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Paper titled

**“Critique of a Compliance-Driven Enforcement Strategy:
Money Laundering and the Financial Sector”**

by

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Organized Crime and Corruption**

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Introduction

This paper touches on, and in a small way links, several competing larger themes: the development of a language of compliance; debates over the viability of a ‘social contract’ between corporations and the wider society; the assigning of impossible or at least improbable responsibilities to for-profit institutions; the impact of the international community and/or the U.S. on Canadian policy making; and most specifically the current global pre-occupation with money laundering.

This paper is not so much about whether or not corporations in general can and will act ‘ethically’ but rather it looks at one particular example—financial institutions. In order to look at the ethical conduct of financial institutions this paper focuses on the one specific topic of money laundering. Determining compliance with voluntary standards is always difficult. The rhetoric of compliance and the rhetoric of ‘ethical conduct’ originate from societal definitions—the strength of these definitions and the consensus surrounding them vary among competing definitions. These two bodies of discourse may be quite distinct. For example, the rhetoric of compliance can be very strong and serve to obfuscate a reality of neglect. A forceful compliance rhetoric may be the result of external pressures of one sort or another and may coexist with more ambivalent evaluations of the conduct in question. Understanding the rhetoric and the need for the rhetoric is part of the task of this paper.

Key findings from an empirical study of the suspicious transaction reporting within the major Canadian financial institutions are included in this paper but even this research is inconclusive in terms of the ‘intentionality’ of the institutions. The monitoring of these ‘ethical’ decisions poses difficulties. While within some corporations the impact from labour and polluting decisions may be geographically hidden (i.e., factories in less-developed countries or rural, unpopulated regions), non-ethical commerce is more likely to be concealed by systemic veils of secrecy, interwoven incorporations and confidentiality claims. In order to map the likely compliance of financial institutions this paper looks at three separate indicators: what we can learn from *international* literature/research; what we can learn from other (non money laundering) research related to *Canadian* financial institutions; and finally, what we learned from our own suspicious transactions research.

This paper begins by providing a context for the focus on money laundering. Lessons from the study of deviance and criminology teaches us that success or failure of a compliance regime may rest in part on the legitimacy with which the policies are held. Where there is unanimous agreements as to the present danger or merit in a voluntary procedure, the argument holds that there is more likely to be a concerted effort to conform with the requirements—with the caveat, the more onerous (or costly) the requirements, the more compelling the ‘need’ may need to be. Where the merit is vague or debatable, coupled with low risk of detection, and low negative risk of sanction (or positive reward), the less likely will be the compliance.

There are three main sections. The paper moves from the ‘general’ acknowledgment of the international focus on money laundering and pressures on countries to reproduce model money laundering legislation and policies, to a more specific ‘micro’ look at some current research findings that we have produced in our study of the ‘Big 5’ banks and their response to voluntary suspicious reporting. The paper then acknowledges the literature that questions this strategy and helps to explain why one should not expect ‘aggressive’ reporting from the financial institutions. The final section looks at the international literature that is beginning to encourage us to maintain a critical perspective on the entire anti-money laundering crusade. Basically, the paper examines why we are focussing on money laundering, discusses why we might not expect that making bankers into front-line enforcement officers will be effective, and finally questions whether or not the money laundering approach itself is appropriate.

The ‘Money Laundering’ Environment

A focus on money laundering has become the international law enforcement approach to transnational crimes and ‘the’ approach to take to effectively impact other sophisticated criminal operations. Gold and Levi¹ call *money laundering* “one of the buzz phrases of crime in the 1990’s”. It is now creating a roar rather than a buzz as we move into the 2000’s. National and international politics and power prove to be key components in understanding this rhetoric. As George Gilligan states:

“ This political dimension can be seen in the ‘regulatory jihad’ against money laundering in recent years as part of the US-led war on drugs “².

Rhetoric around money laundering has motivated significant international cooperation. Internationally, seemingly the entire western world is determined to ‘fight’ the money laundering war. How much of the fight is mere symbolic words and how much of the concern is even actually ‘money laundering’ ought to be more strenuously debated.

¹ M. Gold and M. Levi. 1994. *Money Laundering in the UK: An Appraisal of Suspicion-based reporting*, London: The Police Foundation (p.7)

² *Regulating the Financial Services Sector* George P. Gilligan., Kluwer Law International, p. 22.

One forgets that this focus is relatively new and constitutes a very real departure from traditional law enforcement strategies that target the criminal and the ‘predicate’ (to use a US term) criminal activity rather than the illicit profits. In Canada, our focus on ‘money laundering’ began with the passing of the Proceeds of Crime in 1989. At the same time, money laundering itself became a criminal offense. Law enforcement has turned to ‘proceeds of crime’ as a major weapon against the organizations of sophisticated criminals. The arguments that justify this approach are four-fold:

- Catch the Upper Level Criminals: The 1980’s policing strategies of ‘targeting upward’ to convict ‘king-pins’ of the criminal operations proved both harder to accomplish and less satisfying when it became evident that these individuals retained a degree of control over their criminal operations from within jail. There is some notion that going for the proceeds might in fact serve to bring the investigation near to the criminal ‘bosses’. Enforcement officials are fond of saying that while the top echelon of the criminal organizations may stay away from the criminal commodity (i.e. drugs) they will remain close to the illicit proceeds;
- Capture the Criminal ‘Operating’ Proceeds: Taking away the proceeds of crime was seen to impact the entire criminal operation and ‘put the organization out of business’ by eliminating both the investment capital and the profit;
- Destroy the Criminal Motivation: Taking away the profit was seen to eliminate the motivation for the criminality;
- Restore a Sense of ‘Justice’: Behind this strategy lingers a sense of ‘justice’ being served by having criminal proceeds returned to the State—a Robin Hood acceptance of the merits of taking from the bad guys and giving to the law abiding folk—possibly to fund further law enforcement or prevention strategies.

The focus on the ‘proceeds’ has shifted to target not so much the proceeds but rather the laundering or concealing of these illicit gains. These are seen to be international issues at stake, and therefore a fifth explanation for the enforcement strategy might now be added:

- Appeasement of the International Community: Various black-listing strategies make it essential for countries such as Canada to appease the international community in their various campaigns to harmonize laundering regulations, legislation and policies—a campaign initiated and largely driven by the United States. Justice *plus* financial gain is a powerful combination in state policy-making!

Issues of the sovereign right to make national policies compete with notions of what is demanded by the ‘international community’—as if there were *a* community rather than diverse vested interests coinciding within a global space! From a policy perspective there

are at least three competing objectives to the design of an ideal financial system. One wants:

“...continuing national sovereignty; financial markets that are regulated, supervised and cushioned; and the benefits of global capital markets... Any coherent reform proposal must favour two parts of the trinity at the expense of the third”³

The enthusiastic adoption of anti-money laundering policies, investigations, and sanctions as expressed by spokespersons such as Raymond Kelly, Commissioner of US Customs Service, become part of the rhetoric of the ‘war on drug’:

“We will not win the war on drugs by following the tons of cocaine and heroine and marijuana that move through our streets. We will win it by following the billions of drug dollars that move through our financial system”.⁴

By definition *money laundering* is supposed to involve the ‘laundering’ or cleaning of illicit currency—i.e. a process that provides the appearance of a legitimate source for the illegitimate proceeds, even when a police investigation is undertaken. By this stage, the funds may be integrated into the legitimate economy so thoroughly as to be interchangeable with legitimate earnings.⁵ Money laundering requires a concerted effort to follow the trail of the illicit money in order to locate, seize and forfeit the criminal proceeds. The notion of a ‘route’ that crosses international borders has meant that certain countries can be designated as being ‘weak-links’ in the international ‘war on money laundering’.

The issue becomes an international issue, with international pressures that strive for conformity with a perceived appropriate model of legislation and ‘best-practices’ policies. However, regardless of the routes taken, or legislation put into force, the role of financial institutions around the world remain critical to the laundering processes. In most cases, regardless of what laundering system is used, there will be a point where the illicit currency will be introduced into the financial banking system. The objective may be for wire transferring out of the country; for changing the denominations; exchanging the currencies (i.e. into/out of US dollars etc.); or for domestic deposit to enable future purchases, or to finance other illicit activities, or to enter into further stages in the laundering process.

