4

The Anti–Money Laundering Regime

The global regime to control money laundering involves three dimensions: national and international building blocks, a firm legal and enforcement foundation, and close interaction between the public and private sectors in order to lower compliance costs and raise the probability of achieving its objectives. In principle, the global regime should have an agreed-upon international legal foundation with which national regimes are consistent in terms of laws and standards. The goal should be uniform enforcement and seamless cooperation across national jurisdictions. Cooperation and consultation with the private sector are important because they will contribute to lower costs, create a level playing field, and promote an accepted global public good from which the marginal benefit to each participant exceeds the cost, and where the incentive and scope for free riding are small.

In practice, this idealization of the global anti–money laundering (AML) regime is unattainable. The establishment of a robust AML regime is a challenge because of differences in institutions, perspectives, and priorities among countries as well as within them. As a result, compromises driven by the need to balance competing objectives are made at all levels in all jurisdictions.

This chapter summarizes the AML regime as it has evolved over some 30 years, and particularly since the mid-1980s.[1] It has two basic pillars, prevention and enforcement. The chapter summarizes the AML regime as it has evolved in the United States and includes a review of the *National*

1. See the glossary for thumbnail descriptions of many of the terms and institutions mentioned in this chapter.

Money Laundering Strategies of 1999–2003 in order to illustrate the structure and goals of the US AML regime. That regime is then briefly compared and contrasted with those in other countries in the context of multilateral efforts to establish a uniform, global AML regime. The chapter concludes with a short section on the costs of anti–money laundering efforts, which includes an estimate that a reasonable upper bound of the gross financial cost is $25 per capita.

Three principal conclusions come out of the review of the AML regime. First, the prevention pillar of the US regime has expanded to include a growing number of institutions and activities, while the enforcement pillar covers a growing number of crimes. Second, the past 15 to 20 years have seen the parallel development of a global AML regime alongside the US one, in part as a response to US pressure and leadership but also in response to the political and technological influences of globalization. Just as these forces have contributed to economic progress, they have provided opportunities for economic and financial mischief and have enhanced the scope for cross-border criminal activity.[2] Third, the national and global AML regimes as they exist today are imperfect because their construction has involved trade-offs between the actual and perceived benefits and costs of expanding them, between the cooptation of the private sector and privacy and human rights concerns, between national and international priorities, and between national and subnational priorities and structures.

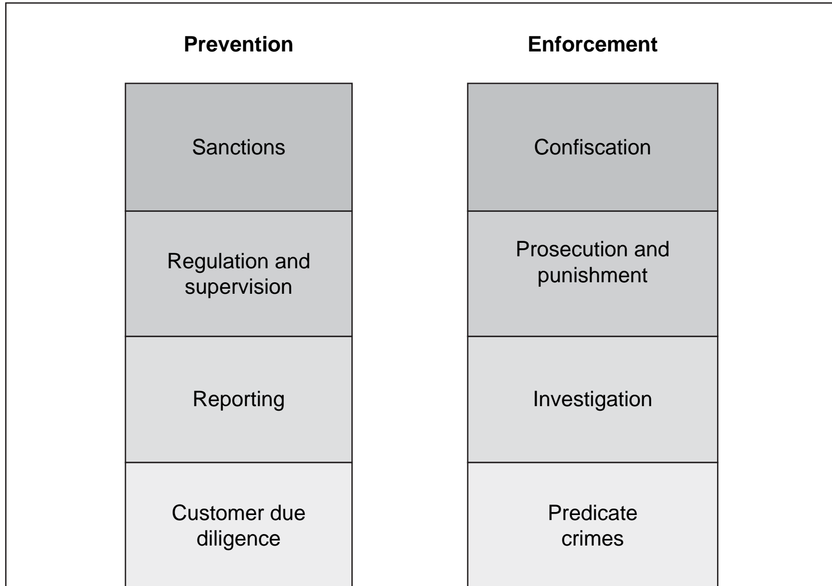
Prevention and Enforcement

The prevention pillar of the AML regime is designed to deter criminals from using private individuals and institutions to launder the proceeds of their crimes. Enforcement is designed to punish criminals when, despite prevention efforts, they have facilitated the successful laundering of those proceeds.

The prevention pillar has four key elements: customer due diligence (CDD), reporting, regulation and supervision, and sanctions (figure 4.1, from bottom to top). CDD is intended to limit criminal access to the financial system and to other means of placing the proceeds of crime. Reporting requirements alert authorities to activities that may involve attempts to launder those proceeds. Regulations implement anti–money laundering laws and often specify detailed CDD and reporting requirements, while supervision ensures compliance with laws and regulations by financial institutions and nonfinancial businesses and activities. Finally, sanctions punish individuals and institutions that fail to implement the prevention regime, in particular with respect to CDD and reporting requirements.

2. Gilmore (1999), Levi (2002), and Wechsler (2001) provide additional background material on the global AML regime.

Figure 4.1 Pillars of the anti–money laundering regime



The enforcement pillar also has four key elements: a list of underlying offenses or predicate crimes, investigation, prosecution and punishment, and confiscation (figure 4.1). The list of predicate crimes establishes the legal basis for criminalizing money laundering. Various detection and investigative techniques are used to identify specific instances of money laundering and link each to predicate crimes. If justified by the investigation, the money launderer is prosecuted. If convicted, the money launderer is not only fined or sentenced to serve time, but the criminal proceeds that he was attempting to launder may also be confiscated or forfeited after having been initially blocked or seized.

Consider how this framework interacts with a hypothetical bread-and-butter money-laundering operation. A drug dealer, having collected $25,000 from the sale of illegal drugs, takes the money to a bank and seeks to open an account in order to deposit the money (placement) before wiring it to a bank in Colombia (layering), with the ultimate intention of bringing the funds back to the United States to invest in a legitimate business (integration). An effective AML regime requires the bank to conduct CDD before opening this account through a process sometimes referred to as "knowing your customer." What is the true name of the customer? Where does he live? What is his line of business? Can the bank be reasonably confident that the money that the customer wants to deposit is not derived from criminal activity?

Assume that the customer succeeds in passing these tests and is allowed to open an account. The bank is still required to submit a report to the authorities about the large cash deposit. An employee of the bank may also be suspicious of the fact that the customer is wiring a large amount of money to a bank in Colombia, and may decide that it is appropriate to submit a suspicious activity report (SAR) to the authorities.

If the bank fails to conduct CDD or to submit one or more reports about the cash deposit and the wiring of the funds to Colombia, contrary to regulations promulgated by the Federal Reserve and other banking supervisors, this failure may be uncovered during a supervisory examination or subsequent criminal investigation. As a consequence, the bank may be fined or otherwise sanctioned or penalized for not complying with the regulations.

Turning to the enforcement pillar of the AML regime, laundering (or the attempted laundering) of the proceeds from drug dealing can be prosecuted under US anti–money laundering law because drug dealing is a predicate crime or underlying offense for such a prosecution. The report of the bank about the large cash deposit or the suspicious transfer of the funds once they were deposited may lead to the detection of the drug dealing. Alternatively, law enforcement authorities may have had the depositor under observation as a suspected drug dealer and might use the bank reports as part of their investigation and prosecution of the underlying crime. Moreover, if it turns out that the bank deliberately assisted the criminal in laundering proceeds, or that a bank officer facilitated the laundering unbeknownst to and in violation of the bank's internal controls, then the bank or the officer could also be prosecuted for money laundering. Finally, it is possible that the funds never made it to Colombia, were seized, and subsequently confiscated as a result of a forfeiture proceeding.

In practice, the anti–money laundering regime rarely operates as in the simplified hypothetical example. The proceeds of the drug sales may be deposited in many separate branches of the bank, into the existing account of a legitimate business, or in amounts of less than $10,000 in order to avoid detection. They may take the form of a check rather than cash because they are the proceeds of a crime other than drug dealing, such as embezzlement. The depositor may be a lawyer acting on behalf of a shell corporation set up for a cigarette smuggler.

The examples of predicate crimes and methods of money laundering presented in chapter 3 suggest that the number of permutations and combinations of crimes and methods is very large. As a consequence, the prevention and enforcement pillars of the AML regime have been extended from banks to other types of financial and nonfinancial businesses and to individuals such as lawyers and accountants (known as "gatekeepers") who facilitate access to those institutions and businesses. However, the basic features of the AML regime remain the same. Prevention combines

customer due diligence and reporting that is required by regulations under anti–money laundering laws. Supervision is employed and potential sanctions are available to ensure that the prevention pillar is firmly in place. Meanwhile, as criminals gather the proceeds of their predicate crimes, the investigation, prosecution and punishment, and confiscation elements of the enforcement pillar are employed to combat the underlying crime as well as to tighten the screws on the money-laundering process.

Current US Anti–Money Laundering Regime

The US anti–money laundering regime is central to the global regime because the central role of the US economy and financial system in the world today frequently results in the United States being the ultimate destination, or at least the conduit, for proceeds from crimes that may have been committed outside the country. Thus, the US AML regime is often, although not always, a model for other national regimes. The first column of table 4.1 chronologically lists the major developments in the US AML regime since 1970. Thumbnail descriptions of the major entries are in the glossary.

In many respects, the US prevention pillar is more elaborate and has evolved more than the enforcement pillar. Although the list of US predicate crimes that can give rise to money-laundering investigations and prosecutions has expanded substantially. In practice, there may be some tension between the two pillars, as when, for example, financial supervisory authorities are uncomfortable with the techniques of criminal investigative authorities.

Prevention

Table 4.2 summarizes the prevention pillar of the current US AML regime, including changes that have resulted since enactment in October 2001 of the USA PATRIOT Act and its subsequent implementation. The elements of the prevention pillar are listed across the top of the table, and three broad categories of economic actors (along with some subcategories) are listed down the side. The cells in the table indicate whether or to what extent the elements of the prevention pillar are applied to the various subcategories of economic activities.

Core Financial Institutions

The most stringent requirements apply to core financial institutions such as banks, securities firms, insurance companies, and various combinations of those institutions. All are required to have comprehensive AML compliance

Table 4.1 Evolution of the AML regime in the United States, Europe, and globally

Year	United States	Europe	Global
1970	Bank Secrecy Act (BSA) Racketeer Influenced and Corrupt Organizations Act (RICO)		
1977	Foreign Corrupt Practices Act (FCPA)		
1980		Measures Against the Transfer and Safe-keeping of Funds of Criminal Origin (Council of Europe)	Offshore Group of Banking Supervisors (OGBS) established
1986	Money Laundering Control Act (MLCA)	Drug Trafficking Offenses Act (United Kingdom)	Inter-American Drug Abuse Control Commission of the Organization of American States (OAS/CICAD) established ICPO–Interpol resolution on economic and financial crime
1988	Anti–Drug Abuse Act Money Laundering Prosecution Improvements Act		Statement of Principles (Basel Committee) UN (Vienna) Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances
1989			Financial Action Task Force (FATF) established
1990	Crime Control Act	Convention (Strasbourg) on Laundering, Search, Seizure and Confiscation of Proceeds from Crime (CoE)	FATF Forty Recommendations released Caribbean FATF established at Aruba meeting of Caricom
1991		First Money Laundering Directive (European Commission)	

1992	Annunzio-Wylie Money Laundering Act		Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Other Serious Offenses released (OAS/CICAD)' International Organization of Securities Commissions (IOSCO) resolution on money laundering
1994	Money Laundering Suppression Act		OAS/CICAD declaration of Principles and Plan of Action at Summit of the Americas
1995	Regulation of funds transfers Revision of currency transaction report (CTR)	Europol created Europol Drugs Unit (EDU) established	Egmont Group of Financial Intelligence Units of the World established Communiqué of Summit of the Americas Ministerial Conference Concerning the Laundering of Proceeds and Instrumentalities of Crime (OAS/CICAD)
1996	Simplified suspicious activity report (SAR), tribal casinos regulated, exemptions to CTR reporting		FATF Forty Recommendations revised International Money Laundering Information Network (IMoLIN) established
1997	Proposed rules for money service businesses	Action Plan to Combat Organized Crime (European Union) CoE establishes the Select Committee of Experts on the Evaluation of Anti–Money Laundering Measures (PC-R-EV)	OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions adopted
1998	Money Laundering and Financial Crimes Strategy Act SARs for casinos and card clubs	Joint Action on corruption in the private sector (European Union)	OECD report on Harmful Tax Practices Asia/Pacific Group on Money Laundering (APG) established UN Political Declaration and Action Plan against Money Laundering Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Other Serious Offenses (OAS/CICAD)

(table continues next page)

Table 4.1 Evolution of the AML regime in the United States, Europe, and globally *(continued)*

Year	United States	Europe	Global
1999	Money service business regulation issued		Model Legislation on Laundering, Confiscation and International Co-Operation in Relation to the Proceeds of Crime (for civil law jurisdictions) released by the UN Office for Drug Control and Crime Prevention (UNDCCP)
	First National Money Laundering Strategy		OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions entered into force
	Foreign Narcotics Kingpin Designation Act		Eastern and Southern Africa Anti–Money Laundering Group (ESAAMLG) established
			UN Convention for the Suppression of the Financing of Terrorism
2000		Recovering the Proceeds of Crime Report (United Kingdom)	Wolfsberg Global Anti–Money Laundering Guidelines for Private Banking (Wolfsberg Principles) issued
			FATF Report on Non-Cooperative Countries and Territories (NCCT)
			OECD list of 35 tax havens with harmful tax practices released
			Model Legislation on Money Laundering and Proceeds of Crime (for common law jurisdictions) (UNDCCP)
			Okinawa G-7 Summit endorses G-7 Finance Ministers' Report on Actions Against Abuse of the Global Financial System
			Financial Stability Forum Report of Working Group on Offshore Financial Centers
			Regional Task Force on Anti–Money Laundering in Latin America (GAFISUD) established
			UN (Palermo) Convention Against Transnational Organized Crime

Year			
2001	US PATRIOT Act: International Money-Laundering Abatement and Anti–Terrorist Financing Act (Title III)	Second Money Laundering Directive (European Union)	Report on Customer Due Diligence for Banks (Basel Committee)
			FATF Eight Special Recommendations on Terrorist Financing released
2002		Europol mandate expanded	FATF Consultation Paper on Revisions to Forty Recommendations released
		Proceeds of Crime Act (United Kingdom)	FATF/IMF/World Bank Agreement on AML Pilot Project for Assessing Compliance with Anti–Money Laundering and Combating the Financing of Terrorism Standards
			Wolfsberg Statement on the Suppression of the Financing of Terrorism
			Wolfsberg Anti–Money Laundering Principles for Correspondent Banking
			International Association of Insurance Supervisors (IAIS) Anti–Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities
2003		Money Laundering Regulations revised (United Kingdom)	New FATF Forty Recommendations released
			UN Convention Against Corruption
			Wolfsberg Statement on Monitoring, Screening, and Searching

Note: See glossary for thumbnail descriptions of some elements.

Table 4.2 Prevention pillar of the US anti–money laundering regime

	Customer due diligence	Reporting requirements	Supervision	Sanction
Financial institutions				
Core financial institutions[a]	Yes	Yes	Yes	Yes
Other types of financial institutions[b]	Yes	Yes	Some	Limited
Nonfinancial businesses				
Casinos	Yes	Yes	Some	Yes
Dealers in precious metals and stones	Yes	Yes	No	Yes
Real estate agents	No	No	No	No
Other[c]	No	Some	No	No
Professions				
Lawyers and accountants	Limited	Limited	Very limited	Very limited
Trust and company services providers	Limited	Limited	Very limited	Very limited

a. Depository institutions, securities firms, insurance companies, and combinations of them.

b. For example, mutual funds commodity trading advisers, and investment advisers.

c. For example, travel agencies, and vehicle sellers.

programs and are traditionally subject to federal as well as state regulation and supervision.[3]

With respect to customer due diligence, these institutions must comply with extensive requirements in setting up new accounts and conducting transactions.[4] The assessment requirements are risk-based in the sense that the amount of information required depends on the institution's size, location, and customer base; the customer's size, location, and type of business; and the services offered to the customer. If the institution is unable to reach a satisfactory finding in the course of its due diligence, it is generally expected to decline to open the account or complete the transaction. The institution is required as well to retain records of its customer due diligence activities.

