CHAPTER 4

CASES

Domestic laundries

Certain businesses lend themselves to laundering money. For example, the business must be capable of absorbing a large volume of cash income, because most illicit income is received as cash. The purpose of laundering funds is to commingle licit and illicit monies so that they cannot be separated and to prevent the discovery of the introduction of illegal money into the business. Because most checks and credit card receipts are traceable by law enforcement officials, businesses such as restaurants, bars, and massage parlors, which take in a high proportion of cash, tend to be more desirable as laundries than businesses that receive most of their income as checks or other traceable instruments.

Another favorable characteristic for a laundry is expenses that do not vary with sales volume. An example of such a business is a movie theater that shows pornographic films. The expenses of such a business (rent, electricity, wages) are almost constant, regardless of whether the theater is full. Illicit income can be introduced and camouflaged in this type of business quite easily, because the additional sales do not increase expenses. Law enforcement officials who examined the records of such a theater would have trouble proving that the legitimate income generated by the theater was lower than that recorded.

Businesses that experience a high rate of spoilage or other loss of goods also may be used to launder money. Groceries and restaurants are good examples. Money is introduced into the business and recorded in its general income accounts as if it had been received from customers.

Fraudulent invoices for produce or other perishable items are issued to these businesses by companies acting as suppliers. The grocery or restaurant issues checks to these "suppliers" or records the transaction as a cash payment an charges it to an expense account, such as cost of goods sold. The undelivered produce or perishable items listed as spoiled and discarded are written off the

books (see Figure 2). The grocery store or restaurant thus avoids tax liability and the funds paid to "suppliers" seem legal and may be spent or invested with little risk of discovery. Within a week of the transaction, it is almost impossible for law enforcement officials to disprove the story of the grocer or restaurant owner.

The above techniques have been used to launder funds successfully for a number of years, and large numbers of domestic businesses controlled by organized crime are still being used for this function. Recently, however, law enforcement officials have adapted new methods, such as sampling, ratio analysis, and flow-charting, to discover laundering operations and to prosecute the people involved in them.

Sampling is a statistical procedure in which the number of customers of an establishment is randomly counted, a conservative estimate made of the amount of money spent by each customer, and a projection made of how much money is actually received by an enterprise in the ordinary course of operation. If the projected income is materially smaller than that reported to taxing authorities, it is a good indication that the business is being used to launder funds.

Ratios to evaluate businesses have been used for many years by accountants, investors, and lending institutions. There are four basic types of ratio:

Liquidity ratios, which indicate the ability of an enterprise to satisfy its immediate (short-term) financial obligations
Operating ratios, which indicate the efficiency of the business
Profitability ratios, which indicate the effective use of assets and the return of the owner's investment in the business
Leverage ratios, which indicate the extent to which the enterprise is financed by debt

By using ratio analysis, an investigator can compare the past performance of a business with that of the industry in which the business operates. This comparison can be used to spot significant deviations from the norm, and these may indicate the existence of a laundering operation.

Another method used to uncover laundering involves researching the

corporate and ownership structures of both the suspected business and all the companies with which it deals. The relationship between the various companies may be illustrated visually by the process of flow charting, which allows investigators, prosecutors, and juries to grasp more easily the sometimes complex relationships that exist in laundering operations.

Although law enforcement agencies have been relatively successful in exposing Domestic laundering operations, underworld leaders have perfected international laundering operations that have traditionally been immune from exposure. Although international laundries vary greatly in form, organization, and complexity, their object is still to disguise the true nature and origin of illegal funds. International laundering schemes often involve the use of dummy corporations, numbered bank accounts, or financial instruments issued by banks located in countries where banking regulations are lax (often referred to as "offshore banks").

Foreign laundries

Much of the money invested by organized crime in legitimate businesses in the United States is first routed through secret numbered bank accounts in countries such as Liechtenstein, Luxembourg, the Channel Islands, Panama, the Bahamas, the Netherlands Antilles, Antigua, Anguilla, Montserrat, the Grand Cayman Islands, Hong Kong, Dubai, the United Arab Emirates, Singapore, Nauru, Vanuatu, Uruguay, Austria, and Bulgaria.