Banking is seen as a convergent point for illicit proceeds. Banking systems that deliberately attract illicit proceeds by facilitating money laundering provide a niche-

³ See Z. Minton Beddoes, “A Survey of Global Finance” *The Economist*, 30 January 1999, pp. 1-18 at p. 2. Taken from *Regulating the Financial Services Sector* by George Gilligan, 1999, p. 211.

⁴ *Fortune*. September 27, 1999. quoted by Rob Norton “First-Humble Opinion - In defense of Money Laundering”

⁵ Article 3, paragraph 1(b) of the *United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*, Vienna, E/CONF.82/15 of December 19, 1988.

market service to criminals. Typically we think of off-shore brass-plate banking services as being the laundering centres—however, the recent focus on banks and laundering activities reveals that some of the most prestigious banks in the world (Switzerland, Monaco, United States, Britain...) are vulnerable, *or make themselves vulnerable*.

The simple sequence of criminals having illicit proceeds and governments agreeing to seriously go after these proceeds via anti-laundering strategies gets ‘messy’. The police, justice officials, media, and public have come to use the term *money laundering* in a broad and imprecise manner. Money laundering legislation is being applied to situations unrelated to any traditional notion of organized crime and in situations where illicit proceeds are deposited or otherwise used but where there is no ‘cleansing’ involved. I shall attempt to show that the term money laundering is being used by some of the most ardent anti-laundering advocates as a ‘selling’ concept for changes that relate to capital flight and tax evasion and *not* money laundering. The term money laundering is attractive because it is exchangeable with transnational crime/ organized crime and drug trafficking—criminality pure and simple and surely worthy of a concerted control regime. In contrast with tax policies that are burdened with confidentiality and voluntary compliance rhetoric, no such sentiment protects the ‘money launderer’. Ironically, in fact, this paper will argue that actual laundering is being largely ignored, or at worst protected.

Combating Money Laundering: Enforcement vs Voluntary Compliance

While much of ‘enforcement’ is based on legislatively defined and sanctioned behaviour, there are other forms of enforcement that consists of various types of regulatory requirements, codes of conduct, guidelines, and agreements. There is a vast (and occasionally tedious) literature regarding voluntary codes of conduct. The general agreement is that voluntary codes are “compatible with neo-liberal model of trade liberalization, privatization, deregulation, cost-cutting, labour flexibility, and global competitiveness”⁶ Much of the literature goes to testing the viability of voluntary codes and often concludes as does Harry Arthurs, that:

“...a modest body of research seems to suggest that they [corporations] can be responsible and profitable too. There is money to be made in ‘ethical’ investment and sustainable development’; social market policies do not seem to impair the efficiency and adaptability of workers; and economic prosperity may correlate positively with civic mindedness and progressive labour practices”.⁷

⁶ Bob Jeffcott, L. Yanz, Maquila Solidarity Network. 1999. “Voluntary Codes of Conduct: Do They Strengthen or Undermine Government regulation and Worker

organizing?”www.laborrights.org/projects/globalecon/jeffcott.html

⁷ Harry Arthurs.1999. “Private Ordering and Workers’ Rights in the Global Economy: Corporate Codes of Conduct as a Regime of Labour Market Regulation”. Draft, unpublished paper.

This may be true when there is an additional product whose ethical production accounts for the profits—however, *what happens when the money is the product*. The key role of banking supervisors is to promote the overall financial stability and soundness of the bank. As stated by Ray Protti, President and CEO of the Canadian Bankers Association:

“Banks are profit-making institutions. If they’re not profitable, employees don’t have jobs. The marketplace has changed so dramatically and so quickly that our institutions have to show a tremendous amount of innovation, creativity, and leadership to maintain their positions and profitability levels”.⁸

The business of financial institutions is the business of making money. There is no intermediary commodity, the production of which can be ‘negotiated’ to meet labour or environmental sensitivities. While regulators and best practices guidelines and other compliance mechanisms pressure financial institutions to assist with enforcement, the banks see themselves as being in a situation of increasing competition with the one objective being to attract funds.⁹

Banks as ‘Enforcement’ Partners

Juxtaposed against this focus on profitability and competition is the fact that the banking industry is supposed to be one of the key front-line institutions in the fight against money laundering. In the control of money laundering, the responsibility for detection rests in large-part with the front line tellers and private banking officials. These enforcement responsibilities are either ‘voluntarily’ secured (with legislative protections against liability for confidentiality violations) or ‘mandated’ by law. The timing of our project to study the suspicious transaction reporting within the “Big 5” Canadian banks coincided with the shift from a record keeping and voluntary suspicious reporting to a mandatory reporting regime. In Canada our *voluntary* system of reporting suspicious transactions has been made *mandatory*. In terms of transference of banking information to law enforcement agencies (i.e. transfer of knowledge) about customers and their transactions, there are three basic procedures: currency transaction reporting (CTR), suspicious transaction reporting (STR) and record keeping.

Currency Transaction Reporting

Currency Transaction Reporting (CTR) is a legislative mechanism that requires all transactions meeting fixed criteria to be reported to a central agency/body. “Reporting” is designed to expose the laundering process at its most vulnerable ‘choke’ points, when the cash enters the financial system and when it is transferred between financial intermediaries. The CTR debate with the United States is an old one that goes

⁸ *Canadian Banker*, Third Quarter, 2000. P. 21

⁹ See “The Electronic Age Has Made It Much harder for banks to recognize Suspect Funds”, by John Willman, *Financial Times*, April 19, 2001.

back to the early 1990's . Senator Kerry on behalf of the US government decided that all countries ought to have a CTR system comparable with the United States (in practical terms they ought to have meant 'better' than the US system considering the inadequacies of the US model). Failure to do so, or at least failure to introduce measures that the US found acceptable, was to be subject to repercussions from the US government—i.e. prohibition from clearing currency through the US currency clearing system.

It did not matter that the U.S. system of reporting and the U.S. FinCEN (Financial Crimes Enforcement Network) centralized analytical centre was glutted with paper and largely ineffective for law enforcement purposes. As Michael Levi said:

“Overall, despite being sincerely believed in by their adherents, it is arguable that in the context of the United States, where there are many banks and where cash transaction reports are made on paper, currency-reporting requirements are an example of an over-trumpeted intelligence methodology, since except in a targeted investigation, the system has neither the capacity to input the data rapidly (within six months of receipt) nor the capacity of putting the information to sound operational use.”¹⁰

By imposing an obligation to report transactions as well as provide financial information that may be related to criminal activity, CTR regimes are supposed to serve a number of important policing functions. The central repository of financial information is argued to have the potential to ‘trigger’ police investigations, to provide information to on-going investigations, and possibly act as a deterrent for both the original perpetrator of the criminal offence and any financial intermediaries who would use their position to help launder illicit profits. The draw-back is the amount of paper that is generated. In the U.S, the Financial Crimes Enforcement Network (FinCEN) has amassed the largest database of financial information in the world. This database includes U.S. transaction report information, licensing information, credit bureau data, and international data that can be theoretically subject to computerized searches for patterns of money laundering.¹¹ The glut of paper, the difficulty of access by law enforcement, and non-timely relaying to those who need the information are the main reasons why Canadian officials opted not to introduce the US version of the CTR system.

In contrast the Australian system involved, from start-up, a complete computerized operation. Elements of the Australian TR system allow most of the information to be delivered via an Electronic Data Delivery System (EDSS). The electronic delivery of standardized information has allowed AUSTRAC to monitor the international funds transfer instructions reports and to react quickly to patterns of laundering.¹²

¹⁰ Michael Levi. 1991. *Customer Confidentiality, Money Laundering, and Police Bank Relationships: English Law and Practise in a Global Environment*. London: Police Foundation. P. 35.

¹¹ Steven A. Bercu, “Toward Universal Surveillance in an Information Age Economy: Can We Handle Treasury’s New Police Technology,” *Jurimetrics Journal*, (Summer 1994, Vol. 34), pp.394-401.

