a criminal law and procedure clause that covers enforcement and sometimes non-enforcement interests, rather than an effort to ensure conceptual consistency. Though attempts to make third parties like lawyers responsible for enforcing AML sometimes encounter serious and even successful resistance, this does not usually alter the definition of laundering itself.

The Presidential Commission on Organized Crime 1984 defined money laundering as "*the process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate*" (Humberto Fidel Regalado Cuellar, Petitioner v. United States of America, No. 06-1456, p. 17). Long before financing terrorism became an issue, the Commission apparently developed an all-inclusive definition which covered also corrupt application of money that might not always be of illicit origin (for instance, the use of legal source funds in covert campaign finance). Though it could be argued that if one had already found a way to apply his income without being detected, there was no need to disguise that income, the aim presumably was to criminalise the behaviour explicitly and rationally to deter those who had a stake in respectability. This laid the foundation of the later loose conceptualisation of money laundering in that it

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[3] See Beaty and Hornik (2001).

[4] http://www.fintrac-canafe.gc.ca/questions/FAQ/faq_question-eng.asp?CatID=61&ID=161&Ord=1

included the mere *possessing* and *concealing* of the very existence of one's illegal income. When enacting the Money Laundering Control Act of 1986, the US Congress chose to use the disjunctive 'or' instead of the conjunctive 'and' in the disguise provision. This broadened the concept to the extent that it now covers the mere movement, deposit and handling of dirty money: false justification is no longer essential.[5] Every type of transaction, financial or commercial, in crime proceeds, regardless of whether it is aimed at providing legitimate appearance to the assets, constitutes money laundering at least as long as it is not reported to the authorities. Section 1956 (a)(1) of the Money Laundering Control Act 1986 makes it unlawful to engage in a financial transaction with knowledge that the funds are the proceeds of a specified unlawful activity and

§ with the intent to promote specified unlawful activity (Sec. 1956 (a)(1)(A)(i));

§ with the intent to engage in conduct constituting a violation of certain tax laws (specifically sections 7201 or 7206 of the Internal Revenue Code) (Sec. 1956 (a)(1)(A)(ii));

§ knowing that the transaction was designed in whole or part: (i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity (Sec. 1956 (a)(1)(B)(i)); or (ii) to avoid a state or federal reporting requirement (Sec. 1956 (a)(1)(B)(ii)).

Section 1956 (a)(2) makes it unlawful to transport, transmit, or transfer a monetary instrument[6] or funds into or out of the US:

§ with the intent to promote the carrying on of specified unlawful activity; or

§ where the defendant knows that the funds are the proceeds of unlawful activity and that the transportation or transfer is designed to conceal or disguise the nature, location, source, ownership, or control of the proceeds of specified unlawful activity or to avoid a transaction reporting requirement.

S 1957 addresses all financial transactions involving any unlawfully derived property exceeding $10,000. The Act introduced two main types of offence which became known in the US legal community as 'promotion money laundering' (to conduct a financial transaction using criminal proceeds with the intent to promote a criminal activity) and 'concealment money laundering' (to conduct a financial transaction using criminal proceeds knowing that the transaction was designed to conceal or disguise the nature, source, location, ownership or control of the proceeds).

Almost every subsequent definition or description of money laundering has reflected the 1986 Act, except that definitions no longer centre on financial transactions and

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5 Of course, 'false justification' can be interpreted as 'handling' and thus be covered by the definition, but the false justification element is not made explicit and is not mandatory. However, it is not plain that inserting a false invoice into a firm's paperwork – an almost invariable event in company frauds - counts as 'handling' crime-money.

6 Which can also mean banknotes.

monetary instruments but encompass any type of activity and any type of assets (including 'promotion money laundering,' though this lacks global acceptance).

The US Money Laundering and Financial Crimes Strategy Act of 1998[7] focuses on the 'movement' element as a description of money laundering and related financial crimes:

> "*[. . .] the movement of illicit cash or cash equivalent proceeds into, out of, or through United States financial institutions*" (see 31 U.S.C. 5340(2)(A))

An early US National Money Laundering Strategy (Treasury 2000: 5) provides a similar construct:

> "*[S]omeone who conducts a financial transaction with knowledge that the funds or property involved in the transaction are the proceeds of crime, and who intends to further that crime, or to conceal or disguise those proceeds, is laundering money*."

Thus reinvestment of proceeds of crime in further crimes is laundering, as is the purchase of a vehicle to smuggle contraband and/or payment of a driver or a courier to complete the smuggling task, even though these in no way represent 'cleansing' proceeds of crime. (An unintended consequence of AML might be to stimulate reinvestment in criminal enterprises by closing off alternative options.)

The US approach of ever broadening the meaning of money laundering and expanding its jurisdictional outreach was reinforced in the USA PATRIOT Act 2001. Thus:

> "*In federal law, money laundering is the flow of cash or other valuables derived from, or intended to facilitate, the commission of a criminal offense. It is the movement of the fruits and instruments of crime. Federal authorities attack money laundering through regulations, criminal sanctions, and forfeiture. The [USA PATRIOT] Act bolsters federal efforts in each area*" (Doyle, 2002, p. 3).

The central purpose of money laundering as ensuring a legitimate appearance of what is in fact proceeds of crime has largely been submerged by this expansive approach: the offence description relates simply to the movement or flow of money to facilitate crime. If we relate this to corruption, paying a bribe is also laundering its proceeds: 'facilitating the commission of a criminal offence'. That means that any offence, the execution of which requires illicitly paying for expenses , implies laundering, irrespective of whether that offence will succeed and bring in profit. Considering the history of money-laundering control in the USA, we should not be surprised that in the end the legal definition of money laundering has become so broad as to cover, finally, the mere shifting and transportation of illicit money. However, clearly this fulfils a law enforcement objective. Equating money movements to money laundering and criminalising them enables regulators to scrutinise a wide range of activities, at home and abroad, and tackle the large cash flows within and exiting the US or other country that has such provisions. This is strengthened by requirements that exist in many

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[7] The Money Laundering and Financial Crimes Strategy Act aimed to develop a strategy to coordinate and concentrate law enforcement efforts in certain areas where money laundering and related financial crimes were extensive or presented a substantial risk (see http://www.fincen.gov/law_enforcement/hifca/index.html#map_hifca).

countries criminalising the movement in and out of the jurisdiction of cash funds over a specified limit that are not declared to customs authorities. (Though these are circumvented by trade based money laundering which transfers value in a different way.)

REFERENCE TO THE PREDICATE CRIME

While during the 1980s, money laundering was understood mainly to relate to drug proceeds, during the 1990s, policy makers in the US and the UK expanded the scope of the definition by pointing out that the origin of laundered funds can be a range of predicate crimes and that because it was hard to prove that the funds or products came from any particular crime, there was a need for a more general provision.[8] This is not strictly defining what laundering means but delineating the set of conduct to which it applies.

SERIOUSNESS OF THE PREDICATE CRIME

For decades researchers in the area of fraud have observed that policy makers have merely paid lip service to the seriousness of white-collar crime and fraud while concentrating on the illegal drugs trade.[9] A UK Threat assessment acutely states: "*As far as the relative scale and significance of the threats, it is still the case that most of those identified as involved in organised crime are engaged in drugs trafficking and distribution. The profits to be made from drugs up and down the supply chain continue to attract criminals of all levels. They support criminal lifestyles, sustain the drugs trades, foster other criminal activities, and fuel acts of extreme violence. The harms caused to individuals, to families, to communities, and in some instances to states, are often only too visible. However, it is important to recognise that drugs have been a priority for law enforcement in the UK and overseas for many years, and as a result more is known about the drugs threat than about, for example, organised immigration crime or fraud, the true scales and significance of which are therefore harder to assess*" (SOCA, 2009/2010, p. 5).

THE THREE-STAGE MODEL AND TYPOLOGIES OF MONEY LAUNDERING

The IMF notes (http://www.imf.org/external/np/leg/amlcft/eng/aml1.htm) that:

> In the AML/CFT context, the term "typologies" refers to the various techniques used to launder money or finance terrorism. Criminals are very creative in developing methods to launder money and finance terrorism. Money laundering and terrorism financing typologies in any given location are heavily influenced by the economy, financial markets, and anti-money laundering/counter financing of terrorism regimes. Consequently, methods vary from place to place and over time.
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> Those involved in the fight against money laundering or the financing of terrorism rely on the most current information on typologies. FATF members provide one another

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[8] The 1990 Council of Europe Convention expanded the definition of money laundering beyond that laid down by the 1988 UN Convention, which defined laundering in association with drug-related offences only.

[9] Lately this has been a complaint by NGOs and police concerned about human trafficking.

and the Financial Action Task Force (FATF) Secretariat annually with observations based on recent cases or studies of particular subject areas. FATF collects this information and attempts to describe the trends in order to be in a position to adapt recommendations to specifically address money laundering and terrorist financing risks. FATF also informs the public at large by publishing annual typology reports on its webpage.

An influential input to the conceptualisation of money laundering attributed to the US Customs Service (Bongard, 2001) but certainly to the US representatives at the *Sommet de l'Arche* at which the FATF was founded (personal interviews, 2003) is the description of laundering as a three stage process:

1. placing the money with a financial institution; then

2. layering it, often in several different amounts through a series of transactions in order to take it away from the criminal source and obscurethe paper trail[10], making it more difficult forensically to evidence; and finally

3. integrating the money into the legitimate mainstream.

This description - designed by practitioners and endorsed by policy-makers - illustrates how money-laundering processes usually run when the money originates in a *cash*-based underground economy. However, there is a range of white-collar/economic crimes such as VAT fraud, subsidy and investment fraud, and corporate and income tax fraud, where there is no need for placement but instead there is a need to take the money out of the domestic financial system, for instance to a safe account abroad (which is closer to 'displacement' than to 'placement').[11] In cases of elite crime such as the Conrad Black, Enron, Madoff and Stanford cases, the criminal money management process does not start with a deposit in a bank, because the money is already in the bank, e.g. as corporate funds, or money voluntarily wired to the perpetrator by the victim, or illegal tax saving or as a criminal saving of business expenses (for instance, social security contributions or environmental cost saving). In those cases, it is seldom clear what steps the offenders took to launder the funds separate from those taken in the course of the frauds, though low asset recovery rates from the offenders – setting aside third party liabilities that may be easier to recover – suggest that either the funds have been spent on sustaining otherwise unaffordable lifestyles and/or that efforts to follow the money were indeed defeated by laundering skills or enforcement resource shortages/priorities. Perhaps we can say that in such cases, the funds were legitimised in that they could notbe shown to be unjustified. In transnational and national bribery cases, in which funds are transferred from major corporations via their own intermediaries to public or sometimes private sector officials, the company may sometimes have to 'unlaunder' funds, i.e. create a slush fund in cash from its official sources, to transfer

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[10] "*giro-criss-crossing*", as Van Duyne (2003) describes the avalanche of money transfers to numerous accounts.