Turning to reporting requirements, institutions are required to submit suspicious activity reports (SARs) to the US Treasury Department's Financial Crimes Enforcement Network (FinCEN), cash transaction reports (CTRs) to the Internal Revenue Service (IRS), and Reports of International

3. Stand-alone US insurance companies are primarily supervised at the state level but are covered by federal AML laws and subject to federal AML regulations.

4. Current US AML regulations describe the CDD process for various institutions as a customer identification program (CIP). The information required for new customers includes name, address, date of birth, and taxpayer identification number (or passport number for a foreign customer). The information required for transactions includes the identity of those participating, addresses, legal capacity, and beneficial owner of the funds involved.

Transportation of Currency or Other Monetary Instruments (CMIRs) to the Customs Service.[5] Some types of activity may have a threshold below which it is not necessary to submit reports, such as suspicious transactions aggregating less than $5,000.[6] The normal threshold for CTRs and CMIRs is $10,000 and covers withdrawals as well as deposits.

One criticism of the US AML regime heard both in the United States and abroad is that these reporting requirements generate so much data as to cause an information overload, making it difficult for the recipient agencies to use the information efficiently in law enforcement and related investigatory activities.[7] Those who report the data contribute to the problem because their own procedures may be biased toward submitting unnecessary reports. No entity is penalized for excessive filing, and doing so can even provide implicit or explicit protection from criticism. The US AML regime and core financial institutions have also been criticized for applying more stringent CDD and reporting requirements to foreign than to domestic customers and transactions.

Core financial institutions such as banks are subject to substantial supervision that normally includes annual on-site examinations to ensure their compliance with a wide array of laws and regulations. A significant portion of the examination covers compliance with anti–money laundering and Bank Secrecy Act regulations, including reviewing other internal or external audits and testing institutions' procedures and processes.

If an institution is found to have fallen short of what is required or to be sloppy in implementing AML regulations, rules, and guidance procedures, it can be subject to informal or formal administrative actions by the regulator and, potentially, civil and criminal penalties. Experienced federal officials note that these examinations primarily serve to reinforce the prevention pillar of the overall AML regime, and rarely turn up direct evidence of actual money laundering.

The four elements of the prevention pillar of the US AML regime are applied comprehensively to US core financial institutions. It is not a zero-

5. US banks have been operating under a de facto order to report suspicious transactions since being required to do so by supervisors starting in the mid-1980s. The de jure requirement came into force in 1992 with the passage of the Annunzio-Wylie Money Laundering Act.

6. Agencies may also lower this limit in certain circumstances. For example, as a result of growing suspicions about check-cashing agencies in New York City, the limit was lowered to $1,000 for a period of time.

7. In mid-2004, the American Bankers Association (Byrne 2004) acknowledged that progress had been made in reducing the amount of data generated, but recommended that the threshold for banks to file CTRs for corporations and businesses be raised from $10,000 to $25,000.

tolerance regime, though, because, beyond the application of specified minimum elements, institutions are permitted and encouraged to employ risk-based procedures, depending on the nature of the institution and its business as well as the characteristics of its customers. Along with the use of proxy devices such as thresholds on reporting, a risk-based approach has the potential to let some prohibited customers and transactions slip through undetected.

Non-Core Financial Institutions

A broad range of other types of US financial institutions has been progressively incorporated into the US AML regime both prior to and as a result of the passage of the USA PATRIOT Act in October 2001. In effect, Congress delegated to the US Treasury many of the delicate decisions on where, as well as how, to draw the lines, reserving to itself the capacity to criticize Treasury decisions at a later date.[8] A major subcategory is money service businesses, which are now required to register with FinCEN if they offer such services as money orders, traveler's checks, money transmission, check cashing, or currency dealing or exchange. However, the catch-all category of other financial institutions also includes entities that may be engaged broadly in money management activities.[9] These US financial institutions are subject to CDD and reporting requirements that are essentially the same as those applied to core financial institutions.

A principal difference in the prevention pillar of the US AML regime as it applies to these institutions is that while they are subject to federal regulation, they are not subject to as systematic or comprehensive supervision as are the core financial institutions. For example, money service

8. The USA PATRIOT Act mandated the extension of CDD and associated reporting requirements to certain businesses, such as those engaged in fund transfers as well as all securities dealers and investment companies. It also authorized, but did not require, extension of the regime to persons engaged in real estate closings and settlements, futures commission merchants, commodity trading advisers, and trust companies. FinCEN has more discretion on whether and to what extent to subject this second group of businesses to the AML regime. To date, final rules have been issued for broker-dealers (securities firms), money service businesses, credit card operators, mutual funds, and futures commission merchants (FinCEN 2003a). Extension of the US AML regime also is being considered for life insurance companies, dealers in precious metals, stones, and jewels, commodity trading advisers, unregistered investment companies (hedge funds), investment advisers, travel agencies, sellers of vehicles, and real estate agents. An advance notice of proposed rule making has been issued for persons involved in real estate closings and settlements.

9. FATF's revised Forty Recommendations (2003c) for combating money laundering and terrorist financing finesses this problem by defining a financial institution as any person or entity that conducts business activities or operations in one or more of a list of 13 categories of activities, some with multiple subparts.

businesses providing any of the five services listed above are required to register at the federal level, while many businesses providing other types of financial services are not required to do so. Those other institutions, in fact, may be required to register at the state or local level, but they may not be formally licensed. Licensing normally requires some scrutiny of the background and other qualifications of the owners and managers. Even when the institutions are licensed, they generally are not subject to regular supervision or inspections. In principle, they can be sanctioned either criminally or civilly for not complying with the requirements of AML regulations, but in practice, the sanctions element of the prevention pillar as it applies to these financial institutions is more limited and may only come to light if suspected offenders are already under surveillance, or in the aftermath of an investigation. As a result, in constructing the AML regime, historical and institutional differences such as divisions of responsibility between the federal government and the states have to be taken into consideration.

Nonfinancial Businesses

The prevention pillar of the US AML regime is even less rigorous for nonfinancial businesses such as casinos, dealers in precious metals and stones, and real estate agents than it is for non-core financial institutions. With respect to customer due diligence, casinos are subject to "reasonable procedures" such as identity checks, record keeping, and determining whether customers are on lists of known or suspected terrorists. Casinos and card clubs with more than $1 million in gaming revenues are subject to SAR and CTR reporting requirements, with special thresholds. In principle, they are subject to federal regulation and some degree of state regulation and supervision, but the scope for effective and graduated sanctions is even more limited than for non-core financial institutions.[10]

Dealers in precious metals and stones as well as pawnbrokers are subject to general CDD and reporting requirements, but again, supervision of their compliance and any practical use of sanctions for enforcement are limited because businesses are licensed in state or local jurisdictions. Aside from withdrawing licenses as the result of criminal or civil proceedings against the business, the authorities have little leverage to supervise the CDD or reporting requirements or to sanction noncompliance.

Real estate agents provide a useful illustration of some of the issues involved in expanding the AML regime. The USA PATRIOT Act provided

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10. Further complicating the process of applying the AML regime to nonfinancial businesses is the fact that they would prefer, if they are to be covered at all, that there be clear distinctions between what is required and permitted and what is not. Core financial institutions have similar preferences, but they are more experienced in living with regulatory ambiguities.

for potential inclusion in the US AML regime of "persons involved in real estate closings and settlements," which would include most agents. They were already subject to CDD with respect to name checks in the course of doing business—the issue was whether they should be subject to general CDD and reporting requirements under the AML regime. On April 29 and November 6, 2002, FinCEN temporarily exempted real estate agents from the regime, and on April 10, 2003, FinCEN called for assistance in determining and designing any necessary regulations. The resulting regime as applied to real estate agents and other participants in closings and settlements is likely to be less rigorous and comprehensive—and perhaps appropriately so—than that applied to casinos.

Publicly available responses that FinCEN had received as of June 9, 2003, to its request for assistance addressed four main points:

- Participants in real estate transactions are already covered because they are required to file CTRs, which can be designated SARs by the filer, and because they can be prosecuted for knowingly assisting or participating in money laundering committed by a client.
- There is little evidence of money laundering in this area of economic activity.
- The costs to those involved in the real estate industry (many are small businesses) imposed by requirements to establish full-fledged anti–money laundering programs would be high.
- Financial institutions are involved in most real estate transactions and should be responsible for AML aspects of those transactions.

The American Bar Association (ABA Task Force on Gatekeeper Regulation and the Profession 2003b, 5) made an additional point on the possibility of regulation in the area of real estate: "Not unlike the constitutional protection against compelled self-incrimination, the [legal] ethics rules [preserving the independence of the bar from government enforcement agencies] reflect an informed and time-tested decision to protect overarching principles critical to our system of justice, even if it means that government enforcement agencies must use their own devices (and not independent lawyers assisting private citizens) to advance certain investigative objectives (in this case, in the area of money laundering)."

The ABA's point illustrates an underlying feature of the AML regime, especially as its coverage expands. The public has an interest to deal with an identified problem. In response, the government in effect co-opts the private sector to perform or assist at the financial and even ethical expense of the private sector.

When FinCEN issues final AML regulations for CDD and reporting covering real estate—assuming that even happens—the scope to supervise compliance with regulations currently on the books will be very limited. In

principle, FinCEN has such authority. It was one of the first national financial intelligence units in the world, and its role has subsequently been substantially expanded through such legislation as the USA PATRIOT Act to become the residual federal-level regulator and supervisor of various entities and activities for which there is no existing federal supervisor, such as trust companies. However, with a budget in fiscal year 2004 of $57 million and a staff of only 277 and a wide range of responsibilities, the unit lacks resources. Federal authority in this area is at most residual, because the basic authority lies with state and local jurisdictions. Sanctions available at the federal level to enforce uniform compliance are scarce.

Table 4.2 singles out three categories of nonfinancial businesses (casinos, dealers in precious metals, and real estate brokers) because they are specifically identified in the FATF's 2003 revision of its Forty Recommendations (FATF 2003c). Recommendation 20 also states: "Countries should consider applying the FATF Recommendations to businesses and professions, other than designated nonfinancial businesses and professions, that pose a money laundering or terrorist financing risk."

A reasonable question is what evidence is required to substantiate an assertion that a particular type of economic activity poses a risk of money laundering or the financing of terrorism. A description of a particular incident in a FATF typologies report would be insufficient evidence to convince many observers.

Other nonfinancial businesses covered to some degree by the US AML regime include travel agents as well as pawnbrokers, telegraph operators, and businesses involved in vehicle, boat, auto, and airplane sales. The regime does not currently cover other businesses sometimes involved in high-value transactions, such as stamp dealers. The line has to be drawn at some point, even if it is moved later.

Professions

FATF's 2003 revision of its Forty Recommendations called for extending the prevention pillar of the global AML regime to lawyers, notaries, other independent legal professionals, accountants, and trust and company service providers, insofar as they are engaged in specified activities.[11] The recom-

11. Recommendation 12d of FATF (2003c) calls for CDD by lawyers, notaries, other legal professionals, and accountants when they assist clients with such activities as buying and selling real estate, managing assets, managing accounts, organizing contributions to create, operate, or manage companies, legal persons, or arrangements, and buying and selling business. Recommendation 12f calls for trust and company service providers to use CDD when they act as a formation agent for a legal person, a director of a company, a trustee, or a nominee shareholder, or when they facilitate the process by providing, for example, a registered office or address. Lawyers are subject to reporting requirements when engaging with or for their client in financial transactions in these areas of activity, and countries also are "encouraged" to extend reporting requirements to the remaining professional activities of accountants and auditors (recommendation 16a).

mendations were an outgrowth of the so-called "Gatekeepers Initiative" agreed to at the G-8 Moscow Ministerial Conference in October 1999. The objective was to expand the scope of the prevention pillar by placing responsibility on professionals involved in facilitating financial transactions. However, there is a broad exemption where these professionals are subject to "professional secrecy or legal professional privilege." Trust and company service providers are required to report suspicious transactions for or on behalf of a client in the indicated areas (recommendation 15c).

The United States has no CDD or AML reporting requirements that apply to these professionals at present beyond CTR requirements and the penalties that professionals incur if they aid in money laundering. However, this type of sanction is part of the enforcement rather than the prevention pillar of the AML regime. US officials have told us that they can get the information they need from lawyers if they want it. On the other hand, in their critique of the levelness of the international playing field on anti–money laundering, Mark Pieth and Gemma Aiolfi (2003, 27) comment that "it would rather stretch the general meaning of the words self-regulation or 'risk-based approach'" to subject attorneys, notaries, and unregulated fiduciaries to this type of ad hoc regulation.

While supporting domestic and international AML efforts, US legal groups have resisted the application of AML requirements to lawyers as well as to trust and company service providers, which are often lawyers. For example, although lawyers are required to submit a CTR, legal groups argue that, on confidentiality grounds, they should decline to check the box indicating that the transaction may be suspicious. An ABA resolution in February 2002 urged "that the United States government seek to protect and uphold the attorney/client relationship, including the attorney/client privilege, in dealing with international money laundering" (ABA Task Force on Gatekeeper Regulation and the Profession 2003a, 2). In another resolution a year later the ABA stated that it "opposes any law or regulation that, while taking action to combat money laundering or terrorist financing, would compel lawyers to disclose confidential information to government officials or otherwise compromise the lawyer-client relationship or the independence of the bar" (ABA Task Force on Gatekeeper Regulation and the Profession 2003a, 1).

US lawyers also argue that they have their codes of ethics, are subject to disbarment by state or federal courts for misconduct, and are licensed by the states. Further, as one argument goes, federal involvement in lawyers' activities raises constitutional (states' rights) issues. In submissions to the FATF when it was considering revisions to its Forty Recommendations, lawyers argued that they should be subject to the AML regime only when acting as financial intermediaries. They noted similar views expressed by groups of legal professionals around the world, and in a Joint Statement to the FATF on April 3, 2003, they complained that research did not support the inclusion of any recommendations pertaining to lawyers in the Forty

Recommendations, and that consultation with them by FATF (on two separate occasions) had been inadequate (CCBE 2003).

As if reaching consensus on how to expand the AML regime to the legal profession were not difficult enough, efforts to regulate accountants and auditors in the United States and other countries further illustrate the difficulties in widening the AML net (box 4.1). Without specific CDD and SAR reporting requirements, the prospects for effective coverage of lawyers, accountants, or trust and company service providers within the prevention pillar of the US AML regime are thus extremely limited at this point. Moreover, the United States has no countrywide mechanism readily available to conduct supervision of these professions, so sanctions at present are left to the enforcement pillar, although recommendation 24b of the FATF (2003c) envisages supervision and sanctions that could involve self-regulatory as well as governmental organizations, as long as they can ensure compliance. For the moment, however, compliance with ethical standards offers no protection from prosecution for participation in money laundering. So although these groups of professionals were included in the new FATF Forty Recommendations with respect to CDD, reporting, supervision, and ensuring compliance, it remains to be seen whether and to what extent jurisdictions comply in the near term. Moreover, the recommendations themselves contain a large loophole exempting reporting on compliance when it conflicts with professional ethics regarding secrecy.

On the other hand, it is to be noted that in the related area of corporate governance, the American Bar Association in 2003 reluctantly adopted a resolution that permitted, but did not compel, disclosure of "confidential client information if the client is using the lawyer's services to commit a crime or fraud that would cause financial harm to others." However, this was a weak response to a crisis of confidence in the legal profession associated with an outbreak of major corporate scandals.

The USA PATRIOT Act (Section 314) calls for increased cooperation between financial institutions, regulatory authorities, and law enforcement authorities in operating the prevention pillar of the US AML regime. Such cooperation would recognize that information sharing improves information content. Public-private cooperation has been a formal part of the US AML regime since 1992, when the Annunzio-Wylie Money Laundering Act authorized the US Treasury to create a Bank Secrecy Act Advisory Committee with members of the government and representatives of the banking industry.[12]

The US banking industry has been critical of the framework that has evolved under the USA PATRIOT Act, commenting through the American Bankers Association to the US Treasury that its initial proposals amounted to a one-way street in which the government placed additional demands

12. The committee was not actually created until 1994.

Box 4.1 Accountants, auditors, and anti–money laundering regimes

The extent to which the global anti–money laundering regime ultimately will affect accountants and auditors is not yet clear, even in the United States. The nature of the duties carried out by these professionals puts them near the top of government lists in terms of those who can identify and report money-laundering activities. Not only are auditors and accountants regularly exposed to companies' financial records, but they also have expertise in the design, maintenance, and control of various internal operations.