¹² Neil J. Jensen, “International Funds Transfer Instructions: Australia

Record Keeping (versus Reporting) Plus Suspicious Transaction Reporting

Canada opted instead for 'record' keeping legislation combined with voluntary Suspicious Transactions Reporting (STR). The Money Laundering Act came into force in June 1991 and the regulations outlining the records that were to be kept—the duration of the retention and the information to be obtained—were proclaimed in March 1993. Among other requirements, this Act requires that deposit taking institutions verify the identify of account holders and those on whose behalf they are undertaking the transaction. The "Know your Customer" doctrine runs through the Canadian financial institution's response to money laundering. Financial institutions were to appoint a senior officer to be responsible for anti-money laundering procedures and regulations.

While this legislation did not introduce *mandatory* reporting, it offered immunity from civil and criminal sanctions for those who voluntarily disclosed information that might be indicative of money laundering. The verbal commitment of the banking community in Canada, via the Canadian Bankers Association (CBA), was that as good corporate citizens. The financial institutions would diligently and voluntarily join the enforcement effort against money launderers.

All suspicious reporting—whether voluntary or mandatory—arguably rests on two essential principles: the 'Know your Customer' policies, and the belief in an ability to profile 'suspicious' transactions. The notion is that while there are millions of transactions that pass through financial institutions, a certain percentage are irregular in some aspect and warrant greater—and more timely—scrutiny. There is the assumption that front-line tellers, or business persons, untrained in wider law enforcement techniques, will be able to learn how to identify these 'suspicious' transactions. Further, there is the assumption that they will be motivated to do so carefully in a manner that either does not ignore 'suspicious' cases nor over-identifies cases that are unlikely to prove to be worthy of police investigations. This of course is build on a third assumption that these suspicious transactions can be 'profiled' and that it is possible to teach employees what characteristics ought to alert the employee to a potential criminal operation that can then be passed immediately to law enforcement.¹³

"True" Suspicious Transaction Reporting systems require financial intermediaries to report *only* those transactions that appear to be suspicious. I say 'true' in the sense that once a country (i.e., Canada under the new legislation) defines *all* transactions over a certain dollar figure, to be 'suspicious', the distinction between the STR and the CTR systems vanishes. The uncritical public may assume it is getting one type of limited monitoring while in fact it is receiving the other. While both systems are open to criticism, the advantage of the STR system is that it is less costly to operate and monitor.¹⁴ This model provides more discriminate reporting of financial transactions than

at the Leading Edge of Financial Transaction Reporting," *Journal of Law and Information Science*, (Vol. 4, No. 2, 1993), p. 323.

¹³See Lou Goulet. 1998. *Suspicious Transaction Reporting: Position Paper--RCMP*.

¹⁴Duncan E. Alford, "Anti-Money Laundering Regulations: A Burden on Financial Institutions," in *North Carolina Journal of International Law*

the CTR reporting model. Due to the attempt to target only those transactions that involve a financial ‘crime’, a STR system ought to be less cumbersome and less expensive for all concerned and in theory, it will generate less useless information by providing more focused referrals by taking advantage of the financial intermediary’s expertise.

The *original* EC directive, “purposely avoided a currency transaction reporting system like that in the United States because it does not distinguish between normal and suspect transactions.”¹⁵ The argument was that authorities ought not to have to evaluate or occupy themselves with the high number of normal transactions. Banks, while they may experience higher front-end costs as they must both provide training to identify suspicious transactions and often designate a contact officer to review any possible disclosures will, eventually, have lower costs because the volume of reports will be reduced. Intuitively, it follows that a targeted report should have a greater chance of identifying money laundering or other types of financial crimes.

Suspicious transaction reporting (either voluntary or mandatory), if adhered to, places a greater onus on the financial institution to do some of the investigative work than the CTR system does. Theoretically this can lead to the creation of a cadre of highly expert contact officers who would, over time, acquire a nuanced understanding of suspicious activity and possibly help secure a higher percentage of convictions. As Gold and Levi note, “this result, which we feel is in accordance with common sense expectations, does suggest that there is a strong correlation between the compliance officer’s degree of suspicion and the ultimate result.”¹⁶ However, they acknowledge that the ‘skill’ or commitment of compliance officers varies greatly and as we see, the debate hardly matters. Driven by the work of the Financial Action Task Force (FATF), the ‘required’ uniform standard now requires mandatory reporting of suspicious transactions and reporting of large transactions. Whether the system works to any significant extent becomes immaterial.

Perhaps more significantly, this form of detection could be targeting the most unsophisticated cases, where ‘suspicious’ literally takes the form of a hesitation to answer questions or an unease is appearance—behavioural characteristics that will be absent from the truly professional launderer. One of the most pervasive complaints about transaction reporting schemes internationally is that they have generally failed to lead to the conviction of sophisticated money launderers. The clumsy novice is most often the criminal that is caught in what is seen by some critics to be a very expensive and intrusive web. Some research also indicates that there may be a class and/or racial aspect as a certain appearance, presentation of self, and/or specific countries involved in financial transfers are seen to be more ‘suspicious’ than other characteristics or jurisdictions.

and Commercial Regulation, (Vol 19, 1991), p. 452.

¹⁵Duncan E. Alford, "Anti-Money Laundering Regulations: A Burden on Financial Institutions," in North Carolina Journal of International Law and Commercial Regulation, (Vol 19, 1991), p. 452.

¹⁶ *Ibid.*, 86.

As one author suggests, detecting money-launderers would be much easier if they wore stripy jumpers and carried bags labeled 'swag'.¹⁷ A researcher from the UK tells the story (that he claims to be true) of reviewing suspicious referrals in one of the banks and on seeing what looked like a very normal transaction, he inquired as to why it was referred to the police. The explanation given was that the depositor 'had one glass eye and lived on a cul-de-sac'!¹⁸ This explanation serves to represent the more cynical view of the ability of front-line or managerial bank personal to distinguish the truly suspicious and significant, from the merely unusual and irrelevant. Again to quote Gold and Levi:

“...the difference between ‘money movement facilities’ and ‘money-laundering’ is often a fine one, particularly when viewed from the perspective of the banker who wants to ‘do the deal’ because ultimately, performing services for paying customers is the source of banking profitability” (p.4).

Three Sources of Data

In order to examine the ability and willingness of the financial institutions to comply with voluntary reporting of suspicious transactions, I am presenting three bodies of information:

- Experiences of international financial institutions with money laundering enforcement.
- Experiences of voluntary compliance from within the Canadian Banking Institutions but unrelated to money laundering.
- Findings from our study of Voluntary Suspicious Transaction Reporting within the ‘Big 5’ Canadian financial institutions.

International Experiences/Evaluations

In this section I shall present the argument that intensive anti-money laundering campaigns, multi-national agreements and diverse political pressures to conform, harmonize and sanction have at best produced unreliable compliance. The rhetorical hype could not have been greater—likewise, the massive money laundering banking cases involving negligence and/or corruption could not also have been greater. Valsamis Mitsilegas describes the process by which money laundering counter-measures evolved in Europe:

“Through its association with transnational organized crime, it was perceived to threaten interests ranging from human life to the social fabric *per se* and state stability and sovereignty. The use of credit and financial institutions for money

¹⁷ John Willman, April 19, 2001. “The Electronic Age has made it Much Harder for Banks to recognize suspect Funds”, *Financial Times*.