[11] For instance, in cases of VAT fraud or social contribution fraud by employers, the 'white' income tax form is in the end also a laundering instrument, not least because it is rare that tax authorities develop and report suspicions of overpayment.

cash bribes, or – as set out in a recent World Bank study (Does de Willebois et al., 2011) - may send funds via shell or nominee companies with a sufficient cover to deceive the vigilance levels of internal compliance and external auditors. All of these behaviours can be fitted into a three-stage model, but one may reasonably ask what that model contributes to the understanding, when what is needed is a model that enables regulated persons to pick out criminal conduct, even if they suspect things to be criminal that are not.[12]

As former Barclays MLRO Doug Hopton (2009: 2-3) expresses it:

> "These historical descriptions are fine as far as they go, but the actual term 'money laundering' is itself a misnomer. It does not recognise that in the modern world undertaking a laundering operation does not have to involve actual money. Consequently a modern definition would be that money laundering occurs every time any transaction takes place or relationship is formed which involves any form of property or benefit, whether it is tangible or intangible, which is derived from criminal activity. One must also not overlook the fact that you do not have to actually move the criminal proceeds to launder them. This is an aspect that can leave financial institutions, particularly banks, in a vulnerable position. The classic example would be in a case of tax evasion. Money earned for a legitimate activity is placed directly into a bank account in another country. At this point there is no problem as the money is legitimate. However, if the account holder fails to declare this income on a tax return in the country in which it was earned, the funds then become the proceeds of crime and the bank, although it may be unaware of it, is laundering the funds. Another traditional view of why money laundering is undertaken is that the criminals' objectives are the avoidance of detection, prosecution and confiscation of their ill-gotten gains. Now while in many cases this is true, there are cases that demonstrate that criminals' primary objective is not the conversion of property but the need to disguise the fact that they own the property. In doing so they break the connection between themselves and any property that can otherwise link them to the criminal offence for which they are seeking to avoid detection. Money laundering is therefore as much about disguising the ownership of property as it is about converting or washing criminal property. This clearly shows that even in a relationship where there is no obvious process by which money is received or paid away, money laundering can still occur….
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> [T]his three-stage model, while a convenient way of describing the activity, is a little simplistic and does not fully reflect what really happens. It relates back to the common historical definition of money laundering discussed earlier. While they are examples of money laundering, they do not define what money laundering actually is. This has led to those with the duty of recognising money laundering having insufficient knowledge to be able to identify it in all its guises. Too often we have looked at money laundering from the aspect of what we expect it to look like, rather

[12] The harms of false positives depend on the jurisdiction – in countries where assets are frozen temporarily when a SAR is made, this is more consequential than in most countries where it merely creates an analytical burden for an FIU and perhaps prevents real suspicions from being investigated more fully because of resource constraints.

than by reference to what it actually is. Numerous cases have come to light where employees have failed to identify relationships in which property has been laundered, simply because what happened did not match with what they had been taught to expect such activity to look like. So while the traditional model is useful, it does not adequately cover all situations in which money laundering occurs.

Nevertheless in practice, AML *investigation* (if not analysis) typically targets mainly 'traditional' crimes-for-profit, the proceeds of which are in cash (and therefore are relatively easily confiscated by criminal or administrative measures). As law enforcement agencies, e.g. in the US, ICE and the DEA, frequently target cash entering the financial system or leaving the country, the limited three-stage model makes sense (see CPS, 2010). Once introduced, this model was copied like the money-laundering offence formulation, without considering the extent to which it was fit for purpose.

Let us rehearse the principal critiques. First, the process as described does not explicitly include the most important phase of money laundering: the phase of *justification*, where the money launderer achieves his ultimate goal of a 'clean' appearance of the money. Indeed, it is generally assumed that during the integration stage, crime money is being converted into apparently legitimate earnings.[13] However, neither layering nor integration, or intermingling, illicit with licit money *per se* leads *necessarily* to such a conversion. More than that is required, because otherwise a net-worth analysis could potentially establish the excess of money of unaccountable origin.

Secondly, this description dismisses the possibility that in fact a 'clean' appearance of crime money can be achieved prior to the placement stage or in ways that do not necessarily involve placing the money with a financial institution (or introducing it into the economy) or layering it through a series of transactions. The money can stay locked in a safe at home, accompanied with a forged invoice that shows a legitimate origin. Before being used, i.e. introduced into the legitimate economy, the money will already be laundered, in addition to that part of it that enters unnoticed into the legitimate economy via lifestyle or maintenance expenses. The problem for the criminal is that entry into the legitimate financial system - the placement stage - is sometimes the riskiest step in the crime-money management process. Under increasing pressures for due diligence procedural compliance (for fear of regulatory sanction rather than of rare criminal prosecution), financial institutions have tightened their know-your-customer rules. Thus, criminals operating in the cash crime-economy have become most vulnerable to detection at the stage where they have to enter the financial system. Therefore, those with substantial sums to save often have to resort to means such as fictitious commercial transactions, fictitious contracts signed by notaries, setting up shell firms, nominee relationships and so on to ensure some initial disguise, if not as yet a perfect legitimate appearance, prior to entering the financial system.

It is a plausible assumption that in much of the crime-economy, such detours and disguises are not even considered. If, for example, we were to consider the investment of illicitly derived $8,000 in a small music-shop, the risk of detection at the placement stage

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[13] Although such scenarios are possible: the money has only entered the licit money flow between banks, *i.e.* has jumped over the layering stage straight into the integration stage or the conversion has taken place during the layering stage.

would be minimal. As this is beneath the reporting threshold, it is unlikely that anyone would require proof of licit origin, even if the money is run through a bank. So this is an example where the illicit origin of the money does not necessarily have to be 'masked' or layered for the money to enter the legitimate system and integrated with licit money: in other words, placement and integration occur concurrently. On the other hand, if the 'loan' (in reality the crime-money) to the music-shop has to enter the books of that firm, this may expose the 'lender' *if and only if financial investigators query it*. On the other hand, one may reasonable counter that unless the funds were used to finance a bombing or other terrorist act, this level of laundering does not pose a significant threat, so it can be disregarded. Examples, summed up by Van Duyne (2003), illustrate the handling of crime-money without using laundering techniques. Even fraudulent businesspeople resorted much less to laundering techniques than expected: they simply took the proceeds of fraud out of their firms to spend it on 'lifestyle' rather than laundering it for reinvestment.[14] Even if not fully laundered, crime money can be deposited with an offshore bank just to evade tax (now a predicate offence under the 2012 FATF Recommendations): this is an element of the money management process rather than part of legitimation/integration (but is still laundering in broad terms).

Furthermore, if we take the three-stage model as a yardstick for comparison, we will see that some existing definitions (including official ones) centre primarily on the placement phase. For instance, according to the US Money Laundering Control Act of 1986, placing the money with a financial institution, knowing that it is the proceeds of unlawful activity or intending to promote unlawful activity, already constitutes a money-laundering offence because the act of placement is implied in the transaction. As soon as the money is placed with a well-known financial institution (which seems to be little problem for Politically Exposed Persons in the UK – see FSA, 2011), the money can already be viewed as part of the legitimate mainstream, i.e. as integrated into the licit financial system, though it is not proof against competent financial investigation. However, money placed with an obscure offshore bank that is not well connected as a correspondent bank may need to undergo a series of transfers before it reaches the safe shore of a reputable institution, i.e. the stage of integration. Yet, as mentioned above, *integrated* does not necessarily mean *laundered* in the strict sense, i.e. looking perfectly legitimate if seriously investigated.

Moreover, the three-stage model is not consistent with the logic of the broad definition that describes as laundering the mere keeping/hiding of crime money at home. And it does not allow for lifestyle expenses of criminals, which penetrates (and stimulates) the legitimate economy as it integrates into the legitimate economic turnover – and may even pay corporation or income tax at some stage. The UK Crown Prosecution Service notes that this model applies only to "*[m]ost sophisticated money laundering schemes*" – a low threshold in practice (http://www.cps.gov.uk/legal/p_to_r/proceeds_of_crime_money_laundering/index.html). On the contrary, the three-stage model lacks sophistication as events can take place outside of its remit, where legitimate appearance is invented and ensured at the end of the process -

[14] This was brought home when a multi-million pound Ponzi fraudster was given a nominal £1 confiscation order, having dissipated the entire sum, followed a Serious Fraud Office conviction – the order was made in case he later came into more funds (*The Times*, 26 March 2013).

or even the beginning, inventing ‘legitimisation’ before the three stages commence. Though some businesspeople and professionals drift into fraud (Levi, 2008), pre-planned sophisticated fraudsters would plan the laundering route as they plan the fraud. Many sophisticated schemes would involve some form of pre-wash before placing the money within the financial system. Although designed from a very basic, cash based underground economy perspective, the three-stage model has remained the prevalent conceptual framework and arguably has stood in the way of developing further ideas of criminal money management in more elaborate economic crime schemes.

THE USE OF THE THREE STAGE TYPOLOGY IN POLICY AND PRACTICE

Though it is very rare for their compilation methodology to be transparent – and thus meet normal scientific standards - there has been a gradual growth in the range and professionalism of typologies, as the FATF Secretariat has grown and more internal research has been done. Nevertheless, there is little published *analytical* material on the value of the three-stage process in particular or on typologies in general. Therefore what follows is largely deduced from available reports of money laundering cases and from FATF/FSRB/national reports and from personal interviews.

There is generally a strong demand for information about patterns of money laundering *and* about what regulators, prosecutors and civil courts (for third party liability) will expect banks and other regulated bodies to do about detecting and reporting it. This is a component of the long term complaints about lack of feedback from SAR reporting that have existed since the 1980s in the UK, US and other countries as AML spread (Gold and Levi, 1994). Cynics might see this as a concern about regulatory risk rather than crime risk on the part of regulated firms, and that may be a correct interpretation in many cases: emails from Standard Chartered and other banks about Iran sanctions imposed by the US, and also about LIBOR from traders in a large range of bank show clear evidence of the illegitimacy of AML/CFT and other regulatory controls. However, in addition to gaming the regulators and criminal justice risks, there is a desire to automate/routinise the suspicion process electronically and for the generic staff training that is mandated by regulators. My recent interviews have suggested that this concern about staff training has been given impetus by the large fines and deferred prosecutions of major international banks. Thus, typologies that enable banks and other institutions to reduce the chance of laundering where they could reasonably be accused of having failed to take action would be very welcome. The egregious cases that have hit the headlines in the past year – HSBC, Wachovia, UBS, Standard Chartered, etc – have all been cases of unambiguous layering and even sometimes placement *once analysed as regulatory issues*. In none of them was there any need for a formal integration process because they were not treated as suspect in the first place. They represent the failure of AML to imbricate itself into the routine processes of all levels of institutions, and therefore this represents a cultural as well as a practical challenge.

The current mission statements and rhetoric within several major international institutions – Barclays, Deutsche Bank, and HSBC for example – are aiming for significant cultural change. However even if that motivation is sustained, there is a need to work out what triggers of suspicion to look for beyond the cases that generated the scandals. One issue is how concerned we should be about false positives. In the Australian and Canadian systems, routine reporting alters the shape of the system and – apart from deceptive transfer pricing issues and off-the-books bartering in trade based money laundering and unrecorded money movements from smuggling and e-money – there is almost a total dataset of transactions in the formal system. However the meaning of those movements still normally requires interpretation, in addition to any resource issues in analysis and action within the loose-coupled criminal justice and regulatory systems. The capacity to report of the regulated systems is far greater than our capacity to act on their reports. However we must decide what degree of over-reporting we are prepared to tolerate when it affects our ability to process the information and act.