In congressional testimony before the Committee on Banking and Financial Services, then Deputy Treasury Secretary Stuart Eizenstat (2000) stated: "We are considering how existing accounting standards on such subjects as illegal acts of clients . . . can incorporate money laundering safeguards." Although the USA PATRIOT Act of 2001 authorized the Treasury to extend existing anti–money laundering rules or enact new ones for auditors and accountants, US regulations have not yet incorporated these professions into the national AML regime.

Under the current US system, accountants and auditors generally play only a passive role in the detection of money laundering and are not directly involved in identifying illegal or suspicious transactions at any stage of their relationships with clients. While they must be aware of the possibility of encountering money laundering or suspicious transactions, they are not required to set up a program for their detection.

What responsibilities that accountants and auditors do have vary slightly according to which profession is involved. Accountants in charge of keeping companies' financial records are not required by any applicable accounting standards to detect money laundering.[1] Their responsibility is limited to reporting illegal acts that have both direct and material effect on clients' financial statements.[2] However, most of the time money laundering has only an indirect effect on financial statements, as in the case of a contingent liability such as fines in connection with crimes that have been committed. Furthermore, even if accountants happen to encounter possible money-laundering activities, current standards do not unequivocally require them to report actual or suspected transactions to the authorities. Their only obligation is to report to the board of the corporation involved.

Auditors have different requirements because they must certify the true representation of a company's activities through its records. Auditors must directly notify the government of illicit or suspected transactions in the event that management does not take satisfactory steps to address the matter. However, they are only required to report transactions that may have a direct negative effect on financial statements. Once a suspicious money-laundering activity that modifies the true representation of a company's activity is identified, it is the auditors' responsibility to assess the legitimacy of the transaction. If auditors find an illegal activity by a publicly traded company, they are required to report it to the Securities and Exchange Commission either through the corporate board or directly if the board is uncooperative. They must also provide an opinion on the financial statement.[3] Therefore, like accountants, auditors do not have to design their audit procedures to identify and track illegal activities, since they are simply required to be aware of the possibility that illegal activities may take place.

For the moment, the only stick-and-carrot mechanism available to the government is the standard of "willful blindness" that the government can use during a prosecution. In addition, the Supreme Court in 1984 in United States vs. Arthur Young & Co. held that "no confidential accountant-client privilege exists" (465 US 805, 818, 1984).

(box continues next page)

Box 4.1 *(continued)*

However, while there is no binding requirement on accountants or auditors to practice customer due diligence or to report suspicious transactions, they are encouraged to follow precautions and a risk-assessment approach when dealing with clients' activities. The issue is whether the government will impose more stringent requirements in the future. One possibility with regard to reporting suspicious activity would be to follow the example of other countries such as the United Kingdom, Switzerland, and Belgium, which require accountants to report all instances of suspected money-laundering activity by clients.

UK legislation covering accountants, auditors, and tax consultants is among the most comprehensive and follows the pattern applied to that country's financial industry. The UK Proceeds of Crime Act passed in 2002, along with associated money-laundering regulations that came into effect in March 2004, set a new and higher standard for accountants, auditors, and tax consultants. These professions are required to perform CDD and maintain evidence of client identification and transactions. In addition, they must set up anti–money laundering procedures, appoint a reporting officer to collect reports on all suspicious transactions, and submit those reports to the National Criminal Intelligence Service. The legislation authorizes criminal penalties for failure to abide by regulations or report suspicious activities.

Anti–money laundering regimes elsewhere in Europe are still in the process of developing procedures with respect to accountants and auditors. The European Federation of Accountants (FEE 1999) has proposed a monitored self-regulation regime controlled by accountant and auditor associations, consistent with the guidelines and principles in the money-laundering directive issued by the European Union. This position is also consistent with that of the 113-nation International Federation of Accountants, which argues: "Money laundering is far less likely to affect financial statements than are such types of fraud and misappropriations. Consequently, it is unlikely to be detected in a financial statement audit. Nevertheless, money-laundering activities may have indirect effects on an entity's financial statements and, thus, are of concern to external auditors" (IFAC 2002). Both the IFAC and FEE (2003) have expressed concern that extending the anti–money laundering regime to the accounting and auditing professions could increase the fees charged to clients and divert resources away from the principal duties and responsibilities of these professions.

1. See Private Securities Tort Reform Act of 1995 (Public Law No. 104–67, 109 Statute 737) and the corresponding SAS No. 54, Illegal Acts by Clients (American Institute of Certified Public Accountants, Professional Standards, vol. 1, AU sec. 317).
2. Securities Exchange Act of 1934 (15 U.S.C. sec. 78j, 1994).
3. SAS 54, Illegal Acts by Clients.

and requirements on financial institutions, rather than the type of network that they thought was the intent of Section 314.[13] Similar criticism can be found in a report by the Council on Foreign Relations (2004), which focuses principally on the financing of terrorism. A group of global financial institutions has established Regulatory DataCorp as a for-profit enterprise to

13. Byrne (2004) testified that administration of the USA PATRIOT Act's Section 314 "demand process" had been improved by implementation of procedural changes that reduced burdens on banks.

provide information to subscribers to aid them in their customer due diligence and to manage their legal, regulatory, and reputation risks. In private conversations, representatives of some of the sponsoring institutions have been critical of the degree of cooperation by the US government with this enterprise. Such public-private tension is inherent in attempts to establish and refine the AML regime.

A summary numerical description of the current US AML regime can be used to measure the extent of coverage by the prevention pillar of the seven categories of financial institutions, nonfinancial businesses, and professions listed in table 4.2. With full coverage receiving 4.0, a full point for each element of the pillar, coverage of the categories could be measured as follows:

- Coverage of core financial institutions would be scaled at close to 4.0, unless there was a small deduction for the risk-based nature of the CDD regime, the presence of thresholds in some reporting requirements, and the dispersed (nonfederal) supervision of insurance companies.
- Other types of financial institutions, on average, would be at 2.75, with credit of a full point each for the CDD and reporting elements, but half a point for supervision, and a quarter point for the limited scope of sanctions for noncompliance.
- Casinos would be at 2.0 overall, consisting of three-quarters of a point each for CDD and reporting because of exemptions and reporting thresholds, and a quarter point each for supervision and sanctions.
- Dealers in precious metals and stones would be at 1.50, because while they are almost at the same level in CDD and reporting requirements as casinos, they fall short in supervision and sanctions.
- Real estate agents would be at 0.50 because they are subject at least to CTR reporting requirements and the threat of the enforcement pillar.
- The two categories of professionals—lawyers, notaries and accountants, and trust and company service providers—might receive a slightly higher 0.75 because there is a somewhat more developed mechanism to police behavior and withdraw licenses to practice, at least after an offense has been detected and proved.

Although this numerical description of the scope of the prevention pillar suggests it is currently incomplete, such a description would have been very much lower before passage of the US Money Laundering Control Act in 1986. Core financial institutions would have registered about 2.0 on average because of some CDD and reporting requirements (for banks in particular), although the extent of the supervision and sanction mechanisms was limited. The Bank Secrecy Act of 1970 required banks and cer-

tain other financial institutions to retain records to facilitate subsequent tracing of financial transactions and to submit CTRs and CIMRs. The submission of SARs was not mandated until the Annunzio-Wylie Money Laundering Act in 1992 and not implemented until 1996.[14] Moreover, securities and insurance institutions were generally not covered, and neither were most other types of financial institutions. Broker-dealers unaffiliated with banks were not subject to SAR reporting requirements until passage of the USA PATRIOT Act in 2001, and the AML regime essentially did not apply at all to nonfinancial businesses, let alone professions.

Chapter 8 will return to the significance of how this pattern of regime expansion has evolved. For the moment, the description helps to illustrate the political, technical, and institutional compromises and trade-offs that are required to establish the prevention pillar of the US AML regime. At the same time, it tells us little about actual compliance.

Enforcement

The enforcement pillar of the US AML regime has expanded over the past 15 to 20 years, although less dramatically than the prevention pillar. The number of predicate crimes has increased during the period. New tools have been developed, and new mechanisms offer the promise of greater efficiency of the enforcement pillar, but their use has not been substantial.

Money laundering was not criminalized in the United States until passage of the Money Laundering Control Act (MLCA) in 1986.[15] Of course, money laundering existed before it became a criminal offense, and law enforcement authorities have long known to "follow the money" when investigating crimes that generate proceeds. Correspondingly, criminals worked hard to break or obscure the connection between their crimes and the proceeds from them. The Bank Secrecy Act of 1970 fully recognized the links between money and crime, including securities fraud, as well as the international dimensions of the phenomenon (Eldridge 1986).

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14. The Annunzio-Wylie legislation was the first to require that banks and certain other financial institutions have AML programs, effectively mandating internal control procedures that were subject to outside scrutiny and supervision.

15. The MLCA defines money laundering as conducting or attempting to conduct a financial transaction "knowing that the property [or monetary instrument] involved in [the] financial transaction represents the proceeds of some form of unlawful activity with the intent to promote the carrying on of specified unlawful activity or knowing that the transaction is designed in whole or in part to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity or to avoid a transaction reporting requirement under State or Federal law" (Section 1956, laundering of monetary instruments).

Predicate Crimes

The list of predicate crimes or underlying offenses that could lead to a conviction for money laundering was relatively short in 1986, with the primary focus on drugs and drug-related criminal activity. The list has been expanded considerably in subsequent AML legislation, and includes more than 150 offenses covering almost everything that might be considered a serious crime, from environmental violations to health insurance fraud.

The US list of predicate crimes conspicuously does not include tax evasion. The ironically titled Bank Secrecy Act (because it was about breaking down bank secrecy) was prompted in part by tax evasion considerations in terms of identifying the parties with underlying financial interests, addressing concerns about tax havens and the role of financial services providers in facilitating access to them, and dealing with international flows of funds. Moreover, the Anti–Drug Abuse Act of 1988 made it a criminal offense to evade taxes on the proceeds of an unlawful activity. This provision was added to the enforcement pillar to allow the IRS to use its expertise to develop anti–money laundering cases. Thus, US enforcement of anti–money laundering de facto is closely tied to the enforcement of tax evasion,[16] even though the crime of tax evasion per se does not normally lead to money-laundering charges, except to the extent that the criminals have evaded paying taxes on the proceeds of their crimes.[17]

Although the absence of tax evasion from the list of predicate offenses is not a particular enforcement problem for the United States, and it conveniently sidesteps domestic political sensitivities concerning privacy and how US tax laws are enforced, the omission adversely affects global cooperation. A former high-level Latin American official commented to one of the authors that if the United States wants other countries to cooperate more on countering the financing of terrorism and money laundering, it should cooperate more aggressively in dealing with Latin Americans who evade taxes on investments in the United States.

The United States has been somewhat responsive to these concerns, which was one reason for US support of a European initiative to address harmful tax competition. The Organization for Economic Cooperation and Development (OECD 1998) released a report on the subject, laying out principles for the identification of harmful tax competition, which was directed primarily at tax havens and their low tax rates, solicitation of

16. For example, in July 2003, a stockbroker (Adam Klein) pleaded guilty to money laundering and admitted that he had also evaded taxes on the proceeds of the underlying crime.

17. *Barrons* (October 13, 2003, F5) reports some new links between the tax enforcement and AML regimes. Multiple payments of cash equivalents adding up to more than $10,000 to fund managers require the filing of a form 8300 that used to go only to the tax authorities but now is reviewed by AML authorities as well. The investor is also notified of these reports, in contrast with SARs or CTRs.

investment funds, and reluctance or inability to provide information to the tax authorities of other countries.[18]

The OECD report stirred a furor not only among those it targeted—so-called tax havens, many of which saw one of their principal sources of foreign exchange earnings under attack—but also within some OECD countries whose governments indirectly sponsored the report. Tax evasion and the international exchange of tax information is politically explosive in many countries, not just the United States.[19] The report led to designating 35 jurisdictions as having harmful tax practices, principally offshore financial centers (OECD 2000). Thirty of these jurisdictions subsequently made a commitment to increase transparency and exchanges of information, so that by December 2003 only five—Andorra, Liechtenstein, Liberia, Monaco, and the Marshall Islands—remained "uncooperative tax havens."

The US Treasury under Secretary Paul O'Neill, during the Bush administration, initially was quite critical of the OECD tax haven initiative. The US eventually agreed with its G-7 colleagues on a joint statement of support in June 2002: "We agree that the administration and enforcement of tax laws depend increasingly on transparency and effective international exchange of information. We call on all countries to permit access to, and exchange, bank and other information for tax purposes; OECD countries should lead by example." However, the OECD initiative has been weakened by less progress than had been expected with respect to intra-OECD, in particular intra-European, tax cooperation.

Treatment of offenses abroad is another feature of the predicate crime element of the enforcement pillar of the US AML regime. Although many domestic crimes qualify as predicate offenses under US AML law, only a subset of crimes committed abroad can lead to money-laundering prosecutions in the United States. This reduces the scope for the United States to cooperate in the global AML regime, since nonrecognition under US law of a money-laundering offense abroad impedes the law enforcement process in other countries. For example, until passage of the USA PATRIOT Act in 2001, foreign corruption was not a predicate crime for a money-laundering offense in the United States. In addition, trafficking in human beings, counterfeiting

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18. The principles involved the combination of (1) low or no taxes (or withholding) with a lack of transparency, (2) ineffective information exchange, and (3) facilitation of tax evasion by applying different tax regimes to foreign rather than domestic investors, such as by not requiring a physical presence or substantial activities in the jurisdiction (OECD 1998). The third criterion was later set aside at the insistence of the United States on grounds that it is difficult to articulate clearly.

19. US opposition is based primarily on privacy concerns, along with the view that tax competition leads to lower taxes. In the context of countering terrorism financing and money laundering, the two views have led to recommendations to promote the international exchange of information, but to not allow under any circumstances that such information be used for tax purposes (Rahn and de Rugy 2003).

of currency, and forgery can be predicate offenses for money-laundering charges if committed in the United States, but not if committed abroad.[20]

Investigation

Turning to the investigation element of the enforcement pillar, reporting through such mechanisms as SARs is one of the links between the AML prevention and enforcement pillars. However, consistent with complaints about the US government's failure to open a two-way street with the private sector, critics often view SARs as a black hole with little if any feedback as to their relative effect (James 2002).

One feature of the investigative element that has received better marks is the explicit authorization via the 1988 US Anti–Drug Abuse Act to use sting operations to obtain evidence to convict money launderers, which has proved to be an important enforcement tool. For example, Operation Highbind in 1993 and 1994 enabled FBI and Immigration and Naturalization Service agents to pose as drug dealers with dirty money and meet with members of Chinese-American fraternal organizations that functioned in part as laundering rings investing criminal proceeds in illegal gambling enterprises.

Federal agents will often masquerade not as customers but as providers of money-laundering services. Such was the case in Operation Juno in 1996, when IRS and Drug Enforcement Administration (DEA) agents ran a stock brokerage that laundered $14.5 million in drug profits through the black market peso exchange.[21] One of the most prominent money-laundering sting operations was Operation Dinero, when DEA agents opened an offshore bank to provide services to the Cali drug cartel.[22] Over the course of six months, they laundered $52 million, recovered nine tons of cocaine, and uncovered ties between the cartel and Italian organized crime.

Prosecution and Punishment

Little is known about how prosecutors make resource allocation and prosecutorial decisions in money laundering or other cases. Mariano-Florentino

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20. Seven of the 20 categories of crimes explicitly cited by the FATF for coverage under national AML legislation are not considered for this purpose to be crimes in the United States if the offense is committed outside the country. The other four categories are sexual exploitation, counterfeiting of products, environmental crime, and insider trading and market manipulation. The last is a particularly sensitive area because the US approach in this area differs substantially from that of many other jurisdictions in that it is not grounded on a definition of the underlying offense.

21. See www.usdoj.gov/dea/major/juno.htm (accessed November 12, 2003).

22. See www.usdoj.gov/dea/major/dinero.htm (accessed November 12, 2003).

Cuéllar (2003) is critical of the failure of the law enforcement community to use the AML enforcement pillar more actively to disrupt the financial infrastructure of criminal activities. Sentencing guidelines, which may or may not be followed closely, govern subsequent punishments (see chapter 5).