¹⁸ Personal interview with Rowan Bosworth-Davies upon completion of their *Annual Fraud Survey 2000*, UNISYS.

laundering purposes on the other hand, added to these categories the threat to the soundness and stability of the financial system as a whole”.¹⁹

A main focus was claimed to be the impact on the financial institutions and the ability of these institutions to facilitate money laundering. In March of 2000 the Deputy Treasury Secretary Stuart Eizenstat stated that the use of banks to launder money:

“...undermines confidence in the integrity of our financial systems, facilitates crime and corruption, and allows criminals to savor the rewards of their illegal actions”.²⁰

‘Threat’ terminology further amplified the need for an international ‘war’ on money laundering. Currently the UN, OECD, OAS/CICAD, FATF and Caribbean FATF, EU, Council of Europe, BASLE, IMF and World Bank in addition to individual jurisdictional campaigns all have adopted money laundering as one of their priorities—if not their number one focus. The EU money laundering framework has 3 pillars: *criminalization*, i.e. making new laundering offenses; *responsabilization* i.e. holding non-enforcement bodies responsible for ‘policing’; and, *centralization of knowledge* i.e. creation of financial intelligence units to receive and process the ‘knowledge’. These three components are part of the FATF approach and have become the approved model for countries to emulate. A strong justification for the passing of the new Canadian legislation (Bill C-22) was that Canada was “the only member [of the Financial Action Task Force] that does not have mandatory reporting”.²¹ The 1996 revisions to the “Forty Recommendations” of the FATF spoke of the need for countries to:

- “consider adopting a system where financial institutions and intermediaries are required to report all currency transactions above a certain amount to a central agency...”; and,
- “require that financial institutions promptly report to competent authorities any funds suspected to stem from criminal activity”

In order to emphasize the shortcomings of the international initiatives, it is important to emphasize that this focus on money laundering is now over ten years old. The FATF was established in 1989 and has become increasingly aggressive in the measures to enforce harmonization of anti-laundering strategies. What had begun as peer-evaluative, consensus-building exercise became a black-listing regime. Around the same time as the

¹⁹ Valsamis Mitsilegas. 2000. *Money Laundering Counter-measures in the European Union: A New paradigm of security Governance versus Fundamental legal Principles*, University of Edinburgh, Ph.D Thesis p.294.

²⁰ *Treasury News*, “Treasury and Justice Issue 2000 Money Laundering Strategy”, March 8, 2000 p.1
2136th parliament, 2nd Session, Edited Hansard, No.79, Wednesday April 5, 2000 [1525-1725] and No. 80 Thursday April 6, 2000 [1110-1250].

original FATF report, countries signed onto the Basle Committee on Banking Regulations and Supervisory Practices and produced a statement of principles titled “Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering”.²²

Canada is a signatory to this 1988 document, which encourages banks to: verify the identity of the beneficial owners of accounts (Know your Customer); adopt an explicit policy of refusing significant transactions with customers who fail to provide evidence of their identity; avoid transactions they believe are associated with money laundering (i.e., suspicious transactions”). In October 2000 the EU Council of Europe adopted what was termed ‘an ambitious plan’ to step-up the fight against financial crime and money laundering in particular.²³ Linked to this was the EU decision that they would encourage the Financial Action Task Force (FATF) to follow-up their June 2000 ‘black-listing’ of delinquent nations, with ‘appropriate countermeasures’ against all of those countries that remain delinquent one year later (i.e., June 2001).

Transparency International (TI) has most recently taken credit for assisting in the drafting of the Wolfsberg Anti-Money Laundering (AML) Principles. TI has worked with 11 international banks to draft 11 Anti-Money Laundering Principles.²⁴ There was a fair amount of press coverage of the release of these ‘principles’ that were claimed to be “voluntary guidelines aimed at preventing private banking operations from being used to launder criminals’ money”.²⁵

One Step Forward—One Step Back

I mention these land-mark moments in the ‘war against money laundering in order to provide the grounds to question where they have gotten us. Before, during and after the international hype against money laundering, there have been huge cases, labeled laundering cases, against—not small unknown banking entities in off-shore locations, but rather the ‘big’ international banks. It can be difficult for banks to decide whether capital moving through their Centres is ‘clean’ or part of some illegal operation such as tax evasion or money laundering. However, the size and the nature of some of the high profile cases present no such ambiguity. The optimism, or the optimistic rhetoric, that is attached to this current focus on the criminal proceeds as an alternative to more traditional law enforcement may not be warranted. An alternative interpretation is that the focus on money laundering is accomplishing exactly what is intended—a public relations

²² The Basle Committee comprised representatives from Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, United Kingdom, United States, and Luxembourg.

²³ We will see later in this paper that these EU ‘enhancement’ initiatives have been challenged by the European Parliament.

²⁴ Banks are ABN-Amro, Banco Santander, Barclays, Citigroup, Chase Manhattan Corp, Credit Suisse Group, Deutsche Bank, HSBC Holdings, J.P. Morgan, Societe General, UBS.

²⁵ *American Banker*, “Laundering Plan Back; New Names, Sponsors” by Rob Garver, Nov. 06, 2000.

exercise that speaks to a commitment to social responsibility without handicapping the flow of international finance. In addition the international consensus building may be designed to begin to lay the collaborative framework for an international focus on tax evasion. Some critics believe that: “the hidden agenda behind the attack on money laundering is for big countries to make it much harder for their citizens to evade taxes by cutting off those offshore centres that offer low taxes...”.²⁶

During the 1980’s Swiss banks were embarrassed by their role in handling funds from the late Ferdinand Marcos of the Philippines. The French parliament’s taskforce into money laundering in Europe reported in February 2001 that Switzerland’s 372 banks made only 313 reports on suspected money-laundering in the year 1999-2000. The Swiss countered that while France had referred 1,655 cases during that same period, Switzerland actually handed over more cases to the prosecutors (198 in Switzerland as compared to 129 in France).²⁷ Aside from the name calling²⁸ these results are paltry and hardly worth the machinery in place to supposedly target the launderers.

UK banks have been found to have facilitated the looting of Nigeria by the late dictator General Sani Abacha—23 UK banks are claimed to have handled \$1.3 billion. Apparently despite repeated requests by the Nigerian Government to freeze the funds held in British accounts and repatriate the money back to Nigeria, no action was taken.²⁹ Citibank accounts in New York continued to do business with a Cayman Islands bank and allowed \$300 million to pass through New York before finally closing the accounts. During a Senate Inquiry into these ‘laundering’ activities, Senator Carl Levin stated: “They weren’t just asleep at the switch—they were in a deep sleep on this one”.³⁰ Citibank was also notorious for handling huge sums of money for Raul Salinas. (over \$87 million). The lengthy inquiry into the Salinas laundering affair, illustrated most of the things that can go wrong with accepting the premise that private banking officers will care about money laundering.

From that inquiry, we have the much quoted comment by the official that handled the Salinas file. To a colleague in Switzerland, Ms Elliott states: “This account is turning into an exciting profitable one for us all. Many thanks for making me look good”.³¹ In the private banking industry, compliance with anti-money laundering procedures remained lax. Audits, compliance reviews, repeated deadlines, and bonus threats were all part of the maze of methods that were used to try to coax compliance. Interestingly, the fear that one might lose their bonus seemed to have the most direct results—which also

²⁶ See *The Economist*, APRIL 14TH 2001 p. 66.

²⁷ *Financial Times*, February 21, 2001. Article by Jo Johnson and William Hall.

²⁸ Last year’s report from the same taskforce, called Liechtenstein “Europe’s most dangerous tax haven” and criticized Monaco’s anti-laundering efforts.

²⁹ *London Times*, March 9, 2001.

³⁰ *New York Times*, “Citibank Criticized for Slow Response to Money Laundering Scheme”, by Tim Golden, February 27, 2001.

³¹ *The Minority Staff Report for The Permanent Subcommittee on Investigations, Hearings on Private Banking and Money Laundering: A Case of Opportunities and Vulnerabilities*, November 9, 1999. P. 14.

speaks to the performance related bonuses that likely result in the low level of compliance in the first place.

The world of private banking is rife with potential money laundering/ tax avoidance/ tax evasion opportunities. The use of multi-jurisdictional accounts and the movement of large sums (often at the advise of other professionals working for the same client for reasons that might not be clear to the ‘banker’) add to the problems of money laundering detection. Quite naturally, over time, private bankers tend to be advocates for their clients.