Assessments of how likely value transfers are to be transfers of the proceeds of crime are not natural processes. They are indirect because the 'known knowns' are a function of cases that are developed and analysed for an understanding of how the value transfers and other aspects of money laundering occurred. Thus conduct that is never suspected at the time and is not made the subject of systematic analysis at any subsequent stage will not be identified as a laundering typology except as the result of a thought experiment (which process will not tell us by itself how common that technique actually is or even whether it has been carried out at all). The level of systematisation of analysis varies over time and between typologies, depending on how available data are and how much effort and skill are put into the development process. Theoretically one could modify understandings derived from suspected cases that go on to be proven as proceeds of crime by adding 'cold case' analyses from the financial components of known investigated crimes, such as drugs trafficking, human trafficking, and fraud cases. Some typologies may generate their own waves of reporting: this probably explains the rise in mortgage fraud SARs following the financial crisis and the revelation of the role played by systemic misrepresentation of income and loans in it, as reported in FinCEN and FBI annual reports. It may not matter (and is not self-evident) whether this represents a thirst for knowledge among regulated persons or their defensive second guessing to avoid sanctions should they be detected for failing to respond to regulatory signals. However the total set of actual money laundering behaviours is unknown and unknowable, so we must look for the best proxies we can locate with the resources we are prepared to put into it.

Some typologies represent modifications of the three-stage process. One – on misuse of corporate vehicles, trusts and company service providers (FATF, 2006) - did include a reference to a *four*-stage ML process, in which 'justification' was inserted as a stage between layering and integration. The advantage of a focus on the justification stage is that this is often the hard-to-penetrate (and to support a prosecution) issue, for example in loan back constructions from companies and trust vehicles established in partial or full secrecy jurisdictions that are quite common in laundering cases (van Duyne and Levi, 2005). Without focusing on the adequacy of the justification (and deconstructing whether such transactions would take place in genuine deals), this link between layering and integration is hard to stop.

PART 2: LITERATURE REVIEW OF LAUNDERING TYPOLOGIES

INTRODUCTION

It is an often repeated mistake that criminals cannot spend the proceeds of crime until they have integrated it. Thus Richards (1999: 44) states that the criminal 'cannot spend it until it is laundered'. It is self-evident that they can readily spend crime proceeds on consumables and on financing the commission of further crimes (the equivalent of internal reinvestment in the ordinary capitalist economy). What he should have meant is that he cannot spend it very *safely* until he has generated a justification that would satisfy lawful questioning to the criminal proof standard. In this sense, the three-stage model has a more limited application – to the assumed preference for saving from proceeds of crime and reinvestment in the legitimate economy – than the compilers of the three-stage model presumed. In an anonymous metropolitan society with a high level of routine globalisation, the surveillance of and forensic investigation into people's past lives is far more modest than it is for high level security clearance or for admission to formally approved jobs such as directorships of financial services firms. The histories of prominent financiers would indicate this.

There is not a large academic literature that deals with the three stage typology or with research on the practice of money laundering or the appropriateness of the model for understanding/explaining it: most socio-legal literature deals with the evolution of AML powers and governance, and with the interpretation of powers and duties. We have already set out some of the key findings of empirical research on laundering in the previous section, and there is no need to repeat them here. As in the case of reports by FATF and other official bodies, where mentioned at all, there is often a ritual incantation of the three stage model in academic research studies. An example is Beare and Schneider (2007), where it appears in chapter three under 'techniques'. Their now dated analysis of RCMP money laundering cases does not tell us much about how *useful* the typology is in guiding suspicion or investigation, but it does reflect back what the characteristics are of past *successfully detected* cases. The most prevalent technique by far (in almost half the cases) was the use of nominees for registering property; then came the claim that proceeds were revenue from a legitimate business, presumably (though this is not stated) one officially owned by the offender (otherwise it should have been under the category of nominee); then layering; then smurfing – which might also have been subsumed under nominees; structuring (breaking down proceeds into less suspiciously large chunks); undervaluing formally assets purchased – which might be viewed as a technique for concealment which transfers the laundering problem to the recipient of the cash; and internal conspiracies with bank staff, etc.. This is not a classification that is satisfying analytically but, in my view, it does point to the difficulties for offenders that placement without triggering SARs or routine reports generates under the Canadian regulatory regime, at least for the modest number of behaviours that led to *serious* criminal investigation. The aim of many of these actions *may* eventually have been integration, but we do not know that from the cases. Without looking in detail at the cases themselves, it seems plausible rather that what the criminals may have been looking for was safe storage of funds away from other criminal predators without risking identification by the government: a less elaborate stage than full integration, and one that might be described as 'good-enough laundering' (though it turned out not be good enough). This is consistent with the observation that in 87.3% of the cases it was the individual(s) accused of the substantive offence(s) who originally placed the proceeds of crime into the legitimate economy (p.87), though in a third of all cases (presumably significantly overlapping with the former category), other natural or legal persons were involved.

More than 4/5 of *identified* proceeds that entered deposit institutions arrived in cash form. In their section on banking services used, 4/5 of cases used a regular savings or chequing account, or a term deposit; 2/5 used a monetary instrument, mainly a bank draft. In 1/5 of cases, a safety deposit box was used to store valuables and cash. The study refers (p.92) to a drugs trafficker in Manitoba who purchased four bank drafts used to purchase property; a search of lawyers' offices found three from different banks deposited into the firm's bank account on one day. Real estate was a popular outlet for proceeds, three quarters for residential property, some of which was customised for marijuana grow operations (and therefore, unacknowledged in the report, not a 'real' laundering mechanism at all). Most of the real estate purchases could be characterised as layering, sometimes using large numbers of bank drafts to sidestep the reporting requirements but creating which in retrospect looks like a transparent smurfing process. However an alternative way of representing these purchases is that they are what to the offenders would have looked like 'good enough' direct placement-integration – they were just buying real estate that they (presumably) would have made no further efforts to conceal. The number of cases in which reports of suspicions were significant to the investigation is unknown (and classified), but had they not been investigated, no one would have asked them to account for their wealth.

Other examples given are more clearly laundering, such as the purchase of shell companies and of cash-generating businesses in which illicit income can be commingled with licit: the depiction of such activities as layering seems reasonable. In some of the fraud cases, though the financial transactions do function as layering, this is closely aligned with the modus operandi of fraud commission. As with some other aspects of AML, one of the difficulties one has in evaluating the utility of the three-stage process is that most of the schemes did not fully integrate their proceeds in the long term. (To some extent tautologically as an artefact of their having been detected; but offenders who have integrated their assets can be picked up for involvement in old offences or for new ones.) The schemes described by Beare and Schneider (2007) had varied levels of complexity and were affected by AML controls (and/or criminals' beliefs about them): however they were calibrated according to the skills, contacts and risk appetites of the criminals and might be better understood as aiming to mask the offenders' involvement in the crimes and to protect the proceeds from easy confiscation by the authorities and from other criminals. The authors do not mention the three stage process in their conclusions and do not appear to regard it as central to their work. Likewise Naylor (2004, 2007) does not regard the three stage process as particularly important or valuable in his critique of follow the money methods of law enforcement and his other wide ranging work on laundering and financing terrorism. As he notes (Naylor, forthcoming), there is a significant variation in the *process* of money movement in different forms of criminality:

> "First, there are different economic motives behind the initial acquisition of the funds. Proceeds of crime represent income earned through prohibited actions. Illegal capital flight is money usually of legitimate origin seeking financial safety in violation of exchange controls. Evaded taxes result from illegally withholding payments out of money generally earned legally, then sullied by the act of evasion. Preceeds of crime

mean diversion of legitimately earned funds to invest in criminal enterprise. Terror dollars involve deploying money however obtained (though quite likely legally) for crimes with no financial motive.

Second, the various types of shady money differ in the point at which illegality occurs. With proceeds of crime, the offense is primary, and the funds derive directly from that proscribed activity. With both capital flight and tax evasion, the offense is secondary – it takes the form of withholding taxes on (usually) legally earned income and/or moving it in violation of exchange controls. With terror dollars, the offense is tertiary, occurring after the money has been raised (usually legally) and moved (again possibly legally) to its final destination. With preceeds of crime, it is also tertiary although preceeds, unlike terror dollars, are destined to be invested in profit-driven crime in order to yield proceeds, for which the offense is again primary. "

He represents these processes in the following Table (from Naylor, forthcoming, Ch.IV):

TABLE 1 INTERNATIONAL MOVEMENT OF ILLICIT FUNDS

Categories and Characteristics

Proceeds of Crime	Flight Capital	Evaded Taxes	Pre-seeds of Crime	Terror Dollars
Always illegal origin	largely legal	largely legal	largely legal	largely legal
Leaves IC covertly	leaves DC covertly	leaves IC overtly	leaves IC overtly	leaves DC (?)
Changes ID abroad	changes ID abroad	changes ID abroad	changes ID abroad	changes ID (?)
Returns to IC overtly	takes refuge in IC	returns to IC	covertly returns to IC	covertly enters IC (?)
Spent (C or I) legally	spent (I) legally	spent (C or I) legally	spent (I) illegally	used illegally

IC = Industrialized Country

DC = Developing Country

C = consumed

I = invested

Nor does Mathers (2004) – a former RCMP undercover operative in money-laundering cases – make particular use of the three stage process explicitly, though many of the cases that he discusses quite racily in his commentary are premised upon such a process, usually transferring funds to hard-to-reach places, moving them into larger currency denominations for easy of transportation and/or storage, etcetera.

Madinger (2012) – a former IRS investigator – makes clear and extensive use of the typology in his practitioner's guide to money laundering investigation. However again, this mostly is in the context of cash and drugs or bribery. As he points out, integration is *never* complete, though the fact that so much of Meyer Lansky's pre-1960s schemes were never uncovered means that in practice, many of them were *de facto* integrated.[15] (This also applies to the vast majority of proceeds of crime, even if one is sceptical of the claims that 3.5% and upwards of global GNP is laundered: the larger the denominator, the higher the proportion of schemes that are unknown and therefore the more questionable generalisations about them.)

Madinger (pp. 19-22) gives examples from the Watergate era of successful investigations of illegal campaign finance contributions that might have been money laundering prosecutions today. He does not make the point that initially the corporations had to 'unlaunder' the funds to generate cash and pretexts for making donations indirectly via their staff: the crucial issue is that the real laundering is the attempted *justification* of the campaign contributions. Another example given is the crude conduct of CIA double agent Aldrich Ames who received nearly $2 million from the KGB in cash at different times. His wife was a Colombian and he simply explained the cash purchase of real estate in the US as funds from her (in fact quite modest) 'wealthy family', providing similar explanations for his cash deposits in Swiss banks. This was 1992, a time when there was more excuse for sloppy due diligence but even at that time, the placement and layering was weak. One might describe the purchase of a large home as integration but that would stretch considerably the term. His accounting for the funds was rudimentary but he succeeded for some time because no-one checked. He had intended to set up a Colombian company in his mother in law's name to give a more plausible explanation for the origins of the funds, but this would not have been a strong defence against any serious financial investigation. In short, in common with many offenders, he did not get far beyond the placement stage.

