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## **Part I**

### **Money Laundering Activities: Explaining the Nature and Emerging Trends**

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Part I of this study outlines the nature, emerging trends, and the changing typologies of money laundering activities. The main aim of this part is to have a comprehensive understanding of the art of money laundering, how it is conducted, and the adequacy of legal rules in responding to the typologies of money laundering that have evolved over time. In chapter 1, a general remark on money laundering is provided with an explanation of the concept, definition, and scope of money laundering. Different approaches in explaining technical and legal perspectives of money laundering are analyzed. The mechanics of money laundering, which involves placement, layering, and integration, are also discussed. In Chapter 2, the emerging trends and evolving techniques of money laundering is reviewed. The vulnerabilities of financial institutions, non-financial institutions, and professional agencies being used as a channel for conducting money laundering are analyzed. The exploitation of front companies, underground banking systems, offshore jurisdictions, and international business transactions will also be discussed. Lastly, this chapter will examine electronic money and the internet, which in itself provides an opportunity for perpetrators to launder illicit funds through more complicated, sophisticated, and cross-border techniques.

## **Chapter 1**

### **The Nature of Money Laundering Activities**

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#### **1.1. The Concept of Money Laundering**

There is no evidence that suggests when the term ‘money laundering’ was invented. However, referring to the historical sense of this term, it can be explained in several ways. One explanation comes from the book *Lords of the Rim* by the American historian Sterling Seagrave.<sup>1</sup> This book explores the phenomenon of merchant conducts in operating businesses in China since 3000

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<sup>1</sup>See generally, Sterling Seagrave, *Lords of the Rim: the Invisible Empire of the Overseas China*, Putnam, 1995, p.12.

B.C.<sup>2</sup> At that time, wealth was concealed by hiding, moving, and investing outside of China. Even though the term ‘money laundering’ was not invented yet, the principles of money laundering were founded. These included the conversion of illicit funds into movable assets and then moving them outside its jurisdiction to invest in other legal economies.

According to a legend, the term ‘money laundering’ originates from the United States of America during the 1920s when organized crime used Laundromat businesses to blur the unlawful sources of its cash.<sup>3</sup> The mafia (with the likes of Al Capone) generated vast amounts of cash from criminal activities such as trading illicit drugs, murders, prostitutions, and gambling. To avoid the confiscation of their proceeds, they operated retail service businesses such as bars, vending machines, hotel, and restaurants. Through these legal businesses, the illegal money was mixed with the legal proceeds and the total amount was reported as the total earnings of the legitimate business. By using this technique, illegal earnings were whitewashed as the money took on the appearance of a legitimate business. After this process, the money could then be used freely without attracting the attention of law enforcement authorities.

Another source states that the term ‘money laundering’ came into use after the 1932 case of Mayer Lansky in the United States.<sup>4</sup> In this case, Lansky carried out an offshore account in a Swiss Bank that was used to hide criminal proceeds of Governor Huey Long of Louisiana.<sup>5</sup> Lansky later established a slot machine house in New Orleans and the Swiss Bank provided funds in the form of loans to Lansky & Co.<sup>6</sup> Through this method, it allowed illegal money to return to the United States of America. Since then, money laundering activities have evolved into using technological advancements.<sup>7</sup>

The term ‘money laundering’ as a concept came into existence in the early 1970s when the United States passed the Bank Secrecy Act (BSA).<sup>8</sup> This Act requires financial institutions to file record keeping and reporting requirements for currency transactions if the transaction is \$10,000 or more.<sup>9</sup> This Act was aimed to provide law enforcement authorities with the tools

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<sup>2</sup>*Ibid.*

<sup>3</sup>Peter W. Schroth, “Bank Confidentiality and the War on Money Laundering in the United States”, the American Journal of Comparative Law, Vol.42, 1994, p.375. *See also* Daniel C. Richman and William J. Stuntz, “Al Capone’s Revenge: An Essay on the Political Economy of Pre-textual Prosecution”, Columbia Law Review, Vol.105, 2005, p.583.

<sup>4</sup>Abdullahi Shehu, “Money-Laundering: The Challenge of Global Enforcement”, 2000, p.2. *See also* Wilmer Parker, “Black/Parallel Markets: When is A Money Exchange A Money Laundering?” Dickinson Journal of International law, Vol.13, 1995, p.423.