R. E. Bell (2001), writing from a British perspective, lays out a useful two-by-two taxonomy of prosecutorial approaches involving the nature of the offense and the prosecution. He asserts that most common are prosecutions in which the charge of money laundering is linked with the charge for the underlying offense, of which money laundering was an integral part. Less common are prosecutions in which the money laundering was outsourced, but the prosecution of the money launderer is integrated with the prosecution of the person who committed the crime. Integrated money laundering in stand-alone prosecutions, according to Bell, is reserved for big international cases where the crime is committed in another jurisdiction. Least common are cases involving outsourced laundering in stand-alone prosecutions, because they are the most difficult and resource intensive to develop. Unfortunately, there are no data publicly available to test these plausible assertions about relative incidence.

Confiscation

Confiscation of the proceeds of crime through seizure and forfeiting procedures is a powerful element of the US enforcement pillar. However, criminal forfeiture was outlawed by Congress in 1790 and not reintroduced until passage in 1970 of two major pieces of legislation directed at combating organized crime: the Racketeer Influenced and Corrupt Organization (RICO) and the Continuing Criminal Enterprise (CCE) Acts (Truman 1995).

Not only does confiscation serve as a deterrent to criminal activity and deprive criminal organizations of resources, but it also helps to fund law enforcement activities. Such tied funding violates recommended best practices in public finance, since the revenue side of government finance should be separated from the expenditure side. Moreover, confiscation and forfeiture can create odd incentives. In a number of states, including Indiana, Missouri, North Carolina, Washington, West Virginia, and Wisconsin, forfeited property under state law goes to education, but when the property is seized and confiscated in collaboration with the federal authorities, the state law enforcement authorities can keep what is returned by the federal authorities for their own use, which is 80 percent of the total amount confiscated.

Such arrangements may distort law enforcement in the direction of pursing cases that have larger expected value in the forfeiture dimension, which may not be the same as those with larger expected value on the scale of other enforcement priorities, such as addressing the most heinous crimes. As Rep. Bob Barr (R-Georgia) said in 1999, "In many jurisdictions, it [confiscation] has become a monetary tail wagging the law enforcement dog".

Senator John Kerry (1997, 176), reflecting on his experience as chairman and ranking member of the Senate Subcommittee on Terrorism, Narcotics, and International Operations, warned against the "dark and dangerous underside" of asset seizure in which defendants buy lighter sentences by bargaining with hidden property. Nevertheless, the tool is widely used in the United States at the federal as well as the state and local levels.

As noted, one important aspect of the confiscation element is the sharing of the proceeds with other jurisdictions. A longstanding program for the equitable sharing of forfeited property with other federal, state and local jurisdictions is governed by published guidelines.[23] In addition, since US ratification of the 1988 UN Drug Convention, the United States has had a program of equitable sharing of forfeited assets with foreign governments that cooperate and assist in investigations. From 1989 to March 2002, the international program shared 44 percent ($171.5 million) of eligible forfeited assets with 26 foreign governments (US Treasury 2002, 61).

A final noteworthy aspect of the enforcement pillar is related to one of the reasons behind asset sharing, which is to encourage cooperation and the sharing of information; this is important not only between governments and levels of government but within a given level of government. A significant step forward in this area was the establishment in 1990 of FinCEN in the US Treasury Department as a central repository of information, with the additional mandate to analyze the information from such sources as SARs.

US National Money-Laundering Strategies

The US Congress passed the Money Laundering and Financial Crimes Act in 1998 in part to improve coordination of the nation's anti–money laundering efforts. The act mandated the Secretary of the Treasury, in consultation with the Attorney General, to develop an annual National Money Laundering Strategy (NMLS) for presentation to Congress over the five years from 1999 to 2003 in February of each year.

The intention of the reports was to cover research-based goals, objectives, and priorities; coordinated prevention measures; detection and prosecution initiatives; and proposals for partnerships with the private sector and cooperation between federal, state, and local officials.[24] The Treasury also was required to submit an evaluation of the effectiveness of US AML policies, an additional task that the US Treasury argued was fulfilled by the

23. The program began in October 1986 with an amendment to the Tariff Act of 1930.

24. The act also mandated identification of "high-intensity financial crimes areas" as part of a stepped-up enforcement effort on which the NMLS was to report. Most of the progress in this area reflected efforts that were already under way in 1998.

NMLS itself (GAO 2003a, 67). The 1999 NMLS was completed and delivered on September 23, 1999.[25]

In many respects, the legislation requiring the NMLS reports reflected the same concerns as those behind the National Drug Control Strategy, an annual report mandated since 1988. Many agencies are involved in dealing with the same problem and need to find meaningful progress indicators. A review of the five NMLS reports—using the framework for the AML regime that involves three broad types of AML goals, the two-pillar regime, application of the market model to money laundering, and evolution of the regime—illuminates the structure and goals of the US AML regime as well as some of the trade-offs and constraints it has faced.

Each NMLS included on average 55 action items (from a high of 66 in 1999 to a low of 48 in 2003) grouped under three to six major objectives. The action items covered a wide range of issues and were much too numerous to constitute a particularly pointed strategy or even to be completed in a period as short as a year. It was difficult to identify the highest-priority items because they were all presented with roughly equal emphasis. The apparent aim of the NMLS was to present a broad strategy rather than specify precise and well-defined objectives. One consequence of this approach was that many items were implicitly carried over from one year to the next, even while new items were added identifying new initiatives or reflecting changing circumstances. The most notable example was a shift in emphasis to countering terrorist financing following the attacks of September 11, 2001.

The NMLS was thus largely an annual report on major aspects of ongoing AML initiatives by various agencies of the US government. Little effort was made explicitly to follow up on issues raised in the previous year's report, even though the Money Laundering and Financial Crimes Act required just such follow-up. The result was a pattern of promises but with limited public disclosure of results. For example, an interagency report on US policy toward foreign government officials (kleptocrats) who use the international financial system to convert public assets to personal use was completed in November 2000, but the results were neither published nor mentioned in the next year's NMLS.[26] Another example was a study completed in 2001 by the Customs Service, summarized briefly in the 2002 NMLS but not released, on percentage commissions charged to launder money in narcotics cases, based on undercover cases. Despite a stated intention of posting the entire study—which included such important information as the annual costs of compliance with the Bank Secrecy Act—

25. As is frequently the case with mandated reports to Congress, only one (the 2000 NMLS) arrived roughly on time (March). The 2001 report was released on September 12; the 2002 report in July; the 2003 report in November.

26. In the interests of full disclosure, Edwin Truman was involved with this project. One innovation in the 2000 NMLS that generally was carried forward was the identification of responsible officials (by position) or groups of officials for each action item.

only a summary of a related report prepared by FinCEN and Deloitte & Touche on the costs of SAR preparation was ever posted (FinCEN 2002).

There were some exceptions in terms of adequate follow-up of previous proposals. In the 2002 NMLS, an important action item from 2001, to study the use of the Internet to raise and move funds to terrorist groups, resulted in a thorough report entitled *Terrorist Financing Online,* included in the 2003 NMLS (US Treasury 2003, appendix H) with supporting analysis of actual and potential policy responses. (See box 4.2 for a more general discussion of money laundering and electronic finance.)

Notwithstanding their shortcomings, the five NMLS reports provide useful illustrative material on the objectives, structure, and evolution of the US AML regime. Table 4.3 presents the distribution of action items in the five strategies across the three broad goals of the US AML regime to reduce predicate crime, promote the integrity of the financial system, and address the global, "public bads" of terrorism, corruption, and failed states (chapter 1). For the five-year period of the strategies, about 65 percent of the action items concerned predicate crime and about the same percentage involved integrity of the financial system. The pattern was quite uniform until the final year, when the share of items focused on crime fell off and those focused on the financial system rose. The three global "public bads" generally received much less attention—even in the post–September 11 period covered by the 2002 and 2003 NMLS reports, less than 30 percent of the action items addressed this AML regime objective. The few action items classified as addressing failed states, for example, were aimed at countries that failed to adopt or live up to international AML standards.

Table 4.4 shows the distribution of the same action items across the elements of the prevention and enforcement pillars of the US AML regime. Each of the four elements in each of the two pillars was addressed to some extent over the five-year period, but in general prevention received more emphasis than enforcement.

Within the prevention pillar, the reporting element (e.g., extension of SAR requirements) generally received the most emphasis, but not in all years. Customer due diligence was the next most frequently addressed element, but in the 2003 NMLS the largest number of action items matched up with the supervision element, in part because of enhanced efforts to combat terrorist financing.

Within the enforcement pillar, the investigation element received the most attention in every year, accounting for about 40 percent of all action items over the period as a whole. Prosecution and punishment were emphasized substantially less but were second, followed by confiscation and augmentation of the list of predicate crimes.

The element of identification of predicate crimes received relatively more attention in the 1999 and 2000 NMLS reports, when the Clinton administration sought to expand the enforcement scope of the AML regime by passing new legislation, an effort that failed in both years. The 2001 NMLS, the

Box 4.2 Electronic finance and money laundering

Electronic finance has opened a new frontier for the global anti–money laundering regime, as well as for the criminals it aims to apprehend. The interaction of technical change with finance and business can take the form of electronic banking, Internet payment systems, or electronic debit cards such as smartcards. The lightly regulated Internet, which combines considerable anonymity with a global scope and electronic speed, is a major concern with respect to money-laundering techniques and the financing of terrorism. Such mechanisms open up opportunities for new types of crime such as cyber fraud that can drain funds from a bank account in Pittsburgh and transfer them to an account in Dubai.

Although such impersonal interactions suggest new ways to disguise the movement of funds, the basic challenges they present in terms of prevention and enforcement are fairly familiar. The opportunities provided by electronic finance to move and launder substantial amounts without interacting with the core financial system are severely limited. For example, drug dealers cannot deposit actual cash in an electronic bank, as the cash first has to be physically deposited in an institution. Electronic cash has to be uploaded to a smartcard from an account in some type of financial institution located somewhere that can be required to keep records of such transactions.

Consequently, the elements of the AML prevention pillar as they are applied to institutions in the core financial system can be brought to bear on electronic finance. The surface anonymity of the interactions may make customer due diligence and reporting suspicious transactions more difficult, but banks and other institutions in the core financial system have the same anti–money laundering obligations relative to their electronic customers as they do relative to their flesh and blood customers. Moreover, in a number of major jurisdictions, those obligations can be and have been imposed on the virtual institutions of electronic finance.

The elements of the enforcement pillar also are available to investigate and prosecute crimes involving electronic finance. Such investigations may involve different skills, but in some cases trails may actually be easier to follow through the Internet, for example, because Internet messages normally leave records behind. Techniques are available to disguise Internet tracks by passing messages through sites called “anonymizers,” but deciphering disguises and following leads that go cold is not new to 21st century law enforcement. A more significant challenge, as with other aspects of the global AML regime, is to improve international cooperation associated with different priorities, procedures, laws, and regulations.

As noted in the 2003 *National Money Laundering Strategy,* the Internet poses unique additional challenges with respect to the specific area of terrorist financing (US Treasury 2003, appendix H). However, most of those challenges are not associated with the actual movement of funds, aside from the familiar fact that the amounts are small and the terrorist act occurs after the funds have been used. The principal additional challenges come from the fact that terrorists use the Internet both to communicate and to raise funds through such institutions as charities.

In sum, while electronic finance may be a new frontier for the global anti–money laundering regime, the frontier is located not in another part of the universe but in the same world where ground rules of economics and finance apply. To be effective, the global regime must build on what it already has started to do, which is to address the challenges posed by electronic finance on an ongoing basis.

Table 4.3 Distribution of US *National Money Laundering Strategy* action items across AML goals, 1999–2003
(percent of all action items)

Goal	1999	2000	2001	2002	2003	Five-year total[a]
Reducing predicate crime	67	90	83	78	10	66
Promoting integrity of financial system	65	57	63	48	81	63
Reducing global "public bads"	7	6	2	28	24	13
Memorandum:						
Total number of action items	66	58	41	50	48	263

a. Number of action items affecting each anti–money laundering goal as a percentage of total number of action items over five years.

Note: Some action items addressed more than one anti–money laundering goal.

Source: National Money Laundering Strategies (US Treasury 1999–2003).

first strategy issued by the Bush administration, which was drafted before September 11 and coincidentally issued the next day, included only one item that matched up with the predicate crimes element, a general commitment to submit a "money laundering bill which will address [unspecified] deficiencies" in the then current statutes.

It took the tragedy of September 11—an example of how the AML regime has been shaped by events—for the Bush administration to embrace the Clinton administration's legislative proposals and move them through the Congress. Most were subsequently incorporated into the USA PATRIOT Act.[27] For example, as proposed by the Clinton administration and at the urging of other OECD countries, the post–September 11 legislation made foreign official corruption an offense that can be prosecuted in the United States; criminalized bulk cash smuggling across the US border; and provided the executive branch with additional authority to crack down on foreign jurisdictions, institutions, and classes of transactions thought to pose a serious money-laundering threat.

We also classified the 263 action items in the five NMLS reports on the basis of whether they could implicitly or explicitly be fit into an analytic framework of a market for money-laundering services. An example would be whether the item was intended to tighten the supply of those services

27. The incorporation into the USA PATRIOT Act of Title III (International Money Laundering Abatement and Anti–Terrorist Financing Act of 2001) was largely at the insistence of Democratic Senate leaders, with support from influential Republican senators. The Republican House leadership initially argued for stand-alone AML legislation, which would have met substantial resistance in the House. The final legislation incorporated not only proposals to strengthen and expand the US AML regime, but also important provisions on correspondent banking and private banking. This substantially expanded the US AML regime in directions that had not yet been accepted globally.

Table 4.4 Distribution of US *National Money Laundering Strategy* action items across AML prevention and enforcement elements, 1999–2003 (percent of all action items)

	1999	2000	2001	2002	2003	Five-year total[a]
Prevention						
Customer due diligence	5	28	12	12	10	13
Reporting	26	50	46	38	16	35
Supervision	8	3	5	2	20	8
Regulation and sanctions	5	0	2	2	4	3
General[b]	18	5	24	28	44	22
Total[c]	***55***	***74***	***76***	***70***	***81***	***68***
Enforcement						
Predicate crimes	6	9	2	0	2	4
Investigation	55	45	32	30	28	40
Prosecution and punishment	11	16	12	8	22	14
Confiscation	5	3	12	10	2	6
General[b]	0	3	15	12	31	11
Total[c]	***62***	***64***	***61***	***52***	***69***	***60***
Memorandum:						
Total number of action items	66	58	41	50	48	263

a. Number of action items affecting each pillar/element as a percentage of total number of action items over five years.
b. Items related to the specified pillar but not to any particular element or elements.
c. Excluding items that may involve more than one element of the pillar.

Note: Some action items are classified in more than one pillar or more than one element of the pillar.

Source: National Money Laundering Strategies (US Treasury, 1999–2003).

by limiting certain types of laundering channels, or to reduce the demand for money-laundering services by increasing the probability of confiscation. On average, only about a third of the action items in each area could be interpreted in this manner.

Almost a quarter of the annual action items in the five strategies called for further study or research with regard to money laundering and the AML regime. The incidence was considerably higher in the 2000 and 2001 NMLS reports, more than 30 percent, and about average in the 1999 NMLS, but substantially below average in the 2002 and 2003 reports. Note that the sharp break in this tendency is not between the Clinton and Bush administrations but with the two strategies prepared after September 11.

One carryover from the Clinton to the Bush administration was an effort to review the federal government financial resources devoted to anti–money laundering at the federal level, with a view to eventually ensuring the appropriate and effective allocation of resources. The 2000 NMLS included such a review along with a "rough cut" set of estimates, but the initiative apparently did not reach fruition because in the 2001 NMLS a new action item was included to review the costs and resources devoted to anti–money laundering efforts, this time to allow for more informed bud-

get allocations. A high-level interagency working group was formed to accomplish this task. The 2002 NMLS, which, as noted, was the only one of the five strategies systematically to follow up the action items in the previous report, stated that analytical disagreements between agencies prevented fuller development of the material submitted. Nevertheless, the work was to continue during 2002 and incorporated the element of resources devoted to stopping the financing of terrorist entities. The effort apparently has not been successful to date, since the 2003 NMLS did not mention its continuation.