He also discusses techniques of financial transfer using letters of credit. If funds to guarantee the sum are already held by the customer, it is not a problem to get a bank to issue a letter of credit transferring large sums against a fictitious set of documents which do not reflect real trading. The launderer or accomplices sets up a shell corporation and organises an over-invoicing arrangement or suchlike technique – a sub-set of trade-based money laundering. The question is whether there is evidence of the falsity of the pricing, or of the connection between the suspect and the backing for the letter of credit. If so, then this is merely layering; if not, it may not be identified as money laundering at all.

[15] Madinger does not make the point that this was pre-AML or even Bank Secrecy Act reporting regulation; but this was an era when prosecutions of organised criminals for tax evasion were not very rare. This success of his laundering schemes may have been related to the difficulty of finding evidence connecting him to predicate acts, but it may owe something to the absence of tools for following the money. He was never convicted of any offence, making him officially not a criminal.

It is arguable that all 'integration' is undetected layering. Even if the funds look completely clean, it may be hard for a suspected person to account for their wealth if they can be shown to be controlling the asset following a 'net worth' review (though that would not by itself be enough forensically to generate criminal liability, though it might generate civil forfeiture or a tax demand.) Whether in fact anyone is suspected and is asked to explain the origins of their wealth remains an open question: so much depends on chance factors or vulnerability to extraneous events such as cooperating witnesses. To that extent, the model of laundering generally is under-theorised. Madinger's focus is how to investigate laundering schemes, and reverse-engineering this gives us a model of how the criminals act. Schemes of varied complexity are set out in chapters 20-23, though drugs cases predominate, perhaps because drugs trafficking investigators are the primary audience for his book.

He sets out (p.257) some mechanisms for testing/falsifying claims about the genuineness of loans, including:

- Is the loan being repaid? (If not, you can be pretty sure there's a problem here.)
- How is the loan being repaid?
- Are all of the payments regular…?
- Who is signing the checks?
- Who is receiving the payments?
- Who is the lender, and is this loan reasonable from his point of view?
- Is there any connection between the lender and the borrower? (e.g. the same lawyer represents both parties)
- What is the security and where did *it* comes from?

He gives examples of over-invoicing and of under-invoicing as trade based money laundering, and of a variety of scams and laundering schemes. He also notes that one of the reasons Bostonians were unable to recover assets from Charles Ponzi was that he had spent much of it on his lifestyle plus lining the pockets of other Bostonians (though he does not state whether this was 'for value' or in bribes). Madinger shows that had money laundering legislation been in place at the time of the Ponzi schemes, he would rightly have been convicted of laundering charges (which in the legal sense start once the substantive offences are complete): but he does not consider beyond the additional prison sentences what would have been the point of this, since Ponzi already was convicted of multiple fraud and larceny charges, and was put out of business. The morality of additional sentencing for laundering when the real offences are fraud is a serious question, and Madinger was mistaken in arguing that the Ponzi case, which brought down Hanover Bank in Boston where he kept his accounts, shows the importance of keeping dirty money out of the system – it actually shows the importance of not being dependent on volatile assets derived from fraud, a much narrower thing. To conclude, Madinger gives many examples which he fits into the three stage process, but it remains obscure whether they are really integration or rather represent more or less advanced forms of layering: this is a generic problem with the typology because it may be argued that integration of proceeds is that stage that will defeat 'serious' financial investigation of origins – a condition that may never occur and that itself is quite a flexible, linear construct.

One experienced forensic accountant observed as follows to this author's questions for this project:

“The PLI triad serves the purpose of providing a very basic explanation of what money laundering is. It has been used to frame regulatory and legislative responses to the crime, however, which fail to deal with its reality and distort understanding of how the crime functions in practice. This has resulted in an almost universal tale of collective impotence across the globe in terms of curbing its incidence and prosecuting the most serious offenders.

The conceptual complaint about PLI is that it encourages the crime to be perceived in a linear way, and that it involves three distinct phases. In practice the crime more often manifests itself in circularity and the distinction between the phases is accordingly either blurred or indistinct….

Madinger describes two approaches: you start with the predicate offence and follow the money to prove the laundering, or you start with the suspected laundering and move back to the predicate crime. The Office of the NYC Chief Prosecutor for Narcotics, for example, devotes much effort to obtaining evidence of the placement stage of money laundering, and this enables them to construct cases based on the first approach. The second approach is covered, according to Madinger, by the hunting out of witnesses who will finger the criminal source, and again the US ability to turn witnesses and use wires is a useful means of making this approach work. Proving the predicate offence in other words is made possible as a result of the focus of the prosecutorial approach and the existence of the law enforcement tools necessary to obtain criminal standard evidence of the placement and the layering stages at least. Essentially, therefore, the US approach to prosecuting money laundering is centred on proving these placement and layering stages, which thus provides the foundation for the widespread acceptance of PLI concept as the means of explaining what money laundering is.

In most jurisdictions, however, the will, or budget, to apply the necessary resource and the necessary methods to make the US approach work is simply not there (of course it doesn't work across the whole of US law enforcement either). The PLI conception of money laundering applied in those jurisdictions is however the same as is used in the US. The reason why money laundering prosecutions are thin on the ground in these jurisdictions usually revolves around the difficulty of proving the predicate offence, since the entry point for financial investigation is the SAR, which is reporting a transaction or transfer which has occurred **after** the crime which may have been responsible for its generation. You have to take, in Madinger's terms, the second, backward, route of investigation, but you will rarely have the means of obtaining the necessary witness evidence that will enable you to establish the link to the predicate.

Money Laundering is a standalone crime. It is based on knowledge that the money is criminal. Proving knowledge in human terms is difficult. The essence of the act that commits the crime is a separation of the money from knowledge of its criminal source. It is therefore an act of concealment which incorporates a measure of deceit. The constituent parts of the offence are therefore not that it forms part of a placement, layering and integration exercise, but that it is an act of concealment that incorporates a deceit. The underlying premise of constructing an offence in

> these terms (and you don't even need to call it money laundering), is that money can only carry knowledge by virtue of the way it is treated by people. If deceit is used to explain or obscure the source of funds, if false invoicing or false lending documents are used to transfer funds, if false sales returns are used to explain the level of turnover achieved in a business, if phantom businesses are set up to create false audit trails, then it ought to be recognised that a prima facie offence has been committed. Under current process the investigation has to go through all the necessary hoops to show that, notwithstanding all the evidence of deceit that exists, the money is criminal in terms of the act. Many investigations fail at this hurdle, or are diverted to civil recovery. What I believe ought to happen is that when it is established that deceit has been used in the handling of money or property, the burden of proof has to shift to the accused. He has to show how he has satisfied himself that the money was not criminal, which implies providing a reason that will also explain the deceit. The conviction will be secure if an incomplete or false reason is provided, and culpability would also be transferable to others down the chain as necessary. This approach would also provide a means of addressing the customary get out (which often attaches to hot international money) that the deception was necessary to complete a scheme of tax evasion (which doesn't count as a crime in some countries – [though it might if the FATF Revised Recommendations get their way]). It would also ensure that money handlers would become much more circumspect in their dealings. The threat of prosecution would become real. The risk reward equation would be adjusted as a result.
>
> *It is no doubt over-simplistic as stated. But the essence of the problem in my view has been that the crime of money laundering has been made too complicated through adherence to the PLI doctrine. It has made it into a crime where most seasoned players simply do not expect to get caught, or if they are they won't be prosecuted. That has undermined confidence in the efficacy of even having such a crime on the statute book.*"

Clearly, the suggestion about the burden of proof here would be unlikely to find favour with the Canadian Courts (and many British judges are not overly sympathetic in the context of proceeds of crime cases, either). However the core argument remains that the PLI model is a distraction, a Procrustean bed which money laundering is chopped down to fit rather than a useful framework for all laundering.

ACADEMIC RESEARCH ON LAUNDERING TECHNIQUES AND TYPOLOGIES

Van Koningsveld (2013) gives an example from the successful appeal against conviction of those involved in the Air Holland case. As he puts it, it remains a mystery as to why such an illogical and costly route for the transport of the money was chosen if the defendants had a genuinely innocent explanation. The suspect investors in cash-strapped Air Holland (now in liquidation) transported cash in plastic bags hidden in the trunk of a car, deposited it in a bureau de change abroad, using an offshore company located at British Virgin Islands, and then ‘lent’ the money back via a company based in Luxembourg to the original owner. An appeal to the Dutch Supreme Court against acquittal is pending. (What he does not state is that the Dutch investigative authorities had some of the suspects under investigation: this was not triggered by a SAR.)

In the Paarlberg case, the extortion money paid to a gangster Holleeder was paid not in cash but was transferred directly from the bank-account of Armita (a Dutch Company controlled by the later murdered real estate broker and underworld launderer Willem Endstra) at Deutsche Bank to Fortisbank in the Netherlands in the name of Ballados NV, registered in the Dutch Antilles. This is equivalent to placement. Then Ballados - which was managed by a local trust company – sent the funds to Switzerland, where the money was deposited in an anonymous code account at UBS. The money was then transferred as a loan to a company (Wilbury Ltd) registered in Anguilla, in its bank account at the Swiss bank Clariden. All these transactions are the second phase of money laundering: the layering. Then Wilbury provided a mortgage loan to Royal Invest, a Dutch company wishing to buy real estate in Amsterdam. On paper Royal Invest now had an apparent legitimate source of the money, being a mortgage from abroad: this was a justification phase. Consequently, the mortgage provided to Royal Invest was used to buy real estate in Amsterdam, which could then be enjoyed or resold. This was the integration phase, at least until the chain of transactions was unravelled and exposed as a sham. In a sense, the criticism here is not that the three stage model does not fit but that it is not as helpful as it might be to predicting the process. For it is not obvious either to regulated persons nor to regulators how such transactions should be picked up as suspicious: simply naming the activity as layering does move the financial sector away from focusing only on placement – which is positive – but given the scale of business, does not offer an immediate route to picking out the wheat from the criminal chaff, even in a world where tax evasion and transnational bribery are predicates and therefore it is no longer an allowable excuse that it was only ‘avoiding’ tax. (Similar problems arise for intermediaries in distinguishing tax evasion from legal tax avoidance behaviour unless- as was the case with some Swiss banks operating in the US – they actually knew that funds were tax evasion because that was what they were targeting for growth of their business.) From the criminal investigative perspective, the three stage model is useful up to a point, but the key problem in the more sophisticated cases is often the effort that is needed to refute the attempted or implicit justification of the funds as legitimate once some layering has occurred. What regularly happens in typologies is that there is some ritual incantation of the three stage model, followed by a slightly or considerably more nuanced set of descriptors aimed at informing the different private and public communities.