This arrangement is ideal for the racketeer who wishes to clean large amounts of cash. Often it involves depositing illicit funds in a secret numbered account and then bringing them back into the United States as a loan from the foreign bank or from a dummy corporation set up under the laws of a foreign country. Not only are the illegal income and its sources hidden from the Internal Revenue Service and law enforcement agencies, but the interest on this supposed loan is often deducted as a business expense on the tax return of the racketeer.

In many cases, organized crime members have not been content with merely using secret numbered accounts in foreign banks. As early as the 1960s, it was recognized that many banks in Switzerland and the Bahamas had been taken over by Americans known to be associated with organized crime

activities. Not only did the American ownership protect the identity of bank customers and allow for the falsification of bank records, but it also enabled the racketeers to bring apparently legitimate money back into the United States in the form of various financial instruments issued by these banks and by foreign governments. Owners realized that controlled banks could also be used to generate illicit income by issuing fraudulent financial instruments that are used in this country as collateral for loans and in other fraud schemes.

Enforcement agents working for the U.S. Comptroller of the Currency now estimate that the volume of phony financial instruments issued by offshore banks is in the hundreds of million of dollars.

How money is laundered

In money laundering, the proceeds of crime are run through the financial system to disguise their illegal origins and make them appear to be legitimate funds. Most often associated with organized crime, money laundering can be linked to any crime that generates significant proceeds, such as extortion, drug trafficking, arms smuggling, and white-crime. Although money laundering often involves a complex series of transactions, it generally includes three basic steps.

The first step is the physical disposal of cash. This placement might be accomplished by depositing the cash in domestic banks or, increasingly, in other types of formal or informal financial institutions. Or the cash might be shipped across borders for deposit in foreign financial institutions, or used to buy high-value goods, such as artwork, airplanes, and precious metals and stones, that can then be resold for payment by check or bank transfer.

The second step in money laundering is known as layering, carrying out complex layers of financial transactions to separate the illicit proceeds from their source and disguise the audit trail. This phase can involve such transactions as the wire transfer of deposited cash, the conversion of deposited cash into monetary instruments (bonds, stocks, traveler's checks), the resale of high-value goods and monetary instruments, and investment is real estate and legitimate businesses, particularly in the leisure and tourism industries. Shell companies, typically registered in offshore havens, are a common tool in the layering phase. These companies, whose directors often are local

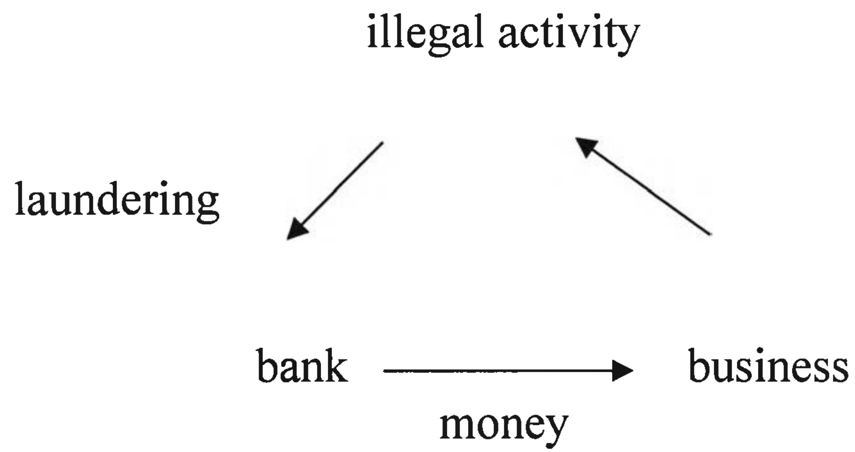
attorneys acing as nominees, obscure the beneficial owners through restrictive bank secrecy laws and attorney-client privilege.

The last step is to make the wealth derived from the illicit proceeds appear legitimate. This integration might involve any number of techniques, such as using front companies to "lend" the proceeds back to the owner or using funds on deposit in foreign financial institutions as security for domestic loans. Another common technique is over invoicing or producing false invoices for goods sold---or supposedly sold---across borders.