Such limited follow-up and disclosure not only hindered the overall success of the NMLS but also undercut the effectiveness of the interagency cooperation that the NMLS approach was intended to encourage. Such cooperation would have been strengthened through public commitments to build on the progress that had been achieved, and with more consistent identification of those to hold responsible for that progress. For example, despite numerous statements of good intentions to develop comprehensive databases on money-laundering cases, as called for in the 2001 NMLS, the NMLS of the following year (US Treasury 2002, 10) reported that "the cost involved in taking any one system used by a federal law enforcement agency as the relevant model outweighed the potential benefit, since different investigative agencies have different goals, missions and performance measures." The 2003 NMLS, in turn, made no mention at all of developing uniform databases, leaving one to assume that the idea was abandoned as attention shifted to countering terrorist financing.

Touching on another important area of cooperation, more than 10 percent of the action items in the five NMLS reports called for consultation with the private sector, with no significant difference in the incidence of such items between the first two and the last three strategies. Action items in the NMLS for 1999, 2000, and 2003 explicitly although briefly recognized privacy concerns.

A prominent element of the first three NMLS reports was interagency and intra-agency studies of the role of "gatekeeper" professions (lawyers, accountants, auditors) in efforts to combat money laundering, including ways to better inform them of their responsibilities, and how, or even whether, to best incorporate coverage of their activities within the AML regime prevention pillar. By the 2001 NMLS, incorporation of these professional categories was directed toward formulating the US position on the revision of the FATF Forty Recommendations in this area. The 2001 NMLS (p. ix) quoted President Bush on the relevance of the professions to the AML regime: "We will aggressively enforce our money laundering laws with accountability and coordination at the Federal, State and international levels. Our goal is to disrupt and dismantle large-scale criminal enterprises and prosecute professional money launderers, including corrupt lawyers, bankers, and accountants." Although this statement does not explicitly recommend extending the prevention pillar to cover lawyers and

accountants, it certainly is consistent with such a reading. Nevertheless, to date those professionals have resisted being included in the prevention pillar of the US regime.

Also prominent in the first two NMLS reports was a focus on taxation, particularly in terms of promoting effective fiscal enforcement, addressing harmful tax competition problems that had been flagged in the 1998 OECD study, examining tax havens, and considering expansion of the list of US predicate crimes to "selected tax crimes." This topic was not included in the 2001 and 2003 strategies, but surfaced in the 2002 NMLS as a call for improving the international exchange of tax information. Raising taxation issues illustrates how the early NMLS process was responding to international concerns about harmful tax practices, including criticism of the US AML regime for not treating foreign tax evasion as a predicate crime with respect to US money-laundering prosecutions or legal assistance.

The taxation issue also illustrates the influence of domestic politics on the AML regime. Although the positions of the Clinton and Bush administrations on the basic issue of harmful tax practices were not substantively different—both favored enhancing information exchange and enforcing international financial standards—the accompanying rhetoric was quite different. The Clinton administration was more receptive to concerns of other countries about low- or zero-tax jurisdictions in the context of tax competition, while the Bush administration, with its antitax orientation, was much less receptive, particularly with respect to the treatment of certain Caribbean jurisdictions. The privacy issue resonated more within the Bush administration, notwithstanding the fact that it was mentioned at least as often in the first two NMLS reports prepared in the Clinton administration as in the last three NMLS prepared in the Bush administration.

A review of the National Money Laundering Strategies illustrates several important points. First, it confirms the relevance of the three broad types of goals for the AML regime: reducing predicate crime, maintaining the integrity of the financial system, and combating global "public bads." Second, it supports the view of the AML regime as having prevention and enforcement pillars with multiple elements. Third, it provides limited but weak support for the market model of the AML regime. Fourth, more broadly speaking, it provides evidence that the AML regime is not an abstraction—its evolution reflects shifting priorities, compromises, and trade-offs. We return in chapter 8 to the future of the US NMLS and our recommendations for it.

The Global Anti–Money Laundering Regime

Globalization in the form of an increase in the volume and speed of flows of international as well as national goods, funds, and information has played a major part in conditioning the evolution of the global AML re-

gime. Lawrence Summers, then Deputy Secretary of the US Treasury, told the Financial Action Task Force plenary on June 26, 1996: "At the very moment that the world economy is expanding and integrating, creating vast new opportunities for business, so the technology and capacity at the disposal of criminals is greater than before."

Four years later, at a meeting of the IMF's International Monetary and Financial Committee, Summers, by then secretary of the US Treasury, ratcheted up his rhetoric several notches. "Abuse of the global financial system is a clear case of a 'global public bad'—indeed, it is the dark side of international capital mobility," he said. "The international community has begun to take action against financial system abuse, including the public release of three lists of uncooperative or problematic jurisdictions [with respect to money laundering, practitioners of harmful tax practices, and lax financial supervision], and has called on the international financial institutions to join this effort. Assisting this effort should be seen as an integral part of the international financial institutions' mandate to protect the integrity of the international financial system. Money laundering activities have the potential to cause serious macroeconomic distortions, misallocate capital and resources, increase the risks to a country's financial sector, and hurt the credibility [or] integrity of the international financial system."

Summers was by no means alone in his assessment. Prior to the 2000 G-7 summit in Japan, the G-7 finance ministers stated in a report entitled "Actions Against Abuse of the Global Financial System": "Financial crime is increasingly a key concern in today's open and global financial world, which is characterized by the high mobility of funds and the rapid development of new payment tools." The actual G-7 summit statement on the topic read: "To secure the benefits of the globalised financial system, we need to ensure that its credibility and integrity are not undermined by money laundering, harmful tax competition, and poor regulatory standards."[28]

These statements illustrate two points about the interaction of money laundering with the globalization phenomenon and the stability of the financial system. First, globalization, and the deregulation that helps promote it, assists money launderers in their criminal activities. Second, the global spread of criminal activity, and the associated phenomenon of money laundering that fuels that process and facilitates the amassing of substantial financial resources, undercut public support for globalization. Vigorous efforts to deal with these problems are understandably limited by considerations of privacy and human rights, and by concerns about the arbitrary use of state power. However, these concerns can also constrain the capacity of governments to deal expeditiously and effectively with money laundering and other criminal activities, which in turn further undercuts support for globalization. The global "public bads" linked to money laun-

28. See Wechsler (2001) for a description of the Summers strategy on these issues.

dering are reckoned by some to outweigh the global "public goods" associated with globalization.

Differences between the US AML regime and those of other nations and regions also continue to impede multilateral efforts to achieve a uniform global regime. While the current global regime has been shaped and prodded to a considerable extent by US developments and initiatives, different forces have at times affected the structure and evolution of other national regimes. For example, the principal concern that prompted establishment of the Australian AML regime in 1990 was tax evasion rather than drugs. In the United Kingdom, concerns about drugs and terrorism dominated in the 1980s, even though comprehensive money-laundering regulations including customer due diligence and reporting requirements for the financial sector did not go into effect until 1994. (Table 4.1 provides a chronological list of the major developments in US, European, and global or multilateral anti–money laundering regimes. The glossary provides thumbnail descriptions of the major entries.)

Despite differences across regimes, and notwithstanding the enormous complications posed by globalization itself to combating criminal activity, the prevention and enforcement pillars of the global anti–money laundering regime have evolved rapidly over the past 15 years. At the very least, as William Gilmore (1999, 204) concluded, while "the strategy will not eradicate international drug trafficking or international organized crime, it will . . . create an increasingly hostile and inhospitable environment for the money launderer and others involved in highly lucrative forms of criminal behavior and afford new elements of protection to economic and political systems. To achieve this is to achieve something of real and lasting value."

Prevention

Customer due diligence is an area where the US prodded other jurisdictions to adopt a parallel component in their AML regimes. The 1986 US MLCA legislation required the chairman of the Federal Reserve Board, who was then Paul Volcker, to consult with his fellow Group of Ten (G-10) central bank governors at the Bank for International Settlements (BIS) about money laundering and bank efforts to control the activity. The legislation pointed out that money laundering is a global phenomenon and that if one country's banks and financial institutions are required to implement AML measures—increasing their costs and turning away their customers—then the same standards should be applied globally to reduce regulatory arbitrage and level the playing field.

The initial reaction of Volcker's central bank colleagues was horror—they maintained that central bankers and bank supervisors should be concerned more about the safety and soundness of individual banks than about the stability of the banking system. Under this view, banking super-

visors should not become involved in law enforcement, which is the responsibility of the judiciary and the police. Calmer heads prevailed, but this episode illustrates the tension between the prevention and enforcement pillars of AML regimes.

The principal result of the US initiative was that the Basel Committee on Banking Supervision in 1988 issued a statement of principles regarding the obligations of banks to know their customers, avoid suspicious transactions, and cooperate with law enforcement authorities. An associated working paper acknowledged that differences in roles and responsibilities of national bank supervisory agencies in the suppression of money laundering at the time reflected "the role of banking supervision, the primary function of which is to maintain the overall financial stability and soundness of banks rather than to ensure that individual transactions conducted by bank customers are legitimate" (Basel Committee on Banking Supervision 1988, paragraph 3). However, the report added that "despite the limits in some countries on their specific responsibility, all members of the [Basel] Committee firmly believe that supervisors cannot be indifferent to the use made of banks by criminals."

The involvement of the Basel Committee in the anti–money laundering campaign marked a significant step not only because it recognized the risks of regulatory arbitrage and the need for a level global playing field, but because it involved the setting of international standards. Following the Basel Committee's lead, the International Organization of Securities Commissions (IOSCO) issued a resolution on money laundering in 1992. In 2002, the International Association of Insurance Supervisors (IAIS) issued Anti–Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities.

Switzerland is an example of a national AML regime that evolved quite differently than the US regime. The Swiss trace their concern with money laundering to adoption of a code of conduct by the Swiss Bankers Association in 1977 in the wake of the Chiasso banking scandals, which began as simple fraud in the early 1960s and ended up as major financial and embarrassment for Credit Suisse and much of the rest of the Swiss banking system. The Swiss approach places heavy emphasis on deep knowledge of customers, which is well justified in a banking system principally oriented toward private banking and investment management rather than retail banking.

In addition, in Switzerland as in Germany and France, suspicious activity reports are commonly based more on strong evidence than on hunches, and they more often lead to criminal investigations than in other countries. The Swiss (Pieth and Aiolfi 2003) argue that their AML regime is more rigorous than the US AML regime; US observers such as former treasury official William Wechsler (2001) think they have a point.

The Swiss system also relies heavily on the integrity and responsibility of financial institutions to ensure compliance with national AML laws and regulations. In contrast, the US and UK AML regimes operate in financial systems where retail transactions are at least as important as wholesale

transactions and asset management relationships.[29] Pieth and Aiolfi (2003) have characterized the US and UK AML regimes as emphasizing the collection and submission of data to national authorities as part of an "early warning system" that may produce little more than information overload.

Financial Action Task Force

At the Paris Economic Summit of the Group of Seven (G-7) in 1989, France and the United States proposed an initiative that led to establishment of the Financial Action Task Force on Money Laundering (FATF) as a temporary body housed at the OECD but separate from that organization. However, establishing the FATF involved an agreement that it would not address tax issues.

The principal initial motivation for the establishment of the FATF was to combat drug abuse and the financial power of drug traffickers and other organized crime groups whose activities are facilitated by money laundering. Public concern about illegal drugs in the United States had reached extraordinary levels in 1989. The FATF delegations include supervisors, officials from finance ministries, and representatives of ministries charged with law enforcement (in the US case, the Justice Department). This interdisciplinary character has contributed to an impressive amount of intragovernmental cooperation as a positive by-product. The FATF's initial five-year mandate was to assess the results of cooperative efforts and suggest additional preventive steps. That mandate was extended in 1994 and 1999 and extended for a record further eight years on May 24, 2004.

In 1990, FATF promulgated its initial "Forty Recommendations" that provided a general AML framework, starting with ratification and implementation of the 1988 Vienna Convention, outlining the roles of national legal and financial systems and regulators in combating money laundering, and setting forth certain principles of international cooperation.[30] The Forty Recommendations were revised slightly in 1996 and then revised comprehensively in 2003 based on analysis, in light of FATF's review of trends in money laundering, of how far the recommendations should be extended to cover the financial and nonfinancial sectors as well as various

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29. So important are retail transactions to the UK financial system that the AML regime there is sensitive to the charge that the regime itself may impede access to retail financial services. For example, the UK CDD regulations contain a subsection providing guidance about application of the regulations to limit the risk of financial exclusion.

30. In 1991, the European Community adopted its first directive on money laundering that sought to establish minimum standards throughout what is now known as the European Union. Stessens (2000) maintains that the action was motivated in part by other global attempts to address the money-laundering phenomenon, and also by concerns that money launderers or criminals would take advantage of the increasingly free flow of capital and financial services throughout the European Union. The need to establish a level playing field in Europe also was a concern. Gilmore (1999) stresses the particular challenge that human rights concerns have posed to establishing an AML regime in Europe.

"gatekeeper" professions through such methods as due diligence, reporting, regulation and supervision, and international cooperation.

A detailed report prepared in October 2001 by the Basel Committee Working Group on Cross-Border Banking and the Offshore Group of Banking Supervisors on Customer Due Diligence for Banks expanded on the obligations of banks to know their customers and upgrade record keeping to include more extensive due diligence for higher-risk accounts, ongoing monitoring, and proactive account management. The report (Basel Committee on Banking Supervision 2001) became the basis for recommendations 5 through 12 of the 2003 FATF Forty Recommendations on customer due diligence for the full set of financial, nonfinancial, and professional categories listed in table 4.2.

Neither the US AML regime nor the regimes of many other major countries today fully conform to the FATF recommendations in this area. For example, the United Kingdom does not apply the regime to insurance companies because UK authorities to date have judged the risk of money laundering through general insurance business as low (IMF 2003d, 108). The United Kingdom has applied its CDD and reporting requirements to lawyers under its Proceeds of Crime Act of 2002, although compliance has been limited. A 2004 survey by Coleman Parkes Research of companies selling high-value goods, such as car dealers or estate agents, found that two-thirds of such UK businesses do not comply with anti–money laundering regulations with respect to CDD and reporting requirements.

Canada was ahead of other jurisdictions in applying AML regulations to lawyers, but repealed the regulations after they were successfully challenged in a number of provincial courts on the grounds that they eroded the right of Canadians to independent counsel and to confidentiality with lawyers. Canada now leaves to the provinces the responsibility for the supervision of lawyers.

In contrast, the Australian minister for justice and customs announced in December 2003 his government's intention to fully comply with the 2003 FATF Forty Recommendations in order to ensure that Australia's anti–money laundering system "continues to model best practice."[31] At the same time, the government released a full set of consultation documents based on the new recommendations.

With respect to reporting requirements, some countries' AML regimes differ from those of the United States. For example, most other jurisdictions use suspicious transaction reports (STRs), which differ from suspicious activity reports (SARs) in that there has to be an actual transaction involved. A SAR can be about a transaction that may merely have been dis-

31. Press release at www.ag.gov.au/www/justiceministerhome.nsf.

cussed or attempted but not consummated. This may make the STRs more useful because they are more focused, but the distinction, as in the earlier comparison with Switzerland, illustrates differences in AML regimes. In Australia, any overseas remittance is entered into a database for scrutiny, a feature of the AML regime that relies on that country's relatively recent abolition of most formal capital controls. In addition, many non-US jurisdictions do not require CTRs or CIMRs or the equivalent, except to the extent that the underlying activity or transaction might be captured in an SAR/STR.[32]

In the area of supervision and sanctioning of noncompliance, recommendation 29 of the 2003 FATF Forty Recommendations calls for supervisors to have "adequate powers to monitor and ensure compliance by financial institutions" and explicitly includes the authority to conduct inspections to ensure compliance.[33] Some jurisdictions do not allow on-site examinations of financial institutions except under special circumstances, relying instead on the audit process. This in turn means that such jurisdictions may be more amenable to including accountants in their role as auditors as participants in the preventive aspects of the AML regime (box 4.1).

A particular challenge to the global AML regime is the existence of informal funds transfer (IFT) systems, such as *hawalas,* that operate on the unregulated side of the international financial system. Although *hawalas* are found throughout both the developed and developing world, their widespread use in the Middle East and South Asia prompted increased attention after September 11, 2001, despite the fact that those terrorists do not appear to have used an IFT mechanism to fund that operation.