It is helpful to look at laundering techniques in terms of the problems that offenders have to confront. The laundering methods used may depend on the nature of regime that is in place. The identification of ‘suspiciousness’ by professionals and others with a legal responsibility to combat money laundering is often a judgment that the people and/or transactions are ‘out of place’ for the sort of account they have and the people they purport to be. Thus, as part of the layering process, foreign students sometimes are approached to offer their accounts to run through transactions from ‘businesses’, for which they are paid commission as ‘money mules’, with more or less explanation by the launderers of the rationale for this. The success of this layering relies on inadequate back-office monitoring of existing account-holders: but in order to launder very large sums, one would need to find a lot of cooperating students. At a much higher level, if the would-be predicate offenders start out with a business that is being used as a medium for what looks like legitimate activity, then placement of funds may look unproblematic: corporate lawyers may be keen to offer well-paid services in the construction of corporate vehicles, and will not routinely suspect senior corporate staff of being major criminals. Since many frauds would be unsuccessful if they did *not* look like legitimate activity, this gives them a structural advantage over other types of offenders. We now turn to examine what is known about patterns of laundering, and since many studies are country-specific, we will examine European evidence. (See also Beare and Schneider, 2007, for a broad range of Canadian cases based on RCMP investigations.)

Although European research on laundering is patchy, it is more extensive than in the US and on a par with the Canadian work: the relative lack of American research is surprising, given the fact that the U.S. has been the policy leader in this field. Van Duyne and Levi (2005) review what was then known about money management by European offenders. The classification in the table below aims to map (only from cases that were final) the ways Dutch drugs perpetrators attempt to hide from government the crime-money itself, or the illegal ways of acquisition. The categories are not mutually exclusive, since more than one way of handling proceeds of crime may be employed in the same case and with the same money. For example, a portion of the money may be exported, part of which is subsequently brought back by means of a loan-back construction, while the expensive car is paid for in cash, to be subsequently put in the name of a relative to retain effective ownership in the event of proceeds confiscation. The issue of <u>how</u> offenders get proceeds into those property purchases is often more obscure, though some notaries have been suspected as conduits (Lankhorst and Nelen, 2005).

Table 2 Methods of disguising and laundering crime-proceeds

Forms of concealment/disguise	**Frequency**
Export of currency	31
Disguise of ownership	10
False justification	
loan back	3
Payroll	2
Speculation	1
Bookkeeping	7
‘Untraceable’	4

Source: Van Duyne and Levi, 2005

Bearing in mind that these observations derive only from identified and proven cases, and some may have derived from an era in which it was expected that money hidden abroad was safe from the clutches of the courts, it seems plausible to interpret the evidence as follows:

- **Export of crime-money** As can be observed in table 2, in most cases the money was simply exported: the 31 observations, covering 17 cases, concerned €16.6 million which had been found in foreign bank accounts (over a time span of eight years). In four cases there was evidence of money export to foreign banks accounts, though either these accounts were already cleared before the police arrived or the files did not mention any figures. In the cases of Turkish or Moroccan drug entrepreneurs, this export appeared to be an obvious option, given their country of origin. Either through bureaux de change or by means of physically transporting the cash, the crime-moneys were brought safely to their home countries.

- **Disguise of ownership** The second most frequently observed form of safeguarding assets while still being able to use them is the simple *disguise of ownership* by putting them in someone else's name. Only in a few cases was this done with any sophistication, for example when corporate structures (legal persons) were used. The usual defects were (a) the closeness of the relationship between the nominal owner and the beneficiary and (b) the difficulty of the nominal owners to prove actually having possessed the means to acquire the assets in the first place. Nominal owners were frequently acquaintances or relatives; some found themselves to be the involuntary owner of unknown property. For example, the mother of one middle level Dutch cocaine trafficker, who lived only on a meager pension, was surprised to learn that she owned a villa. Also in other cases, relatives were (ab)used by putting (moveable) assets or bank accounts in their name.

- Though pre-existing legal persons were used to channel drug-money, few of them were actually set up for the purpose of disguising ownership. The (notable) exceptions were a British crime-entrepreneur, two Dutch cannabis traffickers and a Turkish heroin wholesaler, all of whom invested in real estate using legal persons for the beneficial ownership. Another Dutch hash trafficker established an extensive network of legal persons to disguise the ownership of cash, bank accounts and vehicles. These corporate constructions to *disguise* real ownership overlap with the laundering (*justification*) category discussed below: tampering with paperwork and with other evidence.

- **False justification** From the point of view of 'real' laundering, the successful *justification* (in the event of investigation) of ill-gotten moneys or assets is the core craft: providing documentary evidence that the increase in wealth, whether in terms of money, assets or valuables, has a legitimate source. One of the methods most frequently used is the often mentioned, well trusted *loan back construction*. Given the frequent references in the literature to this, it is surprising to learn that its sophistication was shallow. Van Duyne et al. (1990) described a professional provider of loan back constructions, who designed professional loan contracts, complete with related correspondence and a real money flow of interest and repayments to the lender corporation abroad in order to imitate perfectly real loan transactions (and deduct the interest paid from tax liabilities). The loan back provider saw to it that his clients did pay the required monthly interest and repayment. Except for one case, such professional conduct could not be observed in the cases of this study. Loan contracts were sometimes missing, or the apparent 'contracts' did not mention the repayment and interest terms, nor was there any record that the required demonstrable 'flow back' of interest and installment payments were carried out.

- In two cases, the laundering of a monthly income by means of salary payment could be observed. In one case €75,000 was loaned to an independent but friendly small firm which subsequently handed out a modest monthly salary. This laundering was not intended to justify the millions of euros in proceeds, but to placate the Inland Revenue Service and create the illusion of a genuine income.
- 'Real' laundering by setting up *phony bookkeeping* to make the money really 'white' appeared to be a craft mainly used by drug-entrepreneurs who lived in the Netherlands, mimicking the sort of business they were in. For example a florist, using his horticulture as a cover for growing cannabis plants, had to obtain invoices to cover expenses as well as the income from the cannabis sales. In the cocaine traffic with Colombians, certificates of transportation of goods and accompanying phony paperwork with commodities (sugar) on the parallel market was carried out to justify the return flow of the money to Colombia. Such cover stories were easily busted by investigators.
- **The untraceability of crime-profits** This is a 'default' category, consisting of supposed moneys which could not be found.

A recurrent refrain in money-laundering literature and political speeches is the transnational dimension: money trails around the world through impenetrable accounts held in sunny, far away resorts. Such far-flung hideaways do exist, but how many wholesale drug entrepreneurs are customers of these facilities? *Convicted* British and Dutch drug wholesalers were certainly not: the exotic 'financial secrecy havens' rarely figured as target countries for depositing drug money (van Duyne and Levi, 2005). In the Dutch case, the frequency distribution over the foreign countries clustered around *neighboring* countries, and other jurisdictions were infrequent. It seems that the Dutch drug-entrepreneurs favored Belgium and Luxembourg, the Turks and Moroccans favored their own countries. A Dutch-Thai couple held bank accounts in Thailand because of the nationality of the partner. This finding contradicts the usual image of 'transnational' criminals spreading their ill-gotten profits worldwide over the 'bad' financial secrecy havens. Instead, it seems that the choice of banking jurisdiction is largely determined by proximity to the drug-entrepreneur's 'economic home'. This is confirmed in later studies of Dutch organized crime cases, e.g. van Duyne and Soudijn (2010).

Suendorf's (2001) German-language study of laundering in Germany contains 40 examples of money-laundering in the broad juridical meaning of the word: i.e., every subsequent handling of illegal profits aimed at disguising their origins. Two cases can be considered to fall into the category of thoroughly organized money-management: organizations were established to move the crime-moneys of heroin wholesalers to their respective home countries. One of them is set out below:

The *Bosporus case* identified an extensive and complex network of money-exchange bureaus directed by an Iranian entrepreneur, who served a Kurdish heroin wholesaler. The funds were collected in various cities in Germany, carried to branches of the Iranian or associated independent bureaus. Subsequently the cash was placed in German banks and transferred to bank accounts of allied money change offices in New York. From these accounts the moneys were diverted to Dubai and –if required– back to Germany or Turkey. To fool the German police, the bureau de change submitted occasional suspicious transaction reports.

In eleven of the forty cases there was an attempt to make an investment in the upperworld, though with variable success and degrees of professionalism. Most of the other examples concerned only the channeling of funds into accounts rather than full integration of suspected moneys. Overall, the sophistication and professionalism displayed was modest.

Steinko (2012) reviewed patterns of money laundering in Spain. Drug trafficking is the predicate offence in more than 90 per cent of the cases analysed. However, the most important criminal proceeds are those generated by cases of 'urban planning-related corruption', which have a major environmental and social impact. 60 percent of the proceeds of crime known about were laundered through the financial system. Of this, a third was through through foreign banks, preferably Swiss. He noted (p.496): "The majority of cases are technically and economically modest and have a local dimension. The few financial assets bought with illegal money show a conservative behaviour: no speculative handling of assets bought with criminal money could be detected. The analysis of the illegal non-financial assets illustrates the importance of real-estate properties and vehicles destined for regular use and, somewhat less importantly, for the acquisition of houses and luxury cars for conspicuous consumption. The main objective of money launderers is regular and conspicuous consumption and to obtain an income through the renting of property."

The well-researched threat assessment by the CSD (2012: 63-65) noted that most Bulgarian organized criminals did have licit businesses – more so than in other European studies – and that In 2010, investment of funds of illicit origin was mainly focused on four distinctive sectors: 1) trade (including dealing in real estate property) – 31%; 2) construction – 27%; 3) gambling – 18%, and 4) tourism – 10%. "The majority of the complex money laundering schemes involve notaries, accountants, lawyers, and financial experts. In larger criminal groups bosses may assign the control of such operations to particular persons. There are no specialist money launderers who provide money-laundering services to other criminals."

Imprisoned human traffickers in the UK stated that transferring money abroad was not difficult (Webb and Burrows, 2009), and it seems reasonable to infer that unconvicted ones found it even easier. The proceeds from facilitation of the trafficking were often returned to the home country where land and property were then bought. Facilitators based in the UK kept the bulk of the money there for disposable income and for investment in property and businesses such as shops, hotels, restaurants and sweatshops.

Finally, a British interview-based study of drugs dealers suggests the following pattern of expenditure and laundering (Matrix Research and Consultancy, 2007: 39):

Table 3 Uses of profits by U.K. drug dealers

Use of profit	Often	Sometimes	Never	Non-response	Total
Profits spent on lifestyle	68	2	5	29	104
Profits reinvested in drug trafficking	48	1	7	48	104
Profits invested in property or other assets	25	12	29	38	104
Profits laundered through legitimate business	19	2	39	44	104
Profits spent on drug habit	17	11	10	66	104
Profits sent overseas	8	8	48	40	104

Some dealers stressed that they "did not do anything flashy with their earnings", e.g. "just spending the money on the kids…and paying the mortgage" (p.39). The information collected pointed to unsophisticated money laundering techniques with a tendency to use friends and family, for example by investing in their businesses or bank accounts. One interviewee reported establishing a fraudulent painting and decorating business and buying winning betting slips that he cashed at betting shops across the country (ibid.).

One freelance hauler involved in the drugs trade reported that his boss would specifically identify a firm in financial trouble but who still had regular consignments coming into the country. He then went round and offered them a part of a deal so he could use their legitimate consignment as a front to enable a drugs importation. One might expect such willingness to mix legitimate and illegitimate trade (and confidence to make corrupt offers) to have become more frequent during the economic crises of 2007-10: but the evidence base is not good enough to test this.