Perhaps the largest amount of publicity was reserved the Bank of New York. BONY gained notoriety for handling over \$7 billion of suspect Russian funds. ³² Jonathan Winer, former US Deputy Assistant Secretary of State, gave a presentation in Toronto during 2000. A section of his paper that he did not present stated that Canadian banks were attractive to Russian organized crime because of our lack of money laundering laws. This must have been written prior to the Bank of NY/Russian money laundering fiasco! When questioned as to what happened to the CTR system during the BONY laundering period, Winer responded that the fault was with the corrupt banking officials and not with the reporting system. The amounts of money in these high profile cases—and many more—are huge and the suspicious nature of the funds appears obvious. A number of the most atrocious cases involve corrupt officials so in that respect Winer is correct. However, a self-regulatory mechanism that has no reliable bifurcated checks on corrupt or negligent officials is not a viable system of control .

Different countries and different institutions tend to react in specific ways whenever a scandal occurs—that is if the issues are deemed to possess some sense of political priority. It is in this environment that we must examine recent anti-laundering initiatives. The ‘launching’ of the Wolfsberg Principles may be a case in point. Some of the claims made in the media are perfectly accurate and uncontested. Private banking “is highly secretive and competitive” and therefore it is “no small feat” that 11 banks have agreed to common procedures. ³³ The Wolfsberg guidelines consist of an enhanced form of ‘know-your-customer’ policies. While it is amazing that these policies are not taken for granted and actually implemented by all banks purporting to be concerned about money laundering, more amazingly, given the aggressive international stand that the US has taken against money laundering, there was a *failed* forerunner to the Wolfsberg Principles. In 1998 the U.S. Federal Reserve Board tried to introduce a “Know-Your-Customer” plan. The bank regulators withdrew these anti-laundering procedures in March 1999 because of the intense opposition from the banking industry and some members of the public. “Know-your-customer” policies are considered to be the base-level essential ingredient in any anti-laundering banking policy. To not have these in place indicates clearer than any rhetoric to the contrary, a disregard for money laundering at the domestic level.

³² *Financial Times*, “The Electronic Age Has Made it Much Harder for Banks to recognize Suspect Funds”, John Willman, April 19, 2001.

³³ *New York Times*, Editorial, Nov. 6, 2000, “When Tainted Funds are Banked”.

“Know your Customer” is one of the few policy links that go from the regulatory bodies to the financial institutions that they attempt to oversee. “Know your Customer” policies were initially assumed to be the basis of good banking practice. These policies have become in many jurisdictions a key ingredient behind the assumed ability to profile suspicious transactions. Once the ‘regulated’ institutions put these policies into operation, there is an expectation that a key defense against money laundering is at play. This however takes for granted that the policy is actually being enforced by the financial institutions and second that the financial institution sees it to their advantage (ethically or in terms of the risks that can occur) to comply.

While it is acknowledged that some of the individual banks may have had some forms of “Know-Your-Customer” policies in place stemming from the Bank Secrecy Act, GAO (General Accounting Office) reports and reviews by the Federal Reserve were extremely critical of the anti-laundering efforts of the banks. Private banking in particular was found to be nearly wide-open to laundering, tax evasion, capital flight (and looting) by corrupt government officials.³⁴ The argument is made that a culture of secrecy combines with a culture of lax anti-money laundering controls due quite understandably to competing agendas:

“It is the private banker who is charged with researching the background of perspective clients, and it is the private banker who is asked in the first instance to monitor existing accounts for suspicious activity. But it is also the job of the private banker to open accounts and expand client deposits”.³⁵

Much publicity surrounded the various reports on the private banking industry in the U.S. and internationally where similar scandals had occurred. Result—high profile adverse media; refusal to ‘allow’ the regulators to impose their ‘know-your-customer’ plan that had been proposed by the Federal Reserve; and, now those banks most criticized (i.e. Citigroup) sign-on to the ‘voluntary’ series of Wolfsberg Principles.

It is alarming enough that the banking ‘regulators’ can be forced to withdraw their anti-laundering plan by those institutions that they are meant to be regulating. This of course speaks to the power of the banks. A further concern is that while it is assumed that other banks will ‘sign-on’ to the Wolfsberg Principles, it will remain for a long time a patchwork quilt. While the Wolfsberg Principles are quite innocuous this lack of uniformity will mean that to the extent that the Principles are followed, the banks who serve the private banking sector will not be operating under the same rules. It is recognized that there is intense competition with each other and yet we are to be hopeful

³⁴ *Testimony of Richard A. Small*, “The Vulnerability Of Private Banking to Money Laundering Activities” November 10, 1999. The Federal Reserve Board.

³⁵ *Minority Staff Report for the Permanent Subcommittee on Investigations Hearings on Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities*, Nov. 9, 1999 p. 5)

that at least some will give a degree of concern for who their customers are and where their dollars have come from. However, a number of factors render one suspicious of the motivations. Further high profile cases may reveal to us that aside from a nice symbolic aspect, the principles were easily accommodated/ renegotiated/ ignored!

While we could say that the Wolfsberg Principles are important in that they are at least trying to bring some of the banks up to minimum standards of anti-money laundering accountability—the recent debate between the EU governments and the European parliament appears to be moving in the opposite direction. The efforts of the EU to ‘tighten’ up laws against money laundering have been challenged by the Parliament. Specifically, the Parliament wants to reduce the burden on lawyers, accountants and tax consultants to report suspicious transactions. These of course are the very professions that are so critical to sophisticated money laundering. The amendments preferred by the Parliament would remove these ‘professionals’ from the regime that applies to the banks and credit institutions. It is acknowledged that Parliament has been heavily lobbied by the legal profession.³⁶ The concern is that these new amendments, introduced by the European Parliament, could mean that the EU directive is dropped and has to be drawn up again. In November 2000, their agreement was reached after two years of discussion and debate with difficult negotiations over the issue of whether or not to include lawyers. The EU directive may now come to nothing.

Again, without a conspiratorial mind-set, it is hard to imagine how any organization serious about large-scale, sophisticated ‘money laundering’, does not appreciate that it needs to be serious about the roles played by lawyers. The evidence from money laundering cases is clear:

“...lawyers are utilized as part of particularly large-scale money laundering operations. The greater the quantity of cash generated by the criminal enterprise, the greater the need for increased sophistication in the laundering scheme. This increased sophistication in turn is facilitated by certain legal services to construct and maintain the laundering operation”.³⁷

An analysis of what was approved by Parliament indicates that the scope of laundering crimes is broader and the number of groups that must report suspicious sales has increased—i.e. car dealers and sellers of other luxury goods. Professional use of rhetoric can make a half-empty glass appear to be three-quarters full! These changes allow supporters of the Parliamentary changes to refer to the ‘tough and effective’ actions taken by Parliament. More likely the mesh is set to catch the smaller unsophisticated ‘launderer’.³⁸

³⁶ *Financial Times* “Money-Laundering Rules May Upset EU”, April 2, 2001 Deborah Hargreaves.

³⁷ Beare and Schneider. 1990. *Tracing of Illicit Funds: Money Laundering in Canada*. Solicitor General User Report # 1990-05. P. 310.

³⁸ Marie-Louise Moller. April 6, 2001. *Brussels, Reuters*, “EU Divided on New Law Against Money Laundering”.

Bankers and lawyers are not the only ‘useful’ professional groups that capitalize on money movement. A ‘new’ contingency fee market has developed whereby forensic accountant firms—comprised of bankers, lawyers and accountants (known now as ‘financial engineers’)—devise schemes to save the large corporations taxes and charge a percentage of the savings. The treasure department has identified corporate tax evasion as the nation’s biggest tax enforcement problem—and these ‘shelters’ are seen to be the core of the problem. Charging a fee based on a percentage of the taxes avoided is supposedly prohibited by ethics rules of the accounting industry. Hence, ‘value pricing’ becomes the terminology. All of the ‘Big 5’ Accounting firms charge corporations based on savings from the tax shelters: i.e., PricewaterhouseCoopers, Ernst & Young, Deloitte & Touche, KPMG and Arthur Anderson. While systems are in place to catch the ‘suspicious’ depositor, an entire industry has grown up around assisting the corporations to move money around. 39

Costs and Gains of Adhering to Anti-Money Laundering Strategies

The rhetoric from banking officials tells us that money laundering is bad for the financial institutions and therefore of course they are willing and committed partners in the anti-laundering strategies. The evidence as we have presented it ought to cast some doubt on their commitment to these voluntary (or even to the legislative) strategies. The question remains: is money laundering ‘bad’ for the financial institutions?