CASE OF STUDY

Case 1
Accounting firm
Facts

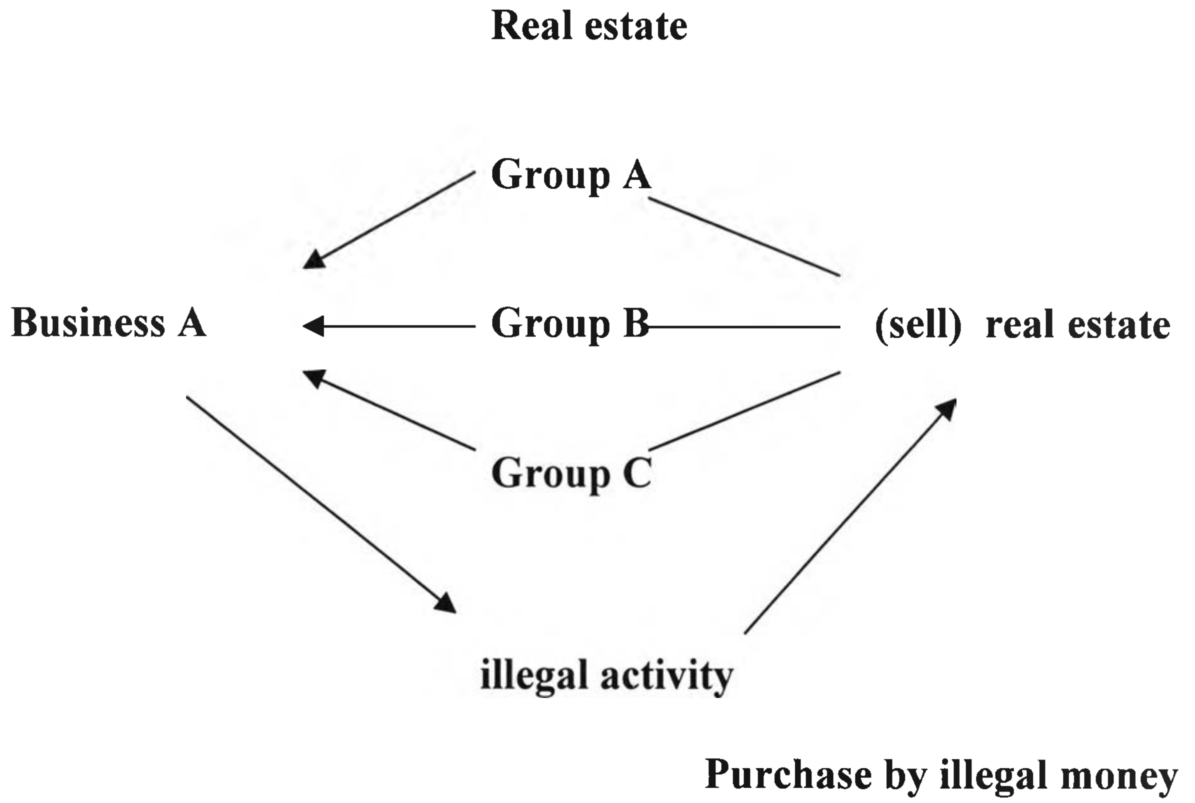
Beginning in May 1994, two alleged narcotics traffickers used an accounting firm to launder criminal proceeds generated from amphetamine sales. The? clients? of the firm would on a regular basis hand their accountant cash in brown envelopes or shoe boxes for which no receipt was issued. The funds were then stored in the accountant? Office until he decided how they could be introduced in the financial system and laundered. At any one time, there were between USD 38,000 and USD 63,000 stored in the accountant? Office. The law enforcement agency investigating the matter found that the accountant established company and trust accounts on behalf of his clients and opened personal bank accounts in the names of relatives. He then made structured deposits to those accounts with the funds received from the alleged traffickers. Additionally, he transferred approximately USD 114,000 overseas? Again, using structured transactions? To purchase truck parts, which were later brought back into the country and sold at a profit, and also used some of the funds to purchase properties. The accountant and three of his colleagues (who were also implicated in the scheme) reportedly laundered approximately USD 633,900 and received a 10% commission for his services..22 Results The accountant and his colleagues are believed to have acted from the beginning with the suspicion that the clients were involved in illegal activities. Even after obtaining further specific knowledge of his clients? involvement in narcotics trafficking, he and his associates allegedly continued to facilitate money laundering. Lessons This case highlights the key role that financial experts can play in the laundering of criminal proceeds. Many of the services provided (establishment of specialized accounts or business entities, making real estate investments) are potential money laundering mechanisms that may be beyond the abilities of the less sophisticated criminal.