The danger (not avoided by van Duyne and Levi, 2005) of this sort of analysis is that although it throws some appropriately skeptical light on official claims and popular assumptions about money laundering sophistication, it rests upon those cases successfully dealt with by the authorities. It therefore excludes those cases that are problematic to prosecute, whether in Europe, Mexico, North America or in 'failed states'. What the studies show is that internationally, there is much variation in patterns of laundering and in the markets for laundering services, which do not appear to be dominated by hierarchical 'Mr. Bigs' or indeed by criminal masterminds generally. However the skills involved in getting massive sums in VAT and other frauds to disappear beyond the reach of well-trained forensic accountants tells us something about the sophistication of *some* launderers and about the opacity of the world of international finance, despite the efforts that have been made to increase transparency and mutual legal assistance. What we can say of such cases - and this is reflected in the FATF (2007) report on carousel fraud and in the report (Monitoring and Evaluation Committee, 2013) on the huge fraud involving non-arms' length loans by Kabul Bank to elites that destroyed the Bank – is that the money disappeared and was irrecoverable. Whether this means that it was integrated or just very well hidden is more difficult to infer. Perhaps it was simply flown out of the country in cash, like the $52 million that President Karzai's brother took to Dubai, which was released with him when no offence could be shown. Since we have little idea what happened to the funds, we presume that they have surfaced in some form and have not been held to account. The key message appears to be that launderers only have to be better than the surveillance processes we put in place.

PART 3: ALTERNATIVE AND COMPLEMENTARY MODELS OF MONEY LAUNDERING: A RETURN TO FIRST PRINCIPLES

It may be helpful to think about the organisation of crime as following this sort of model:

1. Finding co-offenders (if needed)
2. Purchasing materials and other logistics for crime commission
3. Funding lifestyle while awaiting crime completion
4. Converting product of crime into funds if not already in that form
5. Spending and storing proceeds of crimes
6. Neutralizing risks from law enforcement and others
7. Safely integrating legitimately and/or re-investing in crime saved proceeds.

How this process works in practice varies by society and by crime type: the key issue – ignored in the original simple typologies – is that criminals start with different resources of expertise and contacts (whether vertically/horizontally integrated or more loosely networked) and this influences how they can launder and at what cost, as well as their *motivations* to launder, which is also influenced by personality and peer group pressures.

Desroches (2007: 834-5) argues that most higher level drug traffickers in Canada operate in relatively small and closed criminal syndicates, often deal and compete with others at the same level, and have a relatively loose and fluid structure and modus operandi that change over time, place, and in response to situational and legal factors. Higher level drug traffickers closely resemble independent business persons in a wholesale distribution system and work for their own enrichment and not for that of the organization. Most have no sense of membership in a large organization, nor do they work under the direction or authority of others above them in the distribution chain.

Although long-term relations frequently exist and/or develop among drug traffickers, the association between suppliers and distributors is not an employer-employee relationship in which upper-level dealers control lower level distributors. Rather, it consists of an ongoing series of transactions in which participants maintain a high degree of personal autonomy. Each dealer is free to search out other sources and may in fact be connected to more than one supply network. The normative system that exists and is understood by the players is that clients can change suppliers and take their business elsewhere if they so choose. Thus, in general drugs research, it is found that as with ordinary business entrepreneurship, a lot of effort goes into avoiding being disintermediated by people above and below in the supply chain.

At the same time (and in slight unacknowledged tension with the above), "friendship, kinship, and ethnicity are variables affecting trust and upper level dealers typically choose partners, employees, and clients within their trusted social circle" (p.836). Desroches continues (p.840) with the following comments, which (edited here to focus on the key issues for this review) remain broadly correct today:

"There is also relatively little published research on the following:

- the background of dealers
- stages in the careers of dealers
- upward mobility in drug networks
- the role and characteristics of trusted associates
- the significance of credit and the use of fronts in the illicit drug trade
- dealer profits and lifestyles
- how crime profits are invested and protected
- the involvement and/or the use of legitimate businesses and business services
- the use of technology for security purposes
- the role of informal information networks and
- social and economic incentives to desistance and retirement from the drug business."

In this brief overview of the literature on money laundering typologies, we have confronted the problem of what is the purpose of the three stage typology of placement-laundering-integration. We have shown that it may never have been an accurate description for most drugs dealers, since (unless one terms everyone who does not immediately spend all the proceeds a 'launderer') most lower level dealers do not save. Many migrant criminals – for example illegal migrants – either themselves pay or have their families pay for their smuggling, and they simply send the money back to support their families (after repaying the borrowings) via regulated or unregulated MSBs *whom they trust and have reason to trust*: so *they* do not engage in this three-stage process, though those smugglers who earn sufficient *net of their expenditures* to generate substantial savings might do so. The model implies (though this is not explicit) that the process is engaged with as part of a coherent organisational unit, yet 'cuts' from illicit income for lifestyle expenditures may be taken by intermediaries as subsistence/wages for their efforts, so there is a significant trickle-down of unlaundered proceeds. The proportion of proceeds gathered at each stage of the process – and its 'bunchiness' – create different sorts of problems for protection not just from law enforcement but also from predatory criminals who may engage in home invasion robberies, tiger kidnappings, etcetera which ironically may be stimulated by AML controls that stop criminals depositing their funds easily in legitimate institutions.

Emerging findings from Dutch police research on South American drugs traffickers in Europe shows an extraordinary preference for staggering quantities of €500 notes (e.g. according to criminals' own administrative records, this totaled over €298 million in 6 investigations in a period of 33 months during 2003-2011) which are couriered from Europe to Colombia. In one case they then shift the cash to Panama, and thereafter, the trail is lost. Sometimes these high value notes are purchased via tradespeople as well as MSBs. In one case, police were led to a Colombian woman who worked at a bank and had a relationship with a Colombian drug trafficker. Her mother had just been released from prison after serving five years for cocaine trafficking. The bank employee changed money for her boyfriend and other Colombian clients during her break, dividing up the money into smaller sums to avoid the reporting limits. The woman had also involved five co-workers at three other branch locations in her activities. Over three years, the six plausibly changed more than 23 million euros. It is difficult to explain why the funds are not simply kept in Europe if they are to be re-invested there – unless it is just a preference for physical control close to home, as van Duyne earlier suggested in relation to Turkish traffickers in the Netherlands.

There is little to evidence the assumption that laundering is *always* a well thought through game plan; like much crime itself, much of it may be adventitious and influenced by chance meetings, success or failure in interpersonal connections, and by criminals' own reflections on possible methods. However large scale smuggling or counterfeiting of anything does require an attention to total logistics and it is implausible that laundering is the only unplanned aspect of the trafficking process for repeat or large scale one-off threat actors. What needs to be understood is that illicit businesses are (and need to be) flexible to survive and prosper: as a result of the consequences of making misjudgements (death, prison or robbery), 'contingencies' are a general feature of criminal business except where monopoly or oligopoly is present and the state is neutralized.

Thus one of the deficiencies of the three stage model is not that it is *wrong* but that it merely summarises a sometimes complex and dense *process*. For example it tells us nothing about the recruitment skills and logics – including the large number of expatriates from South America or, plausibly, also from Asia willing to courier money or drugs for free travel and some money to visit their families and friends - the assessment and avoidance of risks at different stages, the awareness of commercial issues including jurisdictional arbitrage *within the process as a whole*, not necessarily all possessed by one individual or one 'organisation' (as in the classic 'organised crime' imagery, however variable this is in practice and however misleading coherent that label – see Levi, 2012a).

This brings us back to the functional purpose of the typology: what do we want, need and expect from a typology? The truth may be that what was wanted in the initial stages of the AML movement was a clear image of how the process might work so that people could fix upon it as a process and on phases beyond simple retail placement of cash. It served as a heuristic for a confused/ largely ignorant population of bankers and enforcement agencies faced with a miasma of possible laundering behaviour and needing a simple guide for the perplexed (author interviews in the late 1980s and 1990s). In practice there has been a focus in AML upon the front end identification (notably poor in the case of PEPs – FSA, 2011; FCA, 2013) rather than upon the more difficult customer monitoring post-acceptance/'onboarding'. Furthermore, corporate vehicles have seldom been treated with the scepticism and critical scrutiny that the layering and integration components would indicate that they merit, and it is not plain how the ever-increasing array of regulates could be taught to sort out the criminal wheat from the chaff. So the three-part staging is useful as a folk image but the latter stages and their surveillance by both private and public sectors (like corporate registries) have not been fully thought through and acted against in an integrated manner. One might question how many cases or disruption/preventative mechanisms have been generated by the systematic review of the layering and integration process once someone has 'passed' the placement barrier.

This is not to argue that *once a case has started*, public and/or private sector financial investigation fails to identify some proceeds of crime/unaccounted wealth: cases show that this happens. But by inspection, it seems comparatively rare that previously unsuspected people are picked up for laundering via financial surveillance at the layering and integration stages unless they give an account of their funds that is plainly implausible: and even then, as Sharman's experiment in asking financial services providers to act for him in suspicious trades shows, many will turn a blind eye in current conditions of low perceived risk *to them*.

Thoumi and Anzola (2012: 146-7) note that although some illegal funds in Colombia are sent abroad, they are mostly invested or spent directly in Colombia, unnoticed because of low enforcement despite strong formal AML processes: "the power of the paramilitary, guerillas and drug trafficking organisations, particularly at the local level in many regions, and the gap between formal norms and culturally accepted informal norms have shaped an extralegal economy that is immune to traditional mechanisms for combating illegal economic activities". Thus political impunity and the desire to gain status from investing locally mean that there is no need to go through the concealment components of the three stage model. Ironically because of AML controls, there was more incentive to purchase and/or pressurise the transfer of ill-protected rural land, and consequently Colombia has an enormous problem of rural displacement of some tenth of its entire population, second only to Sudan. This *could* be described as integration of illicit capital, but this would not be especially helpful. Laundering only needs to be as sophisticated as we force it to be. Controls are reasonable in the financial sector, but most economic activity occurs outside that sector. They describe one case in which a services firm had 1,500 Colombian national ID cards which it used to 'smurf' for clients. However in a well-defended local area, there is evidence that some big-time offenders do not bother with the three stage model at all, simply storing vast sums in cash. In Bogota August-October 2010, US$80 million and €17 million in cash were found and seized in five locations (p.161): whether crime-money management behaviour changed subsequently is unknown.

This is not to state that typologies exercises engaged in by FATF and FSRBs are pointless. Supplemented by regular cold case reviews of major cases of fraud and varied forms of 'organised crime' to examine how the funds were inserted and moved – which would not have to wait until criminal proceedings had been completed (or even started) – they can trigger at least reflective practitioner understandings of modes of detected laundering and thoughts about whether they could have been picked up *and acted upon* at an earlier stage than they were, to reduce harms. Just as J M Keynes once argued that politicians often find themselves the slave of some defunct economist, AML practitioners may find themselves the slave of some defunct typologist. The question is how should one sensibly and practically reconfigure the placement-layering-integration framework to include a greater focus on both positive sophisticated justifications for funds and inadvertent, taken-for-granted ways of not seeing and not suspecting that do not actually require positive justification for funds.

So to what extent do the individuals/groups have to disguise the origin of their proceeds or, rather, evade AML controls:

1. Zero level – such as criminal spend or such minor lifestyle expenditure as not to trouble any controls – C$50 on betting, buying a round of drinks in the bar, for cash. The

likelihood of detection by AML controls is negligible, nor is there any great public interest in such detection unless great harm is done for trivial benefit.