Some argue that *hawalas* or other forms of IFT do not pose a unique money-laundering threat because other mechanisms provide the same opportunities (Passas 2000). Others stress that IFT systems often provide low-cost,

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32. Recommendation 19 of the 2003 FATF Forty Recommendations calls upon countries only to "consider" adopting cash-reporting measures. SAR/STR may also be subject to different minimum reporting requirements in different jurisdictions (for example, 15,000 euros in the European Union and generally $10,000 in the United States, roughly 50 percent lower) and differ with respect to type of financial and nonfinancial business required to submit reports.

33. Recommendation 24b applies to nonfinancial businesses and professions, and sets a lower standard for "effective systems for monitoring and ensuring their compliance with requirements to combat money laundering and terrorist financing," including a potential role for self-regulatory organizations in this area. Countries with dual (federal-state) or only local-level approaches to the regulation and supervision of financial and nonfinancial businesses and professions will find it more difficult to meet this standard. For example, the regulation and supervision of the insurance industry in the United States is largely at the state level although it was reported in the *New York Times* (December 26, 2003) that some large insurance companies are pushing for establishment of a federal regulator to level the playing field in US insurance regulation and to influence federal legislation and regulations that affect insurance firms, including elements of the USA PATRIOT Act.

safe, and convenient services that are not otherwise available to the public (Buencamino and Gorbunov 2002). Still others stress that IFT systems thrive where the formal banking system is weak or nonexistent, or where there are significant distortions or controls in the payments or foreign exchange systems. Mohammed El Qorchi, Samuel Maimbo, and John Wilson (2003) have noted the potential adverse statistical, fiscal, and balance-of-payments implications of such operations.

What is clear is that bringing IFT mechanisms into the global AML regime presents complex problems for both recipient and remitting countries because of the very incentives that have allowed these systems to survive and thrive for generations. Regulations alone will not suffice—*hawalas* are essentially illegal in Pakistan and India, yet they thrive in those countries. High-cost regulations requiring registration, transparency, record keeping, and reporting are not likely to be fully effective because the institutions that can incur the costs will not be able to pass them on to their customers, who will continue to demand low-cost financial services. Reasonably effective incorporation of IFT systems into the global AML regime requires balancing many considerations within individual countries and the international financial system as a whole.

The repeated references in this chapter to the FATF evidence its key role as a standard setter in developing the global AML regime, particularly the prevention pillar. The FATF has limited membership (33 nations or jurisdictions)[34] and operates by consensus—potential constraints that it has addressed by maintaining high standards for its members, and by directly or indirectly sponsoring a number of regional clones, a move that reflects its recognition of the economic and political implications of globalization. The Caribbean Financial Action Task Force (CFATF) was established in 1996, the Asia-Pacific Group on Money Laundering (APG) in 1998, the Eastern and Southern Africa Anti–Money Laundering Group (ESAAMLG) in 1999, and the Financial Action Task Force on Money Laundering in Latin America (GAFISUD) in 2000. In addition, the Council of Foreign Ministers of the Commonwealth of Independent States (CIS), the former Soviet Union, announced in March 2004 that it was considering setting up a regional task force on money laundering. Conspicuous in their absence from the regional list are the Middle East and Central Asia, although by the fall of 2004 plans were under way to create a Middle East–North Africa FATF.

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34. Current FATF members are Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, the European Commission, Finland, France, Germany, Greece, the Gulf Cooperation Council, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

The FATF is without significant enforcement power over jurisdictions that do not live up to its standards. It sponsors self-evaluations and peer reviews of its members, thus exercising global-level supervision, but has limited scope to sanction noncompliance. As of June 2003, even the United States was in full compliance with only 19 of the relevant 28 former FATF recommendations based on a self-assessment of its AML regime. Its shortfalls concerned measures applied to insurance companies and money exchange and transmission operations. Since passage of the USA PATRIOT Act, efforts have been under way to correct these problems.

Starting with the Seychelles in 1996, the FATF also has periodically issued statements critical of the actions or inactions by non-FATF jurisdictions.[35] The FATF's success in forcing the Seychelles government to impose rules on its financial businesses inspired a more comprehensive effort to identify other countries and territories in the world whose regimes to prevent, detect, and punish money laundering did not meet internationally recognized standards (box 4.3). This "name and shame" initiative was launched officially in 2000 with the publication of 25 criteria, based on the Forty Recommendations, for identifying noncooperative countries and territories falling short in their AML regimes (FATF 2000). While most jurisdictions on the list were small, it included some major nations such as Egypt, Indonesia, Nigeria, the Philippines, and Russia.

As of July 2004, six countries remained on the list. One of them, Nauru, a Pacific island with a population of 12,600, has been subject since November 2001 to countermeasures that include the application of old FATF recommendation 21 (see footnote 35) as well as enhanced surveillance and reporting of financial and other relevant actions involving that jurisdiction.[36] The countermeasures require financial institutions to report transactions or attempted transactions that involve the jurisdiction or entities known to be incorporated in the jurisdiction. More recently, such measures were applied to Myanmar/Burma.

Liechtenstein, which was on the initial list, is credited with having accomplished one of the most rapid and impressive reconstructions of its AML regime, but it is left with the historical residue of more than 80,000 shell corporations, some with known unsavory links (including Saddam Hussein).

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35. Regarding the Seychelles, the FATF invoked old recommendation 21 to scrutinize closely business relations and transactions with persons, companies, and financial institutions from countries that do not or insufficiently apply the Forty Recommendations. This aim was to force the Seychelles to repeal its Economic Development Act, which was designed, in the words of US Treasury official Ronald Noble, then president of the FATF, "to attract capital by permitting international criminal enterprises to shelter both themselves and their illicitly gained wealth from pursuit by legal authorities." In the same year, the FATF also applied recommendation 21 to one of its own members to induce Turkey to pass adequate AML legislation.

36. See chapter 7 for a more detailed account of the Nauru case.

Box 4.3 The FATF Non-Cooperative Countries and Territories Initiative

The Financial Action Task Force (FATF) undertook an initiative in 1999 to identify jurisdictions that had inadequate AML regimes and were not cooperating sufficiently with the global AML effort. The FATF issued its first report (FATF 2000) the next year on the basis of 25 assessment criteria applied to four areas: (i) financial regulations, including customer identification, excessive financial secrecy provisions, and lack of a suspicious transactions reporting system; (ii) other regulatory impediments, including registration requirements for certain types of businesses and their beneficial owners; (iii) obstacles to international cooperation, including administrative and judicial constraints; and (iv) inadequate budgetary outlays for anti–money laundering activities and the lack of a financial intelligence unit (FIU) or similar entity.

During two rounds in 2000 and 2001, the FATF reviewed 46 countries or territories as part of what has been called its "name and shame" process. The 15 territories included dependent territories such as Bermuda and autonomous territories such as Aruba. In 2002, the FATF suspended new reviews while cooperating with the IMF and World Bank on their reviews of compliance with global AML standards, but FATF continues to monitor jurisdictions that it previously reviewed. On the first or second round of its reviews, the FATF "passed" 23 and "failed" 23 jurisdictions. Of the latter group, 17 later "passed" as the result of subsequent reviews. The AML regimes of six jurisdictions have not yet been passed by the FATF: Cook Islands, Indonesia, Myanmar/Burma, Nauru, Nigeria, and the Philippines.

As part of this process, the FATF has threatened to endorse the application of countermeasures on jurisdictions that do not make adequate progress to improve their AML regimes. Under the original FATF recommendation 21, these countermeasures were envisaged as being applied to jurisdictions with serious deficiencies in their AML regimes. The measures may include more stringent customer due diligence requirements, enhanced reporting requirements, limits on establishing financial institutions in FATF countries, and warnings to nonfinancial-sector businesses with respect to dealings with entities in those jurisdictions. The threat of countermeasures was applied to Nauru, the Philippines, and Russia in 2001, Nigeria and Ukraine in 2002, and Myanmar/Burma in 2003. In the cases of the Philippines, Nigeria, and Ukraine, the threat was later lifted because those countries made some progress in improving their AML regimes. In the case of Russia, sufficient progress was made that it was admitted to the FATF as a full member. The countermeasures were applied to Nauru and Burma/Myanmar.

The FATF has also conducted mutual assessment reviews of the AML regimes of its members, which currently number 33. Two members are regional institutions: the European Commission and the Gulf Cooperation Council. Except for Russia, none of the other 31 members has "failed" a FATF assessment. Thus, the 30 other FATF jurisdictions, including Hong Kong, which is an autonomous territory of China, can be said to have "passed" their mutual assessment FATF reviews.

If Liechtenstein is to move on to clean up this residue, it will require the cooperation of other jurisdictions.

The FATF, International Monetary Fund (IMF), and World Bank agreed in the fall of 2002 on a one-year pilot project to assess compliance with measures to combat money laundering and the financing of terrorism. The project in effect transferred most of the peer reviews and evaluations of FATF members and nonmembers to the other two organizations as a step toward

a global supervision system.[37] Drawing largely on national experts, the IMF and World Bank organized overall assessments in cooperation with the FATF and FATF-style regional bodies.

Guidelines also were established for the use of independent experts with regard to criminal law enforcement matters and nonprudentially regulated financial activities of such professionals as lawyers, accountants, and real estate dealers. Their portions of the reports were printed in italics. This was done out of concern about so-called mission creep in the IFIs and out of concern that greater focus on this area would distract them from their core missions.

Participation in an IMF/World Bank review is entirely voluntary, and the country being reviewed itself decides whether the resulting report is published, a procedure that has the potential to negate the "name and shame" mechanism used to press countries with shortcomings.[38] The IMF and World Bank have no powers to sanction, and limited scope to promote compliance through their lending and technical assistance programs.

Under the 2002–03 pilot project, 41 reviews have been conducted (IMF 2004a, 2004c), 33 of them by the IMF and/or World Bank with the help of independent experts, and the remainder done by regional FATFs. As of April 2004, IMF/World Bank reports on 15 of the 19 country reviews that had been completed had been published in whole or in part.[39]

Notwithstanding the drawbacks to IMF/World Bank monitoring of compliance with international standards on combating money laundering and terrorism financing, the G-7 and the FATF called for continuation of the assessment program on a permanent basis, and the executive boards of the IMF and the World Bank agreed in March 2004. They also agreed to fully integrate the treatment of criminal law enforcement and nonprudentially regulated financial activities into a single assessment document, dropping the italics.

Offshore Financial Centers

Following a recommendation of a working group of the Financial Stability Forum (FSF 2000), the IMF also reluctantly undertook a program in 2000 to assess 44 jurisdictions identified as offshore financial centers (OFCs). Part of the IMF's reluctance to become involved in this area related to the fact that

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37. The IMF had already accepted FATF's standards to combat money laundering and terrorism financing as one of its 12 internationally recognized standards and codes.

38. The country reviews are conducted as part of the Reports on Observance of Standards and Codes (ROSCs), which in turn are part of the IMF's more comprehensive Financial Sector Assessment Program (FSAP) that sometimes involves an in-depth Financial System Stability Assessment (FSSA). ROSCs discuss compliance in a general context, while full assessments also include detailed ratings of compliance.

39. The reviews for Bangladesh, Honduras, Israel, and Tanzania had not been published.

nearly half of the jurisdictions were not Fund members. Several were dependencies of members, such as Montserrat, which is an overseas territory of the United Kingdom. In addition, some Fund members perceived the assessment task as being only loosely related to the institution's core responsibility to ensure macroeconomic and financial stability. Their concern was that the program could take resources and focus away from the Fund's principal tasks. After the assessment program was up and running, and perhaps in response to those sentiments, program director Barry Johnson stated: "First, let me be clear that the IMF does not chase criminals. We help jurisdictions set up the necessary legal and financial infrastructure, provide technical assistance to draft laws and regulations, work with the authorities to develop the required expertise and set up the financial intelligence units needed to gather information from the financial services industry, and ensure that there are trained staff to implement laws and regulations" (*IMF Survey*, February 16, 2004, 39).

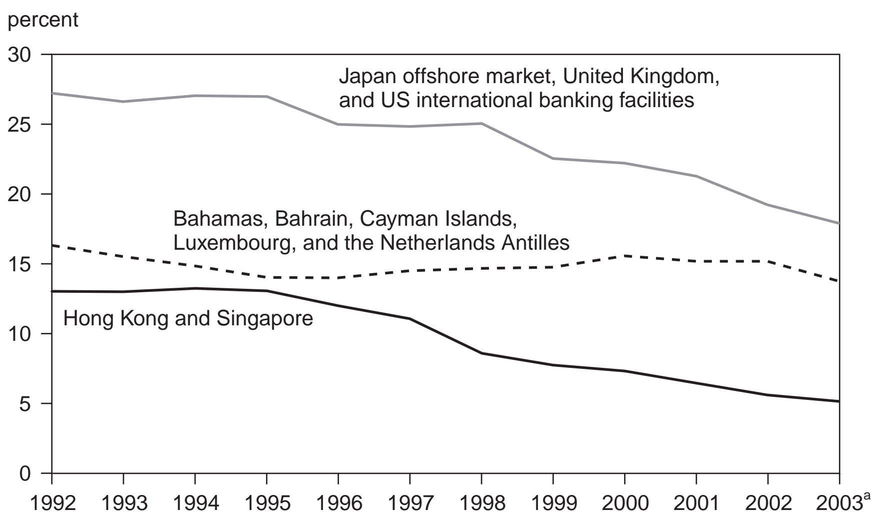
As of November 2003, the IMF had conducted some type of assessment of 40 of the 44 offshore financial centers. The program is regarded as generally successful based on a review by the IMF (2003c) and the Financial Stability Forum (FSF 2004). It is difficult to reach an independent judgment because by mid-2004 reports had been published for only 16 assessments, with publication of another 10 in prospect. The IMF (2003c) review of the program reached four broad conclusions. First, the supervisory deficiencies in offshore financial centers are similar to those in the most other jurisdictions where the IMF has conducted assessments. Second, the wealthier the jurisdiction, the closer it comes to meeting high supervisory standards. Third, the offshore financial center assessments have led to improvements in many supervisory and regulatory systems in the jurisdictions evaluated. Fourth, there is lax supervision and regulation of the nonbanking sector, which is par for the course as AML regimes are established and implemented.

One concern of the offshore financial centers themselves had been that they would lose legitimate business and associated revenues as a result of the assessment process.[40] Figure 4.2 suggests that such concerns may have been misplaced at least with respect to business in 10 offshore financial centers. The share of total cross-border financial assets accounted for by the five jurisdictions normally identified as traditional offshore centers—the Bahamas, Bahrain, Cayman Islands, Luxembourg, and the Netherlands Antilles—has been essentially unchanged for a decade, including since 1999, when OFCs began to receive increased attention. By contrast, the shares of the other jurisdictions in the 10 OFCs—Japan, the United Kingdom, the United States, Hong Kong, and Singapore—have been in a rather steady decline.

Of course, these data are only suggestive. Illegitimate business is probably only a small portion of total business in these centers. Offshore finance

40. See Suss, Williams, and Mendis (2002) for a discussion of the economic motivation for becoming an offshore financial center and an early assessment of the impact of FSF and FATF initiatives on such jurisdictions in the Caribbean.

Figure 4.2 Share of cross-border assets of offshore financial centers, 1992–2003 (percent)



Note: Offshore financial centers' cross-border assets are equal to external positions of banks in individual reporting countries minus local positions in foreign currency of banks in those countries.

a. Data are for the third quarter of 2003.

Source: BIS (2004).

could have attracted more legitimate business to some of these jurisdictions, or the program and associated improvements related to global standards may have had no effect on financial flows. Moreover, smaller offshore financial centers may have lost more business. Esther Suss, Oral Williams, and Chandima Mendis (2002) report that the number of licensed banks in Antigua and Barbuda declined from 58 in 1997 to 21 at the end of 2001 as a result of the attention focused on their offshore financial center activities by the FSF, and because of concerns raised by the FATF's Non-Cooperative Countries and Territories Initiative in 2000.

Enforcement

The enforcement pillar of the global AML regime relies heavily on a number of regional and United Nations conventions (table 4.1). Particularly important are the 1988 UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna), the 1999 OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions the 2000 UN Convention Against Transnational Organized Crime (Palermo), and the 2003 UN Convention Against Corruption.

While these conventions and agreements have succeeded on paper in establishing a common AML framework, in practice there are important differences.