Case 1
Diagram

Case 2
Insurance polices and real estate
Facts

An insurance company informed an FIU that it had underwritten two life insurance policies with a total value of USD 268,000 in the name of two European nationals. Payment was made by a cheque drawn on the accounts of a brokerage firm in a major EU financial market and a notary in the south-eastern region of the country...24 The two policies were then put up as collateral for a mortgage valued at USD 1,783,000 that was provided by a company specializing in leasing transactions. As the policyholders did not pay in their own name, the issuer contacted the brokerage firm in order to discover the exact origin of the funds deposited in its account. It was informed that the funds had been received in cash and that the parties concerned were merely occasional clients. The parties? Two brothers? Were known to a law enforcement agency through a separate investigation into the illegal import and export of classic automobiles. Moreover, two individuals with the same surname were suspected by the same agency of drug trafficking and money laundering. Results This case has not yet been passed to the prosecutorial authorities. Lessons This example shows the necessity for non-bank financial businesses (in this case insurance companies) to be aware of what constitutes suspicious financial activity. It also demonstrates the critical need for effective co-ordination between the information contained in suspicious transaction reports and law enforcement information.

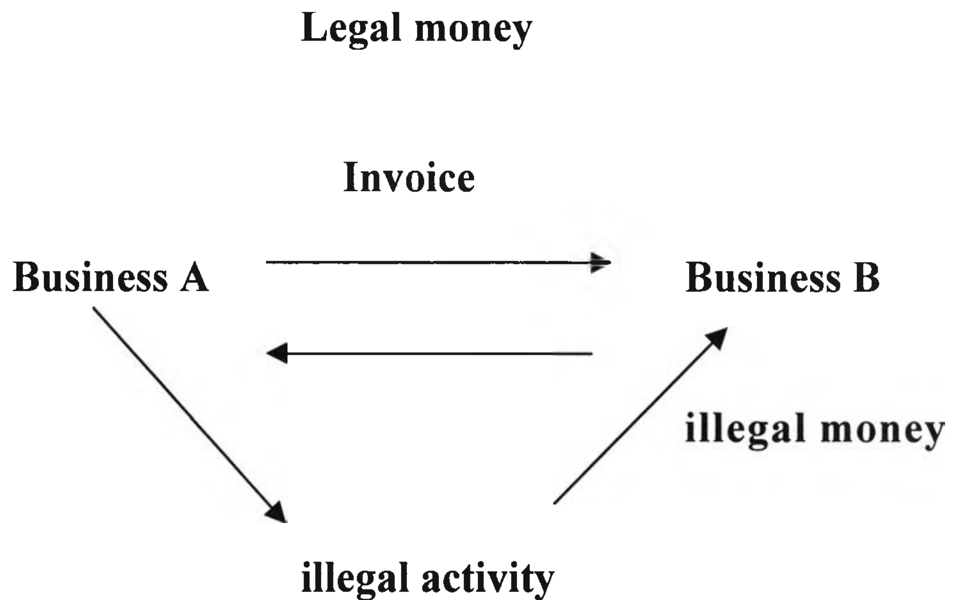


Case 2
Diagram

Case 3
Front companies
Facts

An FIU in country B received a report of a series of suspicious transactions involving the bank accounts of a West African citizen and his businesses, which specialized in industrial fishing. These accounts were opened in banks located in country B and consisted primarily of money changing operations. The businessman also owned several residences in his home country and in the capital region of country B. The companies that he jointly managed all had the same address in his home country. The personal account of the West African businessman received a number of transfers from accounts in another European country and in his home country (over USD 2 million from 1995 to 1996). The business accounts of the companies received transfers from several business entities based in Europe which were ostensibly linked to fishing related activities (over USD 7 million from 1994 to 1997). The transfers out of the account (estimated at nearly USD 4 million over the same period) were made to various companies whose business was (according to official records) connected with maritime activity and to other individuals. The FIU? Analysis showed that the income of the West African companies concerned was grossly disproportionate to reported sales. In fact, the account transactions seemed to have little to do with industrial fishing (i.e., foreign currency sales, transfers from the bank accounts of European residents, transfers between the personal account of the West African businessman and his businesses, transfers between these businesses and those of Europe-based partners). Furthermore, according to additional information received by the FIU, one of the partners of the West African businessman, a co-manager of one of the companies, was suspected of being involved in several financial offences in Italy. This individual reportedly had close associations with two.25 Italian organized crime figures, and his Italian businesses have become the target of investigation into money laundering in that country. Still another business partner of the West African businessman appears also to be involved in financial and fiscal offences. Results This case has not yet been passed to prosecutorial authorities. Lessons Given the unusual account transaction and the lack of a clear economic connections for some of the business activities, the operations described in this example very likely constitute a money laundering scheme to conceal the illegal sources of