2. Level One – needing to hide the origin to achieve a single transaction, though at times reflecting many crimes – "I won it at the casino" bank deposits, buying high value goods for cash, single premium investments (in the classic model these are both placement and integration stages). The likelihood of detection by AML controls is higher but not great, unless patterns emerge. Thus, during the 1990s, a close knit group of people hit upon the idea of stealing large quantities of heavily used notes from the Bank of England cages, where they were being stored for destruction, smuggling them out in women's knickers. They were caught when one of them decided to take out a large single premium insurance policy for cash that was significantly inconsistent with their known income. If they had simply stored and spent the money, it is unlikely that they would have been detected.
3. Multiple levels – having to build structures (identities, corporate vehicles, accounts, organisations, etc.) to cater for multiple proceeds, need to store/transfer very large amounts and so forth. To keep these funds at home would risk home invasion robbery from other criminals, even if the person was 'merely' a tax evader. The likelihood of detection by AML controls is higher still: hence the need for more complex schemes. Integration would fall in here, but not as a stage of a universal model, but more as an inherent component of doing something with the money.

A relatively undiscussed aspect of this is what happens when an offender has corrupt control over criminal justice in his home jurisdiction. True, 'disturbance' such as US pressure in a Noriega (Panama) or Dudus Coke (Jamaica)-type case can force local elites to void their protection. But otherwise elite offenders may keep their assets in whatever form they choose unless they fear a change in regime: even if they keep them in an institution that makes a SAR or large CTR, what will happen in practice? If they have any of the investigation, prosecution or trial system under their control, they can prevent any action being taken on a report from a bank or an FIU at home or abroad.

This brings us back to considering motivation. Displaying status and exerting influence/control are two key drivers of crime, as they are also of some legitimate business. The questions of what people do with their money and why people carry on working when they are already very rich are queries both for licit and illicit capital.

RECONCEPTUALISING MONEY LAUNDERING TYPOLOGIES

The placement/layering/integration model was developed at a time (1988-89) when drugs trafficking was the principal predicate offence in law and in practice, following the Vienna Convention and the creation of FATF. Indeed, my discussions with those present at the *Sommet de l'Arche* make it clear that the model was firmly urged on the nascent FATF at its *travaux préparatoires.* In that era and place, models of Italian-American and rival syndicated crime groups were prominent, and it was generally accepted that this avenue from organised crime to social and political respectability constituted what the sociologist Daniel Bell (1953) termed 'the queer ladder of social mobility'. So the focus of the typology was appropriate at the time. However we are now almost a quarter of a century on, and reconfiguring the process is also appropriate, in the light of our more developed understanding and the arrival of new technologies. Whether this means substituting it for one other 'one size fits all' typology is more questionable, however. Rather we need to stop using the placement-layering-integration process as a comfort blanket and think about the diversity of sources, transfer mechanisms and destinations of proceeds of crime (and, in the case of terrorism and WMD, *preceeds* of crime). A typology is a heuristic that enables us to understand criminal markets and to think about (a) weaknesses in criminal plans and (b) intervention points for prevention, asset seizure/confiscation and forensic evidence connecting crimes/proceeds to businesses and people. The collections process for financial intelligence has been too weak to enable us rationally to assess how frequently different types of laundering technique are used for particular sorts of groups and crimes: not even the 'known knowns' are analysed rigorously. But we are certainly better off than we were in the 1990s, and recent typologies exercises are more carefully constructed. One key task is to clarify for whom and for what purposes we want a 'typology' or set of them. Improving our ability to spot laundering transactions is one such aim; another might be to prioritise what actions on such knowledge are optimal.

The first issue to progress might be to split off financing terrorism analytically from proceeds of crimes. Except where crime proceeds are used to finance terror, the standard thinking is distracting. Terrorism is clearly a social priority to address, but my interviews with CT practitioners and the literature suggest that to date, financing of terrorism legislation and controls have been useful more as a way of connecting funds flows to known suspects and to known terrorist events *ex post facto* than to prevention. There is also the risk of counter-productive policy initiatives such as cutting off the supply of remittances to Somalia, which lie outside the scope of this review. WMD proliferation more commonly than terrorism involves devious multinational corporate arrangements via front or real companies to obtain prohibited components and to bypass national sanctions: but this is also the lengthy history of sanctions-busting in military conflicts and in controlling the capacities of liberation/repression movements in countries such as Rhodesia, South Africa, former Yugoslavia, et cetera. The aim is integration of a different kind – rather deep concealment. Once the products are obtained in violation of the sanctions, hiding of origins of finance and destination is important only to permit future uses of the route: for the products are beyond the reach of the prohibiting state. The generation of slush funds and, for example in the Milosevic and suchlike cases, the hiding of stolen assets offshore, are more akin to grand corruption than sanctions-busting cases. But integration in the sense of generating a respectable explanation for the possession of assets may be impossible. If one has been a public servant on an approximately known income, the possession of huge assets post-demittance from office is implausible to account for legitimately. The idea is that oneself and family should be able to use the assets at some future date and, especially since the advent of targeted sanctions, assets are likely to be held via corporate or individual nominees who are trusted, often as part of the same political movement. If the persons are identified subsequently enjoying the assets, however, they may find themselves in difficulty. So much depends on the surveillance of such individuals, and in this mediatised era, in addition to any electronic surveillance of a kind that has caused controversy recently, photographs of current or ex-politicians and families enjoying homes, yachts etc may have risks and consequences whoever is the nominal owner, who then may be pressed to explain the acquisition of the assets as discussed earlier in this review. So the term 'integration' in the typology is treated in far too simplistic a way. 'Integrated-enough' might be a more sensible model, though this can vary according to context, e.g. the priority of the person or acts with which they are associated; cooperation following regime change, et cetera. Loss of privacy affects elites as well as the masses: recognisability is trickier to manage/suppress in an age of digital surveillance, including cameras in mobile phones. See Nigerian PEP pictures regularly displayed in http://saharareporters.com to embarrass the elites and perhaps trigger civil or criminal actions abroad, though proof in criminal courts may not be easy even where there is photographic evidence of an otherwise surprising connection between an asset and a suspect which makes it plausible that s/he is a beneficial owner. The impact of changes in beneficial ownership regimes is an open question at this time. Again, layering raises the issue of how much work regulated firms are (reasonably?) expected or required by their regulators to do in order to test whether the purported beneficial owner is the real one.

It may be useful to think about money laundering issues from the point of view of criminals in different organisational settings, having contemplated and/or committed one or more of a range of crimes. The 'national crime for gain and money-laundering problem' is the sum of such individual decisions to offend, which can have an interactive effect despite the need for some secrecy to protect against enforcement interventions. Note that the decision to commit a primary offence or to launder can be domestic or it can be foreign (or a mixture for co-offenders).

There appear to be two imperatives for offenders:

1. Not to lose the proceeds of crime (e.g. by seizure and confiscation, theft by other criminals, loss of value over time – e.g. currency shifts - or through physical damage/deterioration). Illicit capital owners face particular predation risks from both the authorities and criminals once they retire and lose occupational protection. Physical safety of proceeds both from robbery and from asset forfeiture (assuming they consider either of these to be significant risks) can be important: though it is easy to overstate the extent to which criminals are thoughtful retirement planners. There is barely even anecdotal evidence about such planning.

2. To realise some utility from them (e.g. through lifestyle spending for intrinsic pleasure and/or ostentatious display, investment in legitimate business, criminal reinvestment, political influence/power, protection, satisfaction of possessing illicit proceeds undetected).

In order to achieve these objectives they have a number of activities they can carry out, which look like the definition of Money Laundering – store, transfer, disguise, exchange, etcetera. The three stage model is a particular, linear example of those activities being directed to achieve certain ends. But (a) the relative growth of economic crimes, bribery, and tax fraud compared with the drugs trafficking for which the three-stage typology was originally developed; and (b) our growing awareness of the range of value transfer mechanisms, means that the model is no longer fit for purpose *even for those funds that are intended to be saved and rendered risk-lessly available for use in public settings*.

There are other models of crime money management – so, for example, reinvesting cash proceeds in more drugs is realising utility (and – probably - falls within the wide definition of ML, certainly of 'crime money management'), but doesn't require placement (in the AML sense), layering or integration. It does require precautions to avoid robbery and a way of swapping money for the drugs safely. For corrupt kleptocrats, and even for less elevated persons, a significant amount of funds need to be kept close to home in liquid form for disbursement to allies and extended family 'needs', including larger, well decorated homes. Thus although investments in large homes abroad are commonplace in elite circles, this does not mean that *all* the proceeds of Grand Corruption or other crimes are deposited outside the country: especially in dictatorships, most kleptocrats appear to want and expect to retain power (Levi, 2012b).

One way of thinking about money laundering typologies is to break them down into types of criminal predicate, though this does not take account of the fact that funds coming from polymorphous crime networks may be laundered together by existing third parties or group members, as part of the criminal economies of scale from not having to search separately for co-offenders.

The implications of this are that when we shift from retail/wholesale drugs, a significant proportion of the big money crimes involve funds already in the financial system. This implies that we need a greater focus on monitoring of transactions involving existing entities rather than on 'front end' client onboarding; and less emphasis on cash based placement scenario training for LEA and regulated institution staff. The big money being laundered needs to move through places with capacity to store and process it, usually discreetly. Although losses from fraud are usually greater than fraud profits or even proceeds, each of the five largest global fraud cases in recent years are more costly than the GDP of 64 countries!

Table 4 *The Range of Crime-Proceeds-Impacts*

Crime	Cash	Scale of Operations	Severity of harm	Most affected population
Drug dealing	Exclusively	Very large	Severe	Urban minority groups
Other blue-collar	Mostly	Small to medium	Low to modest	?
White collar frauds	Mix	Mix	Low to severe (Compensation?)	Broad
Bribery and corruption	Sometimes	Large	Severe	Mostly developing/ already corrupt administrations
Terrorism	Mix	Small	Most Severe	Broad

One conclusion might be that we should focus typologies on big money issues, and move away from counting and analyzing cases and incidents to counting and analyzing the economic and (sometimes separately) the social values involved in them. The proceeds of 'signal crimes' such as contract killings might reasonably always be given priority over tax evasion, but tax evasion proceeds might be given greater priority than social security fraud proceeds which are easier to detect. But in any event, the *possible* routes of laundering are so varied and ubiquitous that an assessment must be made about how plausible it is that any given set of offenders would use one method rather than another, given the offences committed, the form the proceeds take, and the connections they have.

The latter may well be unknown to the financial and other institutions they are seeking to manipulate, but – as the HSBC, UBS and other scandals involving leading pillars of the international banking community indicate – may sometimes be very well known, especially where the predicate offence – if suspected or actually known - is interpreted as ambiguous or as unlikely to attract enforcement against the offender and, especially, against the laundering institution or the account-manager personally. This brings us to the heart of 'credible deterrence' in the money laundering arena, but it does not solve the problem of what financial institutions, FIUs, or criminal investigators need to look out for (and what they can reasonably ignore or downplay) as signs of laundering. This brings me to some important areas of laundering that have received attention from FATF.