While turning down dirty money still allows financial institutions to accept clean money, the revenue potentially generated from the rejected money is lost. The amounts of ‘dirty’ money that moves around through international banks is obviously huge and therefore the lost revenue is considerable. However, the rhetoric suggests that turning down ‘dirty’ money might actually be good for business because of the enhanced reputation of the banks. Having a good reputation is claimed to generate more ‘clean’ profits. The difficulty is in verifying this claim. The evidence that does exist tends to favour the opposing view. Banking is highly competitive. There would need to be real evidence of a detrimental impact from dirty money before accepting the claim that there is any redeeming corporate advantage to ethnocentric behaviour aside from the sense of being a ‘good corporate citizen’—and of course under a mandatory system, being law abiding.

We therefore need to examine the banking rhetoric that tells us that it does no financial institution any good to encourage money launderers to make use of their banking services. While there may be some ‘disruption’ to financial trends to have large amounts enter and leave one’s bank, however, there may also be a positive financial gain and possibly an incentive to attract international business—however dubious that business turns out to be in hindsight. While we hear that banking reputations are injured by high profile cases involving money laundering, the reality is that the bank is in business to welcome money into its operation. Seemingly ‘adverse’ publicity does not necessarily damage a bank’s reputations.

39 *New York Times*, December 19, 2000. “Tax Shelters for Businesses Flourish as IRS Scrutiny Fades”, by David Cay Johnston.

For the purposes of illustrating this point I have selected the Bank of New York/ Russian money scandal involving approximately \$7 billion in transfers from Russia through three accounts at a bank branch in New York from 1996 until August 1999. This case drew enormous international attention due to the amounts of dollars involved and the obviously questionable routes and customers that were involved. This was not a case that revealed itself only retrospectively. Regulatory monitoring ought to have detected the 'non-normal' transactions. While the case involved actual 'corruption' of officials, the amounts of the transactions ought to have been detected by some oversight mechanism. The question then is posed—did the scandal hurt the Bank of New York? Several quotes captures the impact on BONY.

According to the Chairman and CEO of the Bank of New York, Thomas Renyi:

“Despite being at the center of an international money-laundering investigation, Bank of New York Co. remains on track for record earnings this year and has seen almost no impact on its business from the scandalthe bank would post a record profit of \$1.69 a share for 1999, up from \$1.53 a share for 1998.”⁴⁰

The Wall Street Journal reported ⁴¹ that investors trusted the way that the bank responded and acknowledged that in fact the stock actually rose in value. The article quotes Robert Bissell (President of Wells Capital Management):

“The stock price is telling you it is a controllable risk...The market tries to figure out whether someone knowingly got involved in dirty business, and the benefit of the doubt so far has gone to the Bank of New York...”

In response to the rise in the value of the stock, another analyst was quoted as saying:

“That just says that the market is looking past the investigation and doesn't believe it is really material to the long-term outlook of the company”⁴²

A scandal of this size was seen to be a house-keeping detail—something that needed to be 'handled' appropriately and then forgotten. The following quote captures the 'nuisance' value of the incident:

“As a practical matter, it's a bit of an embarrassment and it's a public-relations nightmare to some extent, but from an investor's standpoint, it's behind them,” said Judah Kraushaar, bank analyst at Merrill Lynch & Co. of New York.”⁴³

⁴⁰ Paul Beckett. Dec. 17, 1999. *Wall Street Journal*, “BONY is on Track to Post record Profit for Year”.

⁴¹ Paul Beckett and Steve LeVine in New York and David Cloud in Washington, October 4, 2000. *Wall Street Journal*, “USA: Bank of New York Weathers Unquiry”.

⁴² Ibid. Chris Bingaman, analyst at Villanopva Capital, asset management arm of Nationwide Financial Services.

⁴³ Paul Beckett. December 17, 1999. *The Wall Street Journal*, “BONY Is

In their attempt to explain the lack of anxiety on the part of investors, the journalists concluded that there was a sense that the Bank processes such vast volumes of transactions that it is ‘expected’ that there will be problems—even to the tune of \$7 billion—the question then becomes how did the bank handle the problem once it surfaced.

In terms of sanctions, the corrupt bank official (Lucy Edwards) was fired and pleaded guilty to laundering charges. No charges have yet been made against the Bank of New York. However the Chairman and CEO was penalized. In a somewhat contradictory statement the Bank’s Board stated that it believed that the Chairman and Chief Executive Officer had “no direct responsibility for the events” but it continued, to say that the Board believes the CEO “does have ultimate responsibility for all matters that occur at the company”. Hence his salary was docked:

“Citing the impact of a massive Russian money-laundering probe, Bank of New York Co. lowered the compensation of Chairman and Chief Executive Thomas Renyi by about 11% for 1999. ...Salary and bonus totaled \$6.58 million 1999, down from \$7.38 million the prior year.”⁴⁴

Do the Anti-Money Laundering measures work—with what Consequences?

We have focussed on situations where the financial institutions have failed to follow policies or have resisted putting policies in place—what if the policies are there and are adhered to—with what impact?

Few evaluations of suspicious-reporting regimes exist. Perhaps the most thorough was completed by Michael Gold and Michael Levi ⁴⁵ in the UK. This study was not a full review of the process of financial investigations and it did not include a case analyzes of the suspicious transaction reports. However, through interviews and observation they looked at some of the ‘measures of impact’ such as: the triggering of new investigations; contributing substantially to existing investigations; and, the rendering of ‘useful’ information for future investigations.

It is of note that they begin by hoping that their research would serve to inform the debate within financial, governmental, policing, and public circles about the future utilization of these inroads into the privacy of individuals. One might argue that the international community has seen a symbolic need for *mandatory* suspicious reporting—almost regardless of what researchers find. Their findings were inconclusive. They found that there may be *some* deterrent, disruptive, and displacement effect from the suspicious-

on Track to Post record Profit for Year”.

⁴⁴ Paul Beckett. April 3, 2000 *The Wall Street Journal*, “Bank CEO Sees 1999 Pay Cut: Probe is Cited”.

⁴⁵ Michael Gold and Michael Levi. 1994. *Money-Laundering in the UK: An Appraisal of Suspicion-Based Reporting*, Prepared for the Police Foundation and the University of Wales College of Cardiff. Published by the Police Foundation.

reporting anti-money laundering measures. In addition, they found that these measures provide a more thorough audit trail once an investigation is underway. A concern throughout the report was that to some extent, policies that rely on knowing your customer and profiling transactions might be moot. The trend towards automation and impersonality, works against this ‘suspicion-based’ model of detection.

The researchers noted however that a ‘mandatory’ suspicion-reporting system would produce *more*, but not necessarily *better* cases, i.e., ‘defensive reporting’ without filtering. The number of disclosures could swamp the system:

“On the one hand, the more the disclosures, the more likely it is that one of them may produce a ‘hit’ on the routine checks. On the other hand, the more the disclosures, the less time they have left to do any ‘real investigative work’. (P. 104)

Contradictory Goals and Mandates

Effective suspicious transaction reporting requires a receptive policing response to the referrals received from the banks. Different countries appear to experience different problems when two, quite different institutional cultures come together for anti-money laundering enforcement.

Gold and Levi site the following ‘inhibitors’ to police-bank harmony. First, some bankers wish on principle to maximize the confidentiality of the affairs of their customers while the police believe that bankers, like citizens generally, have a moral obligation to provide them with any information relevant to the prevention and detection of crime. The commercial interests of bankers may reflect a different sensitivity to different frauds—especially those that hurt the banks themselves. A lack of police response in this area, may undermine the confidence of the banks regarding the likelihood that the police will respond on the money laundering cases.