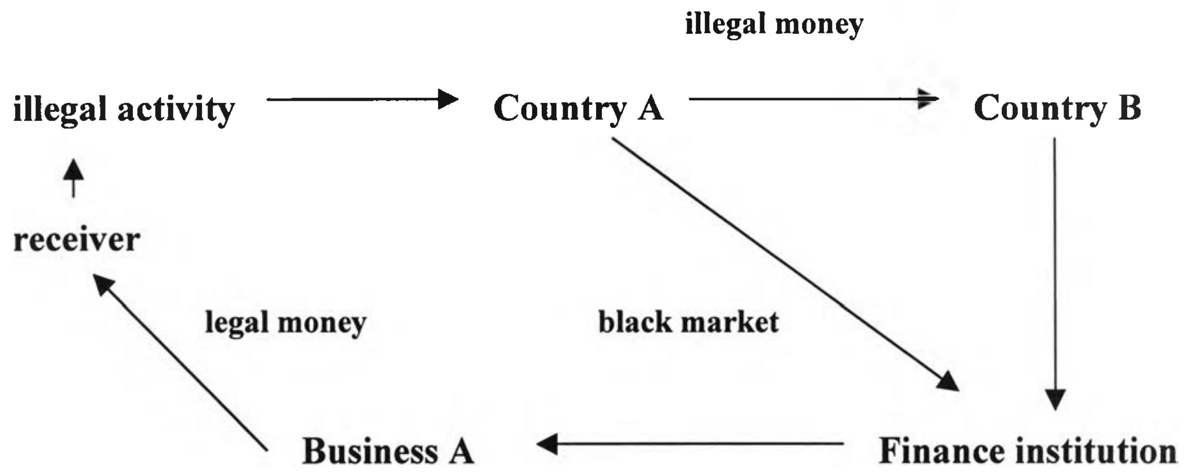
proceeds derived form various criminal activities. This case gives further support to the need for analysis of information from a variety of sources (suspicious transaction reports, financial institutions, company registries, police records, etc.) in order to gain a full picture of a complex laundering scheme.