Our understanding of how much criminals gain from crime and how the costs of crime are distributed, geographically and by crime type, is in its youth (Levi et al., 2013). However abstracting from the limited literature and *a priori* reasoning, some core logistics that offenders confront are:

The logistics of laundering strategies

1. From which countries – domestic and foreign - are the proceeds of the crime(s) conveyed?
2. Does the offender need to shield the counterparty from knowledge of where the funds go to?
    - Is the payer/counter-party consensual – and willing actively to assist the offender in payment; is the crime deception/extortion – in which they cooperate with the offender; or is it burglary/robbery/theft, in which case the victim does not help with funds transfers and the offender is usually unknown unless caught?
3. Does the offender/network have access to existing real trading firms or to front entities which are a plausible pretext for the value transfers?
4. Does the offender want to have ready access to most of the funds for lifestyle/rainy day emergencies, or are the proceeds intended to be saved?
5. If saved, what is the risk perception and risk appetite of the offender/network, and what are their current ambitions for eventual respectability?

As set out earlier in this review, most analyses of existing criminal cases reveal relatively unsophisticated laundering methods, and these feed into the typologies, which usually use them as a base to explore possible methods by which laundering can happen. Probably the most rigorously researched of these is the FATF (2013) study of the vulnerabilities[16] of legal professionals.

[16] a necessary but diplomatically generous term when some of them actively grasped the opportunities to launder.

Let us examine some areas that highlight some of the problems and benefits with ML typologies. The first is e-gambling. Plainly, if e-gambling is criminalised, an all-crimes model would lead us to work out that all proceeds are money laundering. However, discarding that tautology, the main areas of risk are (Levi, 2009):

- Beneficial/Direct Ownership gaming firms *by criminals*
- If online gaming firms can credit winnings or unused funds back to an account other than the one on which the original bet was made: an issue which gaming firms share with other business areas.
- The use of 'front people' for gaming transactions.
- Peer to peer games like e-poker, where value transfers can occur between electronic & human players via deliberate losses, at relatively low cost to the players.
- Payment in (and out) via other financial intermediaries like pre-paid cards, which in Europe (far less so elsewhere) are regulated for AML purposes and have modest limits, but where KYC controls are of modest or inconsistent quality.

A later typologies report by Moneyval (2013) identified the following 'red flags':

- Information provided by the player contains a number of mismatches (e.g. email domain, telephone or postcode details do not correspond to the country);
- The registered credit card or bank account details do not match the player's registration details;
- The player is in a higher-risk jurisdiction or is identified as being listed on an international sanctions list;
- The player is identified as a politically exposed person;
- The player seeks to open multiple accounts under the same name;
- The player opens several accounts under different names using the same IP address;
- Withdrawals from the account are not commensurate with the conduct of the account, e.g. where the player makes numerous withdrawals without engaging in significant gambling activity;
- The player deposits large amounts of funds into his online gambling account;
- The source of funds being deposited into the account appears to be suspicious and it is not possible to verify the origin of the funds;
- The customer logs on to the account from multiple countries;
- A deposit of substantial funds followed by very limited activity;
- The player has links to previously investigated accounts;

- Different players identified as sharing bank accounts from which deposits or withdrawals made.

These red flags have different levels of suspiciousness: why should PEPs engaging in on-line gaming be particularly suspicious? They may enjoy gambling, unless it is proposed that large losses identify them as making more than they have legitimately earned. But most problematic – and not discussed in the report - is why people should choose on-line gaming *over other methods* as a method of laundering money. There are in fact some major disadvantages:

1. **In most cases, there is no physical cash:** Monies are received from regulated financial institutions
2. **Exposure is small per bet –** but *overall exposure* depends on how often bets can be made by the same people/networks
3. **Anti-fraud/cheating systems make e-Gaming sites unprofitable for *outsider* criminals in search of big fraud opportunities**
4. **There is a very good audit trail of all transactions**

- Electronic mechanisms mean usually little accurate visual identification but location, IP address etc. are reasonably well analysed (though sophisticated internet users can hi-jack IP addresses via 'botnets'), and payee is known, subject to
    - bank/payment card Know Your Customer controls over false/stolen identities;
    - regulated operators' controls over linked accounts.

So a risk-based approach suggests that a low priority be given for e-gambling as a laundering method, except if crooks own or control e-gambling firms or if CDD requirements are unduly relaxed for VIP customers. The ratio of effort to benefit is disproportionately high under normal circumstances for significant sums to be laundered (rather than simply lost in gambling 'addiction').

A second area is trade-based money laundering (and trade-based fraud, with which it is often associated – though a successful fraud is not automatically successfully laundered). Conceptually, the aim of the criminal is to keep control of the proceeds in a place which is relatively safe from predators in the underworld or legitimate world. The least risky way to do this is to transfer value by selling currency in the place where it is generated (e.g. by drug sales), and getting benefits in the place where he wants it to be. Thus, exchange controls stimulated black peso exchange techniques by producing a set of willing bulk purchasers of narco-dollars in the Asian and Latino business communities. In people smuggling and trafficking, the income flow is more subtle because extended families who export their children in exchange for better life chances and remittances generally pay in the countries of origin. But where they are kept in indentured conditions overseas, funds are generated that require some level of repatriation, about which little is known save that those imprisoned in the UK had little difficulty sending money back via Money Service Businesses (Webb and Burrows, 2009). Extraordinarily, most of the proceeds of VAT Carousel frauds – which cost EU Member States many billions (Levi et al., 2013) – largely appear to vanish without trace, allegedly often to Dubai (FATF, 2007), though that may not be its final destination. Many millions were held in a niche Dutch-operated bank in the Netherlands Antilles run by John Deuss, who was not suspected of offering facilities to other criminals, nor of running the VAT scams himself.

By their nature, the kinds of appeals made in romance scams and in 419 scams usually generate bank transfers or, to provide a harder trial to follow despite CDD, payments via MSBs. Over and under-invoicing of products and services exported offer a way of transferring value that usually is 'under the radar' and would not normally trigger the suspicions of bankers unless there was a change in turnover that was grossly disproportionate to anything a thoughtful banker might find plausible. And there are always purchases of precious stones that are small, transportable and very valuable: they may not be 'laundered' but – like assets simply deposited in safety deposit boxes - they are effectively hidden unless stolen or detected. So in addition to assets and paperwork discovered on the premises of suspects, what is needed is more systematic analysis of existing cases (like the World Bank's *Puppet Masters* study of Grand Corruption – de Willebois et al., 2010 - but applied in more garden-variety crimes as well as other serious fraud cases, where reports from liquidators and others can yield insights into how money was moved); more proactive 'mystery shopping' to test if controls that are supposed to be in place actually are; and more 'what if?' thought experiments and offender interviews to see if conceptual laundering techniques might plausibly work with the kinds of crimes committed.

Typologies need to be grounded in the mechanics of how the proceeds of crime are technically placed and layered, and how/if this could happen *at scale* for those offences in which size is important. Particular control weaknesses were highlighted in the US sanctions cases with the stripping of identifiers - made more likely by the lack of perceived legitimacy in those sanctions – and the search for patterns is a strong notion. Weak controls over the purchase of large quantities of prepaid currency cards enable cross border transfers at high levels to take place – this might be tested by surprise mass checks of travellers at border crossings, with equipment capable of testing how much funds there are on the cards. Electronic currency exchanges such as BitCoin, Liberty Reserve, et cetera will be popular – despite their strong physical audit trails - provided that offenders can work out how to buy them with the proceeds they have, and how to account for them if identified and questioned. But whether in their present form they can offer enough scale for the billions of dollars even sceptics consider are generated by illicit markets and predatory crimes seems doubtful. These observations are untidy, but the evidence seems to suggest that there is a very broad range of methods by which criminals can store and move proceeds of crime. The key is to make it harder for them to account for these funds, and that takes a sceptical turn of mind willing to deconstruct and question accounts of wealth, including 'property improvements'.

Recent serious penalties for elite financial institutions have focused the minds of management upon the importance of compliance. The 2013 FATF Methodology will focus the attention of governments and the private sector on realistic assessments of their money laundering risks and on appropriate responses to them rather than on the creation of a Potemkin Village of laws, regulations and institutions. Our objectives and outcomes may be crime and money laundering reduction, and the recovery of proceeds for individual and corporate victims and for domestic and overseas governments, as well as putting proceeds beyond use for further crimes and terrorism. Irrespective of whether or not the final goal of many offenders is integration – which is to be doubted – interventions to produce more efficient suspicions and action on those suspicions remain a priority for both governments and the private sector. This short study has sought to re-examine those processes, but the variety of mechanisms that are used for cash and non-cash crimes defy simple heuristics for regulated bodies, financial intelligence units and law enforcement. In an age of austerity, prioritisation is inevitable but the crudity of the financial trails in most money laundering prosecutions (outside major frauds) suggest that either we are deliberately choosing the low hanging fruit and there is no resource left for other kinds of cases, or that there is a collective failure to follow through the ambitions that drive the global AML movement. Either way, we need to focus a little less on the integration stage – unless that is a moment of weakness – and more on how value transfers are arranged, what is the nature of the supply and demand intersections in the market for money laundering, and how we can enhance the chances that false explanations for transfers and for wealth are critically interrogated if we are going to make a difference.

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ANNEX 1

Appendix IV: Specific differences of the definitions of money laundering (from Unger et al., 2006)

	Subject			**Source of subject**		**Goal**	
ref.	*Stock*	*Flow*	*Stock or flow*	*Illegal*	*Criminal*	*Hide the source*	*Make it appear legal*
1			Object		Criminal	Hide the source	
2	Property				Criminal	Hide the source	
3	Property				Criminal	Hide the source	
4		Proceeds			Criminal	Hide the source	
5	Assets				Criminal	Hide the source	
6		Proceeds		Illegal		Hide the source	Make it appear legal
7			Money	Illegal		Hide the source	Make it appear legal
8					Criminal	Hide the source	
9		Proceeds			Criminal	Hide the source	Make it appear legal
10			Money		Criminal		Make it appear legal
11			Money	Illegal		Hide the source	
12		Proceeds			Criminal		Make it appear legal
13			Advantage	Illegal			Make it appear legal
14			Money	Illegal			Ambiguous
15			Money		Criminal	Hide the source	Make it appear legal
16	Property		Money		Criminal		Make it appear legal
17	Property				Criminal	Hide the source	
18		Income		Illegal		Hide the source	Make it appear legal

1 =Dutch penal code (2004) (Objects are all means and property rights)

2 =Council Directive (1991)

3 =United Nations law model for money laundering (2003)

4 =FATF (1996)

5 =IMF and World bank (2004)

6 =Interpol (1995)

7 =IOSCO (1992)

8 =IFAC (2001)

9 =Australian Institute of Criminology Research and Public Policy Series (1996)

10=Kleemans, Brienen, van de Bunt, WODC (2002)

11=Savona (1997)

12=Graham (2003)

13=Duyne, van (2003)

14=Walker (1995)

15=Cuéllar (2003)

16=International Conference on Global Drugs (1997)

17=European Communities Convention (1990)

18=President's Commission on Organized Crime (1984)

ANNEX 2

THE FOUR-STAGE MONEY LAUNDERING MODEL (Koningsveld, 2013)