Given the international dimension to money laundering, the legal rules in one jurisdiction may reflect conditions elsewhere, i.e. in high-bank-secrecy locations the domestic laws may reflect the state’s desire to compete with other offshore secrecy havens, or conversely, laws may reflect the pressures from international groups such as FATF. In both of these situations, the imposed legislation may not seem particularly relevant to the domestic situation. The foundation of most partnerships—including enforcement ones—is the relationship between the people. ‘People factors’, i.e., conflicts of personalities or departmental interests aggravated by poor training or job insecurity can generate poor cooperation within and between law enforcement agencies and financial services institutions.⁴⁶ As Gold and Levi note:

⁴⁶ See *Money-Laundering in the UK: An Appraisal of Suspicion-Based Reporting*. Police Foundation and University of Wales, 1994.

“It is possible to imagine a world in which the interests of the police (including non-police regulators) in maximising intelligence collation and the interests of bankers coincided precisely. However, this is not the world in which we live”.⁴⁷

‘Other’ (non-money-laundering) Domestic Financial Institution Compliance Experiences

As we have noted, a focus on profitability runs throughout banking—fed in part by shareholders and CEOs with a vested interest in each financial institution being highly competitive. This prioritizing of profit making is juxtaposed against an increasingly strong rhetoric of social responsibility in the ‘fight’ against money laundering. As only one indication of which of these conflicting pressures is winning, it is interesting to compare the ‘machinery’ in the financial institutions that is in place to combat defalcations as compared to money laundering. In defalcations the bank directly loses money.

- Regarding profitability and defalcations, there are policies in place across the Big-5 banks to aggressively sanction offenders who ‘cost’ the banks. We came across no such policies regarding a laxity to refer suspicious transactions to the police. Employees who were caught, in even fairly minor criminal money offenses against the banks, were always fired and usually were charged. Enforcement of the money laundering provisions did not appear to produce this degree of sanctioning—or *any sanctioning*. The flip-side of rewards is punishment—a GAO report questions the US Treasury Department on why no top bank official or major bank had ever been seriously sanctioned for money laundering. Officials have been sanctioned in clear corruption cases but ‘laundering’ cases remain in a vaguer sphere. ⁴⁸
- Sophisticated monitoring programs and technology are in place to chart profitability and defalcations. Suspicious transaction files were not computerized and record keeping in this area was in disarray—possibly due to being in a state of transition.
- While all five banks stated that their employees received training in the detection of suspicious transactions and money laundering it was acknowledge by one bank directly to be given fairly low priority and that the turn-over in staff might mean that everyone did not have adequate training.

⁴⁷ *ibid* P. 5

⁴⁸ *Washington Post*, “USA: Citigroup Called Lax on Money Laundering”, November 30, 2000, by Kathleen Day.

- The physical space within the headquarters of each financial institution that is devoted to each of these functions all reflect the lesser focus given to money laundering prevention.

Picking up on the ‘what gets measured, gets done’⁴⁹ philosophy, it is important to consider the reward system within institutions that have claimed to implement sound voluntary codes—especially where those codes might work against other rewarded objectives. During their US 1999 review of the operations of private banking, one bank official stated that “no one took the ‘know-your-customer’ policies seriously *until* bonuses were threatened.⁵⁰ An internal study of bank defalcations within Canadian financial institutions revealed a maze of individual, departmental, and branch incentives that were offered based on performance. These rewards—individual and group—were seen to be partially responsible for ‘over-zealous’ banking decisions (i.e. unwise loans and credit lines etc). The peer pressure from the group incentives was particularly powerful. Hence any policy that results in the loss of customers—especially customers with large amounts of money—is operating against the current reward structure. Banks are organized around the concept of attractive funds and few banks reward those who turn money away.

The rhetoric of the financial institutions may speak as if all of the objectives of the bank are ‘equal’—profit, risk management, customer satisfaction and societal pressures to reduce money laundering—in reality these goals often can not be given the same attention.

A study of fraud in corporations by Peter C. Yeager⁵¹ points to corporate policies that give contradictory cues to the employees, i.e. policies that encourage employees to be personally ‘innovative and creative’ in the pursuit of profit (with the year-end results of these individual performances being evaluated), while having a less tangible responsibility to assist the banking institution to be good corporate citizens in the detection of *suspected* money laundering (with nebulous or non-existence personal rewards and possibly few for the banking institution). In the defalcation study, those situations that were seen to require ‘inherent trust’ and seemingly could not/or were not audited or monitored proved to be the most vulnerable to exploitation. The twin notions of ‘calculated risk of detection’ and the ‘likelihood of swift negative sanctions’ served among the main internal regulatory mechanisms within the financial institutions to protect the banks from frauds and theft.

⁴⁹ *The Corporate Ethics Monitor*, “The Role of Social Audits” by H. Bogach and L. Gordon, p.46, May-June 2000.

⁵⁰ *The Minority Staff Report for The Permanent Subcommittee on Investigations, Hearings on Private Banking and Money Laundering: A Case of Opportunities and Vulnerabilities*, November 9, 1999.

⁵¹ “Management, Morality, and Law: Organizational Forms and Ethical Deliberations”, in *Corporate Crime: Contemporary Debates*, 1995. Edited by F. Pearce and L. Snider.

Other studies have also concluded that wherever profitability is at stake, government policies ought not to depend on ‘voluntary’ measures. A study by the Canadian Financial Services Sector (CFSS)—the MacKay Task Force 52—looked at access to banking services. This report was critical that the banks had not ‘taken seriously’ the agreements that they had made with the government in 1997 to increase access to the banks to low income citizens. The MacKay Task Force concluded that if progress was not made then the government would need to legislate compliance (p.12). Research carried out by Canadian Community Reinvestment Coalition (CCRC)⁵³ as well as a study commissioned by the Canadian Bankers Association (ACNielsen Canada study) concluded that compliance with the measures across the financial institutions was dismal. 54 It concluded that not only were the guidelines that the financial Institutions negotiated with the Government regarding access to low-income people to banking services *not* being adhered to by the banks, but further:

“In addition to successfully delaying government regulations in this area, the voluntary code negotiated with the government continues to benefit the banks by allowing them to boast that they have taken steps to making banking more accessible. As recently as May 1999, promotional material by the Canadian Bankers Association touted the 1997 promises of ‘more flexible cheque-cashing and account-opening requirements’ as well as an initiative of giving bank staff ‘sensitivity training to help them better meet the needs of low-income Canadians’”.(CCRC study p.5)

One would have to conclude that money laundering prevention would fall into the same type of category—or even lower in priority—as access to low income customers. Profitability measures would lead, followed by prevention of defalcations and finally those policies that have no direct gain for the financial institutions such as high-risk access policies and the prevention of money laundering. While evidence of this ‘ranking’ is clearly debatable, there are some indications of this prioritization of profitability and the prevention of defalcations:

The main disincentive for the banks to allow money laundering within their financial institutions may be the adverse publicity and damage to one’s reputation if a major

52 See *Change Challenge Opportunity, Task Force on the Future of the Canadian Financial Services sector*, Published by the department of Finance, September 1998.

53 See CCRC. June 1999. *Access Denied: The Failure of Voluntary measures to Improve Banking Services*, 1999 National Survey Report.

54 However, the CBA (Ray Protti) suggested in 2000 that the government’s decision not to let the banks offer car lease financing and retail insurance was ‘strongly anti-consumer’ because the Mackay task force had indicated “that low-income Canadians have no life, health or home insurance, a market the banking industry could serve through branch sales”. Conceivably these are the same low-income Canadians who are not allowed to have access to traditional banking from the banks! (see *Canadian Banker*, 3rd Quarter, 2000 p. 27)

scandal breaks—possibly, but as we have seen not necessarily—changing an ‘ethical good-corporate-citizen’ issue into a ‘loss of business and therefore loss of profits’ issue.

Much debate considers whether businesses such as the financial sector ‘welcome’ voluntary regulations in order to prevent mandatory regulations. Some evidence would seem to support this contention. In an article titled “Can Self-regulation Succeed?”⁵⁵ that focuses on consumer protection rather than money laundering (in fact the money laundering issue is noticeable in its absence) the author states that the business community has a clear preference for voluntary rather than legislation:

“...Bankers, for instance, are already weighted down by the Bank Act’s 500 plus pages as well as some 100 other federal and provincial statutes affecting their industry”.