An initial European Commission directive on money laundering issued in 1991 was principally concerned with laundering of drug proceeds and applied only to the financial sector. A second directive in 2001 widened the focus to all "serious offenses" and required members to bring within the coverage of the AML regime auditors, accountants, tax advisers, notaries, other legal professionals, real estate agents, casinos, and dealers in high-valued goods. In June 2004, the European Commission proposed a third AML directive incorporating terrorism into the AML framework and conforming the EU AML regime to the 2003 FATF Forty Recommendations.

There are two basic approaches to criminalizing money-laundering predicate offenses. Under the US approach (used in Japan as well), specific crimes are listed, which has the advantage of pinpointing those types of activities of substantial concern.

The alternative approach, found in most other jurisdictions, criminalizes money laundering in connection with all offenses involving proceeds from the crimes or in connection with all "serious offenses," conventionally defined in terms of a punishment threshold such as a maximum or a minimum imprisonment. This approach has the advantage of capturing what is regarded as serious by the local authorities,[41] but it may exclude categories important to other authorities, thereby undermining the quid pro quo mutual reinforcement of national AML regimes. In general, law enforcement has every reason to support adding concerns ranging from narcotics to terrorism to the AML agenda.

Legislative implementation of enforcement measures around the world has been spotty. For example, according to the IMF/World Bank 2004 assessment report on the Czech Republic's AML regime, that country's definition of money laundering as an offense generally meets the international standard, but the implementing criminal code fails to cover the acquisition, possession, or use of assets with the knowledge that such assets originate from a criminal activity, and sets a higher burden of proof than is consistent with the international standard. Similarly, as of 1993, Greece was a party to various international agreements but had not yet enacted any implementing legislation, and France, Luxembourg, Portugal, and Spain had criminalized money laundering only in connection with drug offenses.

The 2003 FATF Forty Recommendations sought to resolve this dilemma by linking the two approaches. It establishes a definition of "serious

41. Even using a definition of a "serious crime" that specifies either a maximum or minimum does not guarantee uniformity of treatment. Some serious crimes are not "caught" by either test, and in other cases the activity is not a crime.

offenses"[42] and also specifically designates 20 broad categories of predicate offenses for money laundering that include corruption, bribery, market manipulation, and environmental crimes.

However, the designated predicate money-laundering crimes in the 2003 FATF Forty Recommendations do not include tax evasion, consistent with the FATF's mandate to avoid tax evasion. As discussed earlier, this omission not only reveals a lack of uniformity in the global AML regime but can also hinder cooperation. Some countries such as France include tax evasion as a money-laundering offense in their national legislation, but undercut the inclusion because the offense is not reportable by financial institutions.

An Oxfam global report on tax havens in 2000 claimed that developing countries as a group may be forgoing $50 billion in annual tax revenues as a result of tax competition and the use of tax havens. The report does not provide background on how the estimate was derived, so it is impossible to evaluate the figure. However, the figure itself conveys the criticism that the playing field in international finance as regards tax issues is uneven. In August 2003, Secretary-General Kofi Annan issued a report to the UN General Assembly calling for increased international cooperation on tax issues involving money laundering, transnational crime, international terrorism, tax evasion, and tax incentives for investment by competing countries.

With respect to the investigation element of enforcement, some jurisdictions such as the United Kingdom do not condone sting operations. Recommendation 27 of FATF (2003c) endorses investigative techniques such as "controlled delivery, undercover operations and other relevant techniques," but not explicitly sting operations. Jurisdictions also differ in their standards and procedures to enforce due process, human rights, and privacy. The US Casablanca undercover operation in 1998 was regarded as a resounding success in the United States, but the operation and its aftermath created tensions with Mexico. In February 2004, four bankers convicted in Mexican courts in connection with the operation were released when the US sting operation was declared unconstitutional under Mexican law.

Approaches to the structure of the AML regime as well as prosecutions for money-laundering offenses differ across jurisdictions depending in part on fundamental legal principles, such as whether they are based on common law or civil law. For example, under civil law principles it is more difficult to establish criminal liability for legal persons. Common law principles are generally credited with supporting better economic performance (Caprio and Honohan 2001), but the better protection they afford property rights

42. The FATF definition requires a maximum penalty of more than one year of imprisonment or a minimum of more than six months.

tends to get in the way of a tight AML regime in which everything is regulated. These differences and impediments generally are not regarded as insurmountable, but they complicate the establishment of a uniform global AML regime.

Finally, in the area of confiscation, national practices again differ. For example, the 2003 FATF Forty Recommendation 3, citing the Vienna and Palermo UN Conventions, carefully calls upon countries to adopt confiscation measures, outlines the desirable content (identification and freezing of property, preserving the state's ability to recover the property, and investigation), and suggests that countries consider measures to allow confiscation without a criminal conviction, or through procedures that shift the burden of proof to the defender to demonstrate the lawful origin of the property. Cross-country practices are far from uniform in this area, which tends to impede international cooperation by, inter alia, limiting the scope to share assets that might be seized.

On the other hand, most countries have financial intelligence units (FIUs) to combat money laundering, and the 2003 FATF Forty Recommendations include nine (26 through 34) that primarily relate to enforcement issues, including the establishment of FIUs, along with six (35 through 40) that relate to international cooperation on anti–money laundering. The powers of such national FIUs differ, however. For example, the Czech FIU cannot share information with its foreign counterparts in the absence of treaties or conventions. In addition, where an FIU is situated within governmental structures may affect its ability to coordinate information flows and interact with those who are conducting criminal investigations.

The Egmont Group of Financial Intelligence Units established in 1995 now includes more than 80 entities that coordinate their work on money-laundering issues. The aim is to support national programs through the exchange of information (under closely specified conditions), enhance expertise, and foster better communication. Although such organizations as the Egmont Group are not centrally involved in international enforcement—which continues to be handled through traditional police and justice channels governed largely by bilateral and multilateral treaties, conventions, and arrangements (such as mutual legal assistance treaties in criminal matters in the case of the United States)—they represent a significant recognition that enforcement is an important dimension of the global AML regime.

In Europe, the mandate of the Europol Drugs Unit (EDU) established early in 1995 to coordinate actions on drug crimes was eventually expanded to cover criminal activities associated with money laundering. Later in 1995, Europol itself was created and it absorbed the EDU in 1999. The European Union has been faced with more intense coordination and enforcement issues as it has developed and deepened the single market, with a greater need for common rules and areawide enforcement actions.

At the global level, the international police coordination organization Interpol established a Financial and High Tech (FHT) Crimes Sub-Directorate

under its Specialized Crimes Directorate in September 2001. The FHT investigates funds derived from criminal activities, as well as currency counterfeiting and intellectual property rights offenses. It focuses on providing expertise to law enforcement agencies and increasing interjurisdictional communication and cooperation (Interpol 2003).

National and global AML regimes initially exist only in agreements and laws. They are effective only if there is compliance and implementation. For example, in early February 2004, the European Commission notified France, Greece, Italy, Luxembourg, Portugal, and Sweden that they had failed to implement changes in their national laws mandated by the 2001 EC Money Laundering Directive.[43] On the other side of the world, the story is told that the government of Vietnam is unconvinced that it needs to apply CDD to its banks if it owns them.

The World Bank (2003a) makes the case for how money laundering adversely affects developing countries because they are often small and more susceptible to disruption. But it acknowledges that the magnitude of these consequences is difficult to establish because the impact cannot be precisely quantified either in general or for a specific country. In developing countries with limited governmental resources, and where anti–money laundering may, correctly or incorrectly, be regarded as a luxury good, one option for strengthening the global AML regime is to provide technical and financial assistance bilaterally or through international financial institutions.

Costs of the US Anti–Money Laundering Regime

In principle, the gross financial costs of the AML regime should be weighed against the benefits of efforts to prevent and combat money laundering, to which we turn in chapters 5 through 7. Systematic quantitative information on the costs of the AML regime is scarce, so this section draws on scraps of US and British information in order to make a ballpark estimate of the gross financial costs of the US AML regime. That estimate for 2003 is on the order of $7 billion, or about $25 per capita.

An anti–money laundering regime imposes both direct and indirect as well as financial and nonfinancial costs that take three forms: (1) costs incurred by the government or public sector in establishing and administering the regime, (2) costs incurred by the private sector in carrying out the requirements of government, and (3) costs borne by the general public. Were it not for these costs, the standard of zero tolerance for money laundering could be applied to measuring the success of the AML regime in achieving all of its goals. In other words, any dollar of proceeds of crime or

43. The European Union also could have made a major contribution to the global AML regime by limiting the largest new euro note to €100, comparable to the largest US note of $100; instead the largest note is €500.

some other form of those proceeds that was laundered would be proof that the system was flawed.

In addition to the gross financial costs of prevention and enforcement, the potential for information overload, in practice, should also be considered. The government may collect so much information because it perceives the costs of doing so as being negligible, but this approach runs the risk that the massive amount of irrelevant information might drown out information that is of value.[44] The result may be a point on a "Laffer curve" for AML information beyond which additional filings reduce the investigative capability of the government. Pieth and Aiolfi (2003) as well as several reports by the government itself have voiced concern about the collection of excessive information by the US AML regime. The General Accounting Office (GAO 1996) argued specifically that too many CTRs were being filed, imposing unnecessary costs on both the private and public sectors, and undercutting the usefulness of the reporting system. Seven years later, FinCEN (2003a) set a goal to reduce the number of CTRs (now numbering over 12 million annually) by 30 percent. Although the stated aim was to reduce the submission of CTRs with little or no value to law enforcement, and which thus imposed costs for industry, an implicit motivation was to lower costs and increase the effectiveness of CTRs for the US government.

Evidence on the issue of information overload in the United Kingdom comes from KPMG (2003, 16): "The nature of the process at ECB [Economic Crime Branch of the National Crime Intelligence Service], exacerbated by the significant number of poor quality SARs provided by disclosing entities, has led to significant delays in disseminating SARs which have not been fast-tracked." Michael Gold and Michael Levi (1994) reached a similar conclusion.

Problems of incidence and interpretation also are involved. Consider each of the three areas in which the AML regime imposes costs: the government, private-sector institutions, and the general public. The government incurs direct costs through prevention and enforcement, such as operating the SAR and similar databases and investigating specific transactions.

The government uses laws and regulations to shift some of its costs onto financial and nonfinancial institutions and, potentially, independent professions.[45] Banks incur direct costs when they are required to set up inter-

44. Generalizations in this area are difficult in the absence of carefully assembled data. For example, it is possible that the costs of compliance are unknown. The government may bear only a small share of those unknown costs. It may not be in a position to judge costs and benefits for either the private or public sector. It may be unaware of the issue, though that would be unlikely in the often contentious environment of US financial regulations. Finally, the government may not recognize that one of the costs of the AML regime is the less efficient use of any information because of the costs of searching for it.

45. Reinicke (1998) refers to this process of increasingly assigning and delegating information and analysis responsibilities to the private sector as "horizontal subsidiarity."

nal control systems to detect money laundering or systems to generate the data sought by the government. Costs borne by financial and other institutions and businesses may be shifted to customers. Of course, the individual institutions consider the costs net of any direct or indirect financial benefits. Representatives of a number of the institutions interviewed for this study emphasized that they integrate the requirements of the AML regime into their overall risk management systems, and that they see reputation or "image" advantages and other gains from running "squeaky clean" operations.

Also relevant are distinctions between the institution's long- and short-run costs as well as the general level of competition it is facing. Nevertheless, to the extent that the net effective financial costs are positive, the price of the services provided by individual financial institutions and businesses go up; if the institutions use a cost-plus-markup approach to pricing decisions, the general public pays some of the costs. For example, banks raise the price of services to the customer, either directly via monthly fees or indirectly via higher minimum balance requirements to recoup some or all of their net AML costs. A potential indirect effect of this cost shifting is that these price increases may exclude some customers from access to standard banking services such as electronic deposits or check cashing.

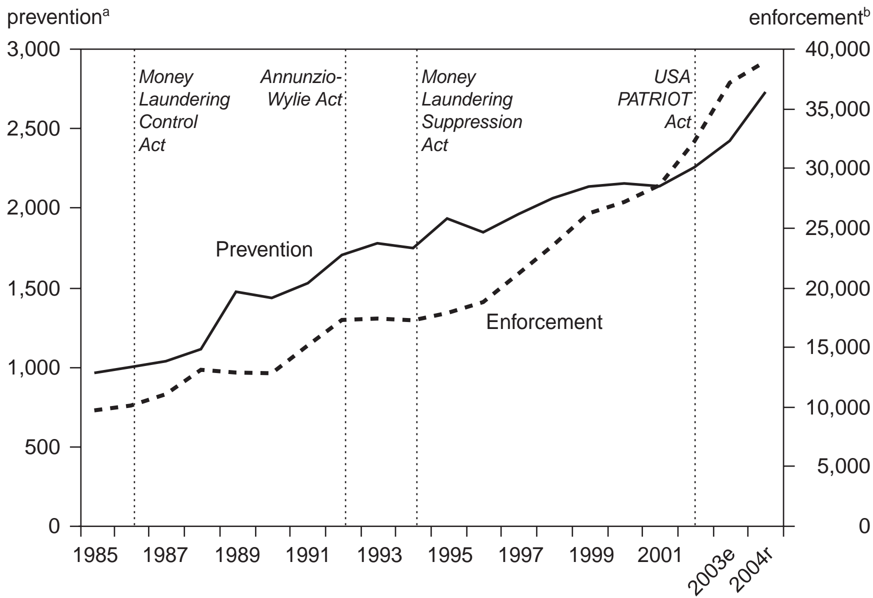
Customers also bear opportunity and transaction costs, since they must provide additional documentation to satisfy the regulations and may experience as a consequence delays and other types of transaction costs. A less tangible b}t often no less important cost to some customers is the increased intrusion, or loss of "privacy." Intrusiveness also can contribute to a will-not-pay or will-not-play posture on the part of customers who either defy the rules or withdraw from participation in the financial system. Either way, the overall effectiveness of the AML regime may be weakened because of a loss of information. Similar compliance problems can arise if AML requirements are perceived to be applied unevenly among customers (e.g., more harshly to individuals than to corporations).

Costs to the Government

No systematic estimates are available for the costs of the various elements that make up the AML regime in the United States or any other country.[46] Moreover, developing such estimates poses complex conceptual challenges. For example, the government's costs to operate SAR and CTR databases can be estimated, but those costs are a small part of total government AML costs and do not include the enforcement costs associated with inves-

46. The best analyses are by the UK authorities, and we rely on them quite heavily. Although the 2000 *National Money Laundering Strategy* initiated a tally of resources that the US government devotes to combating money laundering, the findings were never made public.

Figure 4.3 Trends in US federal prevention and enforcement real outlays, fiscal 1985–2004 (in millions of 1995 dollars)



e = budget estimate
r = budget request

a. Includes outlays for US Treasury and non-Treasury agencies involved in the prevention process. US Treasury agencies are the Office of Comptroller of Currency and the Office of Thrift Supervision. Non-Treasury agencies are the Commodities Futures Trading Commission, Federal Reserve System, National Credit Union Administration, Federal Deposit Insurance Corporation, and Securities and Exchange Commission.
b. Includes outlays in Function 750 (Administration of Justice: federal law enforcement, federal litigative, judicial, correctional activities and criminal justice assistance) of the US federal budget. FinCEN is also included in Function 750.

Source: US Federal Budget, *Annual Report: Budget Review* (fiscal 1985 to 2004). Board of Governors of the Federal Reserve System, fiscal 1985 to 2004.

tigative and regulatory activities employing these databases. Those latter costs are difficult to estimate, in particular the marginal costs, because few investigations focus solely on money laundering. Rather, the AML regime generates data that government agencies use along with other investigative materials in pursuing criminal investigations and developing prosecutions.

Despite such constraints, it is possible to put together ballpark estimates of total US annual (fiscal year) federal outlays for all types of prevention (principally by financial regulators) and enforcement activities, using as a starting point the "750" account of the federal budget covering the administration of justice. Figure 4.3 displays the trends in real (1995) dollars from 1985 (prior to enactment of the 1986 Money Laundering Control Act) to

2004. The data include expenditures associated with the AML regime as well as expenditures associated with other regulatory or law enforcement activities. In real terms, the average annual increase over the period was 6.1 percent for total prevention expenditures, 7.4 percent for enforcement expenditures (almost an order of magnitude larger than prevention), and 7.3 percent for the combined total.

Not a great deal can be said about expenditures on the actual AML regime, although one can ask whether the passage of the four major pieces of AML legislation in the years indicated in figure 4.3 by the vertical lines had a marked impact on our proxies for aggregate prevention and enforcement expenditures.