Case 3
Diagram

Case 4
Money transfers
Facts

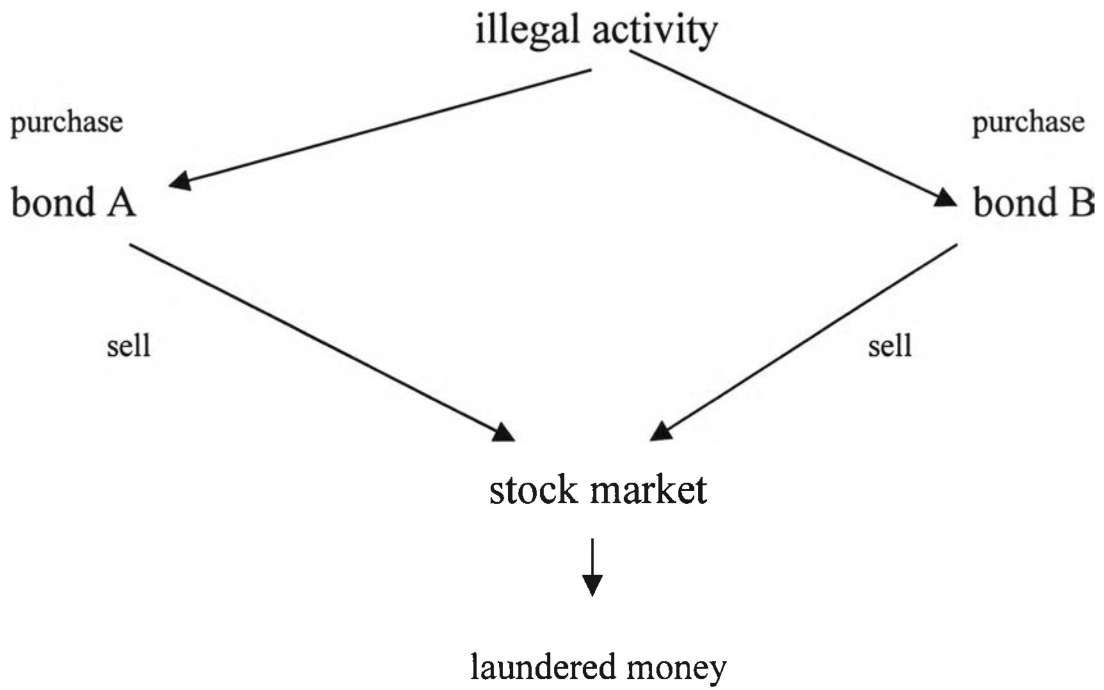
In July 1997, the police arrested the leader of an Iranian drug trafficking group, suspect A, for possessing stimulants and other kinds of drugs. The subsequent investigation revealed that the suspect had remitted part of his illegal proceeds abroad. A total of USD 450,000 was remitted via three banks to an account on behalf of suspect A? older brother B at the head office of an international bank in Dubai. Transfers were made on five occasions during the two months between April and June 1998 in amounts ranging from USD 50,000 to USD 150,000). Another individual, suspect C, actually remitted the funds and later returned to Iran. On each occasion, C took the funds in cash to the bank, exchanged them for dollars, and then had the funds transferred. Each of the transactions took about one hour to conduct, and the stated purpose for the remittances was to cover? Living expenses?. Results Suspect A was initially charged with violating provisions of the anti-narcotics trafficking law. The money transfers revealed during the investigation led to additional charges under the anti-money laundering law. This was the first time that anti-money laundering provisions had been applied to the overseas transfers criminal proceeds. Court proceedings for this case are on-going. Lessons This case represents a classic example of a simple money laundering scheme and is also a good example of a case derived not just from suspicious transaction reporting but also as a follow-up to traditional investigative activity...26



Case 4
Diagram

Case 5
The derivatives market: a typology
Facts

The following typology is provided as an example of how funds could be laundered using the derivatives market. In this method, the broker must be willing to allocate genuinely losing trades to the account in which criminal proceeds are deposited. Instead of relying on misleading or false documentation, the broker uses the genuine loss making documentation to be allocated to the detriment of the dirty money account holder. As an example, a broker uses two accounts, one called? A? into which the client regularly deposits money which needs laundering, and one called? B? which is intended to receive the laundered funds. The broker enters the trading market and? goes long? (purchases) 100 derivative contracts of a commodity, trading at an offer price of 85.02, with a? tick? size of $25. At the same time he? goes short? (sells) 100 contracts of the same commodity at the bid price of $85.00. At that moment, he has two legitimate contracts which have been cleared through the floor of the exchange. Later in the trading day, the contract price has altered to $84.72 bid and $84.74 offered. The broker returns to the market, closing both open positions at the prevailing prices. Now, the broker, in his own books assigns the original purchase at $85.02 and the subsequent sale at $84.72 to account A. The percentage difference between the two prices is 30 points or ticks (the difference between $84.72 and $85.02). To calculate the loss on this contract, the tick size which is $25 is multiplied by the number of contracts, 100, multiplied by the price movement, 30. Thus: $25 x 100 x 30 = $75,000 (loss). The other trades are allocated to the B account, which following the same calculation theory of tick size multiplied by the number of contracts multiplied by the price movement results in a profit as follows: $25 x 100 x 26 = $65,000 (profit). The account containing the money to be laundered has just paid out $75,000 for the privilege of receiving a profit of $65,000 on the other side. In other words, the launders has paid $10,000 for the privilege of successfully laundering $75,000. Such a sum is well within the amount of premium which professional launders are prepared to pay for the privilege of cleaning up such money. As a transaction, it is perfectly lawful from the point of view of the broker. He has not taken the risk of creating false documentation, which could conceivably be discovered, and everything has been done in full sight of the market.



Case 5
Diagram