<sup>5</sup>Abdullah Shehu (2000), *Ibid.*

<sup>6</sup>*Ibid.*

<sup>7</sup>*Ibid.*

<sup>8</sup>The Bank Secrecy Act was passed on October 26, 1970.

<sup>9</sup>*See* Section 5313 of the Bank Secrecy Act of 1970.

necessary to combat money laundering. Records required in the BSA include a Suspicious Activity Report (SAR), a Currency Transaction Report (CTR), a report on foreign bank accounts, and reports on cross-border movement of currency and monitoring instruments. The rationale for these reporting-based systems is to create a 'paper trail' that aids law enforcement agencies in prosecuting money laundering cases. It was under the Bank Secrecy Act of 1970 that the federal government indicted the first National Bank of Boston on February 1985 for its failure to report a series of cash transactions involving more than \$1.2 billion.<sup>10</sup> Based on this indictment, the Bank of Boston pleaded guilty and was fined \$500,000.

The term 'money laundering' was firstly used in the primary legal document in 1982 through the case of civil forfeiture between *United States v \$4,255,625.39*.<sup>11</sup> This case concerned the efforts to conceal or disguise ill-gotten gain and civil forfeiture of large sums of money from Molins in Columbia to Sonal in Miami, Florida.<sup>12</sup> In its decision, the court concluded that the transfer of sums from Molins to the bank in Sonal was more likely a money laundering process.<sup>13</sup> Although the court did not define the term, scholars concluded that this phenomenon referred to money laundering.

Furthermore, to the effective implementation and enforcement of the BSA of 1970,<sup>14</sup> Congress enacted the Money laundering Control Act (MLCA) of 1986.<sup>15</sup> This Act was intended to create a liability for individuals who conduct financial transactions with the knowledge that the funds' origins were either illegal or illicit.<sup>16</sup> This Act prohibits both conducting a monetary

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<sup>10</sup>Frederick J. Knecht, "Extraterritorial Jurisdiction and the Federal Money Laundering Offence", *Stanford Journal of International Law*, Vol.22, 1986, p.391.

<sup>11</sup>Heba Shams, *Legal Globalization: Money Laundering Law and Other Cases*, (London: British Institute of International and Comparative Law, 2004), p.26.

<sup>12</sup>*Ibid.*

<sup>13</sup>*Ibid.*

<sup>14</sup>Despite the detection, investigation, and prosecutorial successes in these cases, they reveal also some of the problems investigators encountered with the BSA. Compliance was lax, and courts were inconsistent in their judgment of an individual's requirement to report'. See Jeanne Bickford, "Filthy Lucre: A Socio-Legal Study of the Criminalization of Money Laundering", Dissertation, University of California, Irvine, 1996, p.43.

<sup>15</sup>This Act contain two sections: #1956 addressess certain financial transactions involving the proceeds of 'specified unlawful activity', and #1957 addresses any monetary transaction in property known to derive from a specified unlawful activity. #1956 has three subdivision: #1956(a)(1) addresses domestic money laundering, #1956(a)(2) addresses international money laundering; and #1956(a)(3) involves sting operations. See Andres Rueda, "International Money Laundering Law Enforcement & the USA PATRIOT Act 2001", 10 Mich. St. U. Det.C. L.J. Int'IL, 2001, p.147.

<sup>16</sup>The intent to make money laundering a crime according to the Senate Judiciary Committee was to create a Federal offense against money laundering; to authorize forfeiture of the profits earned by launderers; to encourage financial institutions to come forward with information about money launderers without fear of civil liability; to provide Federal law enforcement agencies with

transaction knowing, or with reason to know, that the funds were derived from unlawful activity; the transportation, transmitting, or transferring of funds with the knowledge that those funds were derived from unlawful activity.<sup>17</sup> This Act also categorized three money laundering practices as criminal offences, namely: active engagement in the laundering of money, willingness to accept monies that originate from criminal activities, and structure transactions in a way to evade reporting requirements.<sup>18</sup> This Act also provides both civil and criminal sanctions. Civil sanctions include fines of up to \$10,000 and forfeiture. Criminal sanctions include imprisonment for up to 20 years and fines of up to \$500,000 or twice the amount laundered – whichever is greater.<sup>19</sup>