Over the period measured, the average three-year increase in prevention expenditures was about 13 percent and in enforcement expenditures about 26 percent. These averages can be compared with the three years surrounding the passage of the four pieces of US AML legislation from one year prior to passage, as the base, until two years after passage. For prevention, the comparison reveals that the only above-average increase was surrounding the passage of the MLCA in 1986, and the excess was less than 10 percent; for the other three dates the increase was the same as or less than the average. For enforcement, a similar above-average increase occurred from the base in 1985 to 1988, but the increase from 2000 to 2003 (surrounding the passage of the USA PATRIOT Act) was substantially larger, about 20 percent more than average. Thus, there may have been marked increases in expenditures by the federal government associated with these four major adjustments to the US AML regime, but they appear to have been largely washed out in the aggregate data by other factors affecting regulatory and supervisory expenditures.

A rough rule of thumb is that perhaps 2 to 3 percent of total US government regulatory and enforcement expenditures at present might be attributable to the AML regime.[47] On this basis, the federal government in fiscal year 2003 may have spent something like $1.5 billion on the AML regime, which would be 0.014 percent of nominal GDP in 2003.[48] For the public sec-

47. The costs of AML regime prevention and enforcement are combined with data on other aspects of regulation and law enforcement that have nothing to do with money laundering. This is easiest to appreciate on the law enforcement side, which includes activities (such as Secret Service protection) that have negligible or zero money-laundering components. US government officials generally opt for the lower estimate (2 percent), which is consistent with the "rough cut" estimate of the federal budgetary costs of the US AML regime of $1 billion in fiscal year 2001 presented in the 2000 NMLS (appendix 6). The higher estimate (3 percent) is consistent with the data assembled for this study, which included expenditures by the Federal Reserve System that were excluded from the 2000 NMLS estimates.

48. Suskind (2004) reports that US Treasury Secretary Paul O'Neill subsequently decided that the $1 billion estimate for budget expenditures in fiscal year 2001 should have been closer to $700 million. We were unable to find the basis for his revision, and, as noted, the original estimate excluded costs incurred by the Federal Reserve System.

tor as a whole, including state and local expenditures, the total may have been twice as large, about $3 billion as an upper-bound estimate.[49]

Costs to Private-Sector Institutions

Estimates of AML regime costs to private-sector institutions are similarly elusive. In the case of large banks it is possible to separate out the costs of units explicitly set up to comply with AML regulations and reduce a bank's vulnerability to it. However, internal costs associated with filling out forms and examining customer records for AML compliance cannot be readily separated from other reporting requirements related to the Bank Secrecy Act. Interviews with officials in a number of large financial institutions suggest that it is these dispersed costs that are the principal expense.

The literature on the costs of bank regulation is small, but a review by Gregory Elliehausen (1998) of what is available helps to obtain some sense of the order of magnitude of costs for banks and, by extension, other financial institutions and nonfinancial businesses subject to AML regulations. Elliehausen distinguishes four concepts of costs: opportunity costs when regulation prevents an institution from engaging in a profitable activity; operating costs, divided between start-up and ongoing costs; total costs of the activity, even if not required by law or regulation; and incremental costs specifically associated with the required activity.

Most useful for purposes here are estimates cited by Elliehausen drawing on the work of the accounting firm Grant Thornton (1992, 1993) for the Independent Bankers Association of America. Elliehausen is relatively comfortable with the methodology in these studies, which provide estimates of ongoing operating costs of complying with Bank Secrecy Act regulations as of 1991, including a large component of AML regulations as well as other matters. One Grant Thornton study estimates that compliance with the Bank Secrecy Act accounted for 0.2 percent of individual banks' noninterest expenses, while the other said 0.5 percent. This range translates into between $240 million and $600 million for the entire banking system. Using the larger number and scaling it by the growth of nominal GDP between 1991 and 2003 produces a figure of about $1 billion. A ballpark upper-end estimate of the costs of AML regime compliance for banks would be $1.5 billion in 2003, recognizing that AML requirements have increased over that

49. We did not find even roughly comparable data on the AML prevention and enforcement expenditures by state and local governments, so we were forced to rely on some ready reckoning. Government consumption expenditures at the state and local levels are about 1.7 times those at the federal level, which might suggest applying a larger multiplier to estimated federal expenditures to come up with total government expenditures on anti–money laundering. However, a disproportionate amount of the AML activity is at the federal level, which suggests doubling the estimate for the federal government should produce a reasonable upper-bound estimate of total government financial costs of the US AML regime.

period. The figure might reasonably be doubled to obtain an upper-end guesstimate of $3 billion for all private-sector institutions.[50]

Studies by KPMG (2003) and Pricewaterhouse Coopers (2003) for the UK National Criminal Intelligence Service and the Financial Services Authority (FSA), respectively, provide a partial cross-check for these estimates. The KPMG study provides a "rough estimate" of the current cost of the UK SARs regime for reporting entities of £90 million. If we scale this figure by the size of the US economy relative to the size of the UK economy and convert it from pounds sterling to dollars, the corresponding estimate is $1.1 billion. Since reporting of SARs is an important but only one element of the AML regime, this rough estimate suggests that a figure of $3 billion for the entire US regime is not unreasonable as an upper-bound estimate.

The Pricewaterhouse Coopers study for the FSA reports on the one-time compliance costs of extending customer due diligence to existing customers who had not previously been subjected to CDD because they were customers of the institutions prior to the introduction of those requirements in the United Kingdom in 1994. The study suggests that the costs for banks are slightly more than half those for all major financial institutions.[51] Pricewaterhouse Coopers also compares the costs of the two proposed approaches with the overall AML compliance costs in the United Kingdom. Using the arithmetic outlined above, the comparable total for compliance costs to financial institutions in the United States would be about $2.1 billion, which is in the same ballpark as our estimate of $3 billion.[52] A 2002 study by Celent Communications, a Boston financial-research organization, reportedly concluded that AML spending by US financial institutions in the wake of the passage of the USA PATRIOT Act would total $10.9 billion over 2003–2005, or about $3.5 billion a year. Allowing for the fact that some of these would be one-time costs and Celent might have had an institutional interest in generating a larger rather than a

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50. Excluding real estate from the "finance, insurance, and real estate" category of US GDP by industry, depository institutions account for about 40 percent of the rest of the category, which also includes nondepository institutions, security and commodity brokers, and insurance. On the other hand, the AML prevention regime is currently applied with much greater force to depository institutions, which suggests that doubling the estimate for banks should produce a reasonable upper-bound estimate.

51. Pricewaterhouse Coopers examined two approaches to implementing the AML regime. The finding cited in the text combines estimates of the costs of the more expensive approach with estimates of the costs for six major banks that are already implementing something close to the more expensive approach.

52. The May 9, 2003, *Federal Register* (page 25108) notice of the incremental paperwork burden associated with revisions to the US CDD regulations applied to 22,057 US financial institutions covered by the USA PATRIOT Act. Each institution was expected to incur 11 hours per respondent on average. Assuming that these hours would be divided equally among tellers, bookkeepers, and financial officers on the basis of mean hourly earnings as reported by the US Bureau of Labor Statistics, augmented by 30 percent for benefits, the total cost of this adjustment to the US AML regime was a modest $5.7 million.

smaller estimate, the Celent estimate would appear to be in the same ballpark as the aforementioned estimates.[53] Recall, however, that these are estimates of gross financial costs and do not take into account any financial or nonfinancial benefits of complying with the AML regime.

The two studies for the UK authorities also looked at AML costs to the government. The KPMG study of the SAR regime estimates these costs at only about 12 percent of the costs to reporting institutions. However, that figure should not undercut our guesstimate of the rough equality between the overall costs of the US AML regime to the government and private-sector institutions. Many government costs with respect to prevention, such as drafting regulations and conducting examinations, are unrelated to the actual management of information flows. The United States is also far more active than the United Kingdom in prosecutions (chapter 5). Moreover, our estimate of total US federal prevention costs (figure 4.3) is only about one-fifth of the total prevention plus enforcement costs.[54]

Elliehausen's summary of the research in this area establishes a strong case for the presence of economies of scale with respect to the costs of AML compliance, where assets or some more refined definition of a bank's output measure scale.[55] Fixed costs of compliance reflect such items as computer systems, which account for a large component of start-up costs for AML regimes.[56] However, variable costs may also be lumpy for small institutions; ongoing compliance involves larger proportions of labor costs, but special skills (human capital) are involved. To the extent that a large component of the costs imposed on firms are fixed costs, it is understandable that there is resistance by casinos, the real estate industry, lawyers, and accountants to expanding the AML regime into their lines of business.[57] The AML regime

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53. Celent Communications was cited in *Business Week* (December 1, 2003, 102) as the source for an estimate that more than 13,000 US financial institutions had yet to implement basic watch lists to screen new customers. The firm argued that many small institutions would rather pay a fine than install costly new technology for customer screening.

54. The Pricewaterhouse Coopers study estimates that the cost to the UK government of the expanded retrospective CDD would be a minuscule amount (0.3 percentage points) of the total cost to firms. This low figure is understandable because the change in the AML regime applies principally to the reporters and the cost to the government only involves receiving additional reports but not any subsequent action using the reports.

55. Pricewaterhouse Coopers (2003, 88) reports that large banks benefit from economies of scale in outsourcing some aspects of customer due diligence to credit bureaus.

56. KPMG (2003, 48) estimates that the capital costs of the UK SAR regime are roughly two-thirds of annual compliance costs. On the other hand, Celent (www.celent.net/japanese/PressReleases/20020927/AntiMoneyLaundering.htm [accessed March 8, 2004]) reported that hardware costs were only 6 percent of the estimated total of three-year AML regime expenditures by US financial institutions.

57. HM Treasury (2002) estimates that the cost of extending the UK AML regime to lawyers, accountants, and real estate dealers, converted into dollars and scaled to US GDP, is $2.1 billion. However, it should be noted that the US AML regime does not as yet apply extensively to these professions.

imposes additional one-time costs for continuing in business, as well as subsequent costs resulting from frequent changes in regulations.

A report to Congress on the use of currency transaction reports illustrates some of the complexities of AML regime costs for banks, and presumably for other reporters as well. A survey by FinCEN (2002) of the reasons why banks did not take advantage of the potential exemptions from CTR reporting detected little difference between the responses of so-called megabanks, each with more than $32 billion in assets, and all other financial institutions. Among the more prominent reasons for not using the exemption was that it is not cost effective to change systems once they are in place, suggesting a large role for fixed costs. Other reasons included the additional due diligence costs involved and fear of regulatory action if an exemption were to turn out to be wrong. The survey findings suggest some of the reasons for the potential information overload in the reporting element in the US prevention pillar.

Costs to the General Public

Notwithstanding the economic and social benefits of the AML regime, the general public incurs costs from the increased regulation in the form of reduced efficiency and higher charges. While there is little to go on to estimate out-of-pocket or opportunity costs of the AML regime, comprehensive cross-country research by the World Bank (2004) shows that more regulation in general is associated with lower labor productivity, greater use of the informal economy, increased corruption, and higher costs. There is no reason to believe that such effects of regulation would be any different in the case of the AML regime—the only question is the magnitude of the adverse effects. A topic for future research might be to adapt the World Bank's survey approach in connection with estimating AML regime costs to the general public.

The Pricewaterhouse Coopers report (2003, 75) on expanded CDD in the United Kingdom stated that "a new regulation, which makes it more expensive to enter a market, might be expected to soften the level of competition, to the potential detriment of consumers." In addition, Elliehausen (1998) argues that the policy implications of economies of scale in the costs of regulation are that they inhibit entry of new firms into banking, limit interinstitutional competition, undermine deregulation efforts across the financial sector, and reduce incentives for financial innovation because regulatory costs are relatively high at low levels of output that are associated with the early phase of regulation.

Pricewaterhouse Coopers provides some quantitative insight into the costs of the AML regime to the UK general public. The report estimates a cost per customer of between 7 and 12 percent of the overall cost of implementing the one-time adjustment in the UK AML regime with respect to

CDD, depending on which approach would be chosen. The estimate is based on the customer's time required, the opportunity cost of that time, and any materials. In addition, there may be other transaction costs associated with routine business operations.

What might be a plausible upper-end estimate of the out-of-pocket costs of the AML regime to the US general public? A rough guess is that private-sector institutions are able to shift up to a third of their gross financial costs to consumers, perhaps something on the order of $1 billion per year on the basis of the earlier guesstimate of the $3 billion annual cost of the AML regime to those institutions as a group. We have no empirical basis for this figure, but in the context of our estimate of the costs of the overall AML regime, these costs are not additional to those borne by those institutions. Perhaps a similar figure of $1 billion, which amounts to one-third of the estimated gross costs to financial and nonfinancial institutions and businesses, is reasonable as an upper-end estimate of current additional costs of the AML regime to the US general public. It may be on the high side given the Pricewaterhouse Coopers estimate cited in the previous paragraph, but that estimate appears to be based on a rather narrow conceptual base.

In addition to the general costs of regulation to the public, certain aspects of the AML regime may impose a disproportionate burden on poorer households. For example, requirements to present multiple forms of identification to establish a bank account have created problems in low-income (legal and illegal) immigrant communities. Indeed, as noted above, the United Kingdom provides an exception it its requirements for CDD in part so as not to make access to the financial system too difficult for low-income and immigrant groups. In the United States, the risk-based approach to customer due diligence raises social concerns about possible profiling by country of origin or by race. Moreover, increased regulation in the formal economy is likely to increase reliance on the informal economy. When it comes to money laundering, this means reliance on informal means of transferring funds across borders, which is particularly relevant for legal as well as illegal immigrant workers who transmit a large portion of their earnings back to their countries of origin.[58] One consequence of customers lacking low-cost access to the traditional banking system is a less effective AML regime, because their exclusion makes tracing money that much more difficult. The larger the flow of legitimate funds through unregulated channels, the harder it is to find money laundering through the same mechanisms.

In summary, adding together our crude estimates of the gross financial costs of the US AML regime to the government, private-sector institutions, and the general public produces a rough upper-bound total of $7 billion. The figure includes $3 billion for the government, $3 billion for private-sector institutions (of which $1 billion might be shifted to the general pub-

58. A task force report by the Inter-American Dialogue (2004) estimates total remittances to Latin America in 2002 were $32 billion.

lic), and $1 billion in additional costs for the private sector. Assuming this figure is in the ballpark, it represents about 0.06 percent of US GDP in 2003, or about $25 per capita.

The costs of a given AML regime differ across countries. The United States and some other wealthy industrial countries can establish a comprehensive AML regime at modest cost relative to GDP because they have efficient banks and other institutions with sophisticated internal control systems that make it relatively easy to add AML dimensions. Institutions in poorer nations may have more difficulty in complying with requirements such as the FATF's Forty Recommendations. Similarly, large institutions may enjoy competitive advantages within wealthy nations to the extent that setting up an effective AML system within an institution has substantial fixed costs. Interviews with officials of financial institutions suggest that these are very much second-order issues, but too little is known about them to dismiss them summarily.

Much more attention deserves to be given to the costs of the AML regime, but it would seem that the biggest issue is not necessarily the financial costs. Of course, views may differ with respect to nonfinancial costs, such as intrusions on privacy. In the wake of September 11, the judgment was that additional nonfinancial costs should be absorbed, and the advocates of increased prevention and enforcement received new powers. More recently, the pendulum may have swung back some, but in the United States this is a familiar story in terms of the AML regime, where it has not been at all uncommon over the years for any given piece of legislation actually to relax provisions mandated in previous legislation. The principal example is the Money Laundering Suppression Act of 1994, which authorized the liberalization of regulations for the granting of exemptions for cash transaction reports. As noted by FinCEN (2002), the relaxation of those particular regulations has been only a partial success. The legislation authorized the Treasury to designate a single agency to receive SARs at the same time it extended the AML regime to money transmission businesses and to casinos. In other words, relaxing the regulations was part of the political quid pro quo for expanding coverage of the AML regime.

Even if the estimated total financial cost of the US AML regime is considered to be small—as stated, $7 billion is a mere 0.06 percent of 2003 GDP—the cost needs to be justified, particularly if the prevention pillar is to be expanded or the enforcement pillar strengthened. This suggests a need for better data and fresh approaches to the analysis of these issues in the years ahead.