The pressures of commercial expediency can place a premium on the *flexibility* of ethical standards. ⁵⁶ As Gilligan states:

“Compliance models of regulation are more malleable than those regimes based on instrumental models of control, so they provide more scope for renegotiation and reclassification of moral standards of behaviour.” (P.71)

Suspicious Transaction Research: Canadian Banking Institutions

In preparation of the forthcoming ‘mandatory’ legislation, the Big 6 banks have offered to participate in a research project that will study the suspicious transaction reporting policies and practices currently in place. **Canadian Bankers Association** has offered not only their support and access but also financial assistance to the project. This research is part of a larger money laundering study being carried out by M. Beare and S. Schneider.

Each bank has its own policies, training materials, and data collecting system. Preliminary findings indicate that the banks are quite different one from the other and in some cases the procedures may fall short of the expectations of the OSFI Guidelines.⁵⁷ Whatever flaws there may be within the approaches to suspicious transactions taken by the Big Banks, they have perhaps made the only real effort to comply with anti-laundering guidelines.

⁵⁵ David McInnes. “Can Self-regulation Succeed?”, *Canadian Banker*, 1996, Volume 103, No.2 March/April.

⁵⁶ See *Regulating the Financial Services Sector* George P. Gilligan, p. 77.

I believe it would be accurate to say that the results were somewhat disappointing—again, and I would argue further that there may be little reason to believe that the mandatory system of reporting will produce any better results. There was:

- Wide discrepancy across the banks as to what was reported to the police as a ‘suspicious transaction’.
- In the majority of cases it was only a deposit that was reported—not a complicated true ‘laundering’ scheme.
- Low levels of computerized processing that in none of the banks would have allowed for an accurate on-going monitoring of their suspicious transaction reporting.
- The RCMP from the banking perspective often failed to provide them with information as to the outcome of the reported file and in many cases there appeared to be no police follow-up.⁵⁸

Conclusion: Money Laundering Debate and Competing Cultures

What is missing from all of the rhetoric about the need to prioritize money laundering is the evidence! As Valsamis Mitsilegas stated in his study of money laundering and the EU:

“The emotive securitisation discourse which served to ensure the legitimacy of the measures was not followed by any credible measurement of the scale of the problem. “. 59 (P.298)

⁵⁷ See Appendix A

⁵⁸ The working relationship between the banks and the RCMP is guided in part by “Operational Guidelines for Proceeds of Crime Investigations between the Canadian Bankers Association and the Royal Canadian Mounted Police”, signed in 1994. The signatories to this MOU are the Director of Economic Crime and the Director of Security for the Canadian Bankers Association. The offenses specified include Enterprise crime offences, designated drug offences and/or Customs and excise offences. These are the offences that are covered by the Proceeds of Crime legislation. It is the RCMP/Bankers Suspicious Transaction Referral form that is currently being filled in by most of the banks. A similar MOU is in place between the RCMP and the Credit Unions. This agreement, titled the Operational Guidelines for Proceeds of Crime Investigations between the Canadian Credit Union System and the Royal Canadian Mounted Police was signed in 1996. As with the banks, a RCMP/Credit Union Suspicious Transaction referral form is used by the Credit unions to pass the suspicious transactions information to the police.

⁵⁹ Valsamis Mitsilegas. 2000. *Money Laundering Counter-measures in the European Union: A New paradigm of security Governance versus*

He quotes from a 1998 report adopted by the Commission of the European Communities:

“Although, the IMF reports, there is currently no theoretical literature on the macroeconomic effects of money laundering, indirect macro-based empirical research and related studies of crime and the underground economy, coupled with the pervasive role of money laundering in illegal activity, suggest that money laundering may be sufficiently widespread to exert an independent impact on the macroeconomy”.

Basically—they don’t know what the impact is and a huge machinery has been put in place to ‘fix the problem’. The literature is growing that challenges *either* the facts of the impact or the response to the impact—or both. Tom Naylor has completed a study for the Nathanson Centre (on our website) refuting, from an economist’s perspective, the claims made regarding the money laundering threat. While no one is arguing that criminals ought to be able to benefit from their illicit proceeds, the diverse costs of the enforcement regimes, the different relationship of these illicit proceeds to the legitimate society depending on the nature of the commodity that generated them, and the over-simplified notions of why criminals operate outside of the law all need to be examined by policy makers. Hysteria, smear-campaigns / blacklisting, and draconian mis-directed laws *may* not be the appropriate responses.

We do however know the impact of massive capital flight and we do know the growing concern for tax evasion. Among all of the international organizations it is the OECD that speaks most directly about tax evasion, capital flight and looting—without framing it, I would argue inappropriately, as money laundering.

In Summary:

This paper argues however that there are two main difficulties with reliance upon these mechanisms to do these anti-money laundering enforcement tasks:

- the criteria for detection are necessarily too vague and to some extent not in keeping with current technological developments in banking; and,
- the objectives of the anti-money laundering initiatives are too contradictory to the objectives of the financial institutions.

Front-line banking officials are not 'police' officers. A financial institutions objectives are to attract customers and make profits. Unless we were to alter our understanding of how banks operate, intensive training in money laundering *plus* an incentive/ promotional

system internal to the banks must be put in place to reward those bank officials who detect the suspicious customers that result in 'positive' referrals to the police.

Based on the literature from other jurisdictions, and from interviews that were held with Canadian banking officials, care must be taken to ensure that the regulations that accompany Bill C-22 do not erode the positive aspects of the current involvement of the financial institutions in the government's attempt to curb money laundering. An increase in reporting does not in and of itself add up to better surveillance of the movement of drug money. The US provides us with a model whereby the glut of paper, untimely accessibility of the information to the police and resources spend on irrelevant files can undermine important policy intentions.

Appendix A

Office of the Superintendent of Financial Institutions (OSFI): Canada

OSFI issued a “Best Practices” document in 1990 that was intended to guide the financial community in policies that would serve to identify suspicious transactions. In September 1996 a new report, titled **Guideline: Deterring and Detecting Money laundering**, was issued. The changes between these two documents were said to be the result of the legislation that was passed between 1990 and 1996 as well as insights gleaned from consultations with the Schedule I and II banks, selected trust and loan companies and other sources. The revised document presents to all federally regulated deposit-taking institutions a set of guidelines that they are expected to implement. A thirty-four page document with appendixes outlines:

- An explanation as to what money laundering is;
- An outline of Canadian legislation;
- Guideline Policy specifying that a ‘formal statement of policy from each financial institution’s Board of Directors or senior management should enunciate the institution’s commitment to combat the abuse of its facilities for the purpose of money laundering;
- Confirmation that adherence to the ‘Know Your Customer’ policy remains the best measurement of the strength of the internal controls against money laundering;
- The requirement that each financial institution must designate a senior officer to be responsible for anti-money laundering processes;
- A description of the Transaction Record Retention process;
- Instructions for drawing up an ‘exemption’ list of ‘known’ customers who regularly deal in large amounts of cash;
- Instruction for the maintenance of a central record keeping System that would allow OSFI to carry out an efficient review of the records and allow the banks to report on their money laundering deterrence and detection procedures;
- A requirement that each financial institution develop a process to ‘disclose’ suspicious transactions promptly both internally to senior management and externally to the RCMP.
- A requirement that all financial institutions provide appropriate training for all personnel handling transactions and that all employees be made aware that they have a statutory obligation to cooperate;
- A requirement that when dealing with wire transfers (via the SWIFT MT system), information on the identify of who is ordering the transfer and who is the beneficial customer should be completed;
- A warning against ‘tipping off’ a customer that a police investigation;
- A warning against “pass through” accounts that would allow clients of foreign banks to conduct financial transactions in Canada.

For emphasis the guidelines state that:

“It is imperative that when a financial institution has an absence of factual information to negate any suspicion, the suspicious transaction should be reported to the Local proceeds of crime section of the RCMP without delay” (Guidelines P. 13)