Money laundering was put onto the world stage through the adoption of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (hereinafter: the 1988 UN Vienna Convention).<sup>20</sup> The Convention recommends its parties to criminalize money laundering and drug trafficking.<sup>21</sup> The Convention is acknowledged as the most important step in the internationalization and criminalization of money laundering activities.<sup>22</sup> The Convention also played a significant role in introducing the concept of ‘money laundering’ worldwide. From this international initiative, the term ‘money laundering’ spread to the rest of the world through the enactment of domestic legislations and regulations.

## 1.2. The Perspectives of Money Laundering

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additional tools to investigate money laundering; and to enhance the penalties under existing law in order to further deter the growth of money laundering...’. See Senate Committee on the Judiciary, 1986, the Money Laundering Crime Act 1986, Senate Report 433. Cited in Jeanne Bickford, “Filthy Lucre: A Socio-Legal Study of the Criminalization of Money Laundering”, Dissertation, University of California, Irvine, 1996, p.31.

<sup>17</sup> 18 USC §1956, 1957. The Money Laundering Control Act contains two sections. §1956 addresses certain financial transactions involving the proceeds of ‘any specified unlawful activity’, while §1957 addresses any monetary transaction in property known to derive from a specified unlawful activity. §1956 has three subdivisions: §1956(a)(1) addresses domestic money laundering, §1956(a)(2) addresses international money laundering, and §1956(a)(3) is sting operations.

<sup>18</sup> *Ibid.* See also the Money-Laundering Control Act, codified at 18 U.S.C. 1956-1957.

<sup>19</sup> *Ibid.*

<sup>20</sup> United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, open for signature in Vienna, Austria in December 1988 and enter into force in November 1990.

<sup>21</sup> *Ibid.*, Article 3(1) (a) and (b).

<sup>22</sup> William C. Gilmore, “Money Laundering: The International Aspect”, in David Hume Institute, *Money Laundering*, Hume Papers on Public Policy, Vol.1, No.2 (Edinburg University Press, 1993), p.2.

There are many ways in describing the term ‘money laundering’. However, this study separates it into two aspects and uses both technical and legal perspectives. The technical perspective describes ‘money laundering’ as the process that constructs the acts of money laundering from beginning to end. Meanwhile, the legal perspective refers to the formulation of various legal instruments such as conventions, legislations, and arrangements. This section aims to clarify that these two perspectives are important to create a better understanding both conceptually and legally for the definition and scope of money laundering. It also identifies the essential elements that formulate the act of money laundering. Finally, it aims to understand unique characteristics of money laundering offences that differ from conventional crimes.

### 1.2.1. An Overview of the Technical Perspective

In simple terms, money laundering can be described as ‘the turn of dirty money into clean money’.<sup>23</sup> One characteristic in common to define money laundering is ‘the transfer of illegal assets into economic systems’.<sup>24</sup> Another definition of money laundering is ‘the process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate’.<sup>25</sup> Based on these definitions, the scope of money laundering can be distinguished into three elements: firstly, there is a sum of money derived from specific illegal activities; secondly, to avoid the money from being confiscated or the criminal from being prosecuted, the money needs to appear legal by converting it into clean money; and thirdly, this can be done by putting it through a number of steps that include placement, layering, and integration. At this point, it can be assumed that money laundering is the movement of illegal money for the purpose of disguising its origin and integrating it back into the formal legitimate economy.

In light of the implementation process, money laundering takes place when funds from illegal activities are placed and moved through financial institutions for the purpose of disguising its origins and integrating it back into the formal legitimate economy. Thus, in essence, money laundering is a

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<sup>23</sup>Rick McDonell, “Money Laundering Methodologies and International and Regional Countermeasures“, paper presented at the Conference Gambling, Technology and Society: Regulatory Challenges for the 21<sup>st</sup> Century, Sidney, 7-8 May 1998, p.2.

<sup>24</sup>Javier Garcia, “International Measures to Fight Money Laundering”, *Journal of Money Laundering*, Vol.4, No.3, 2001, p.7.

<sup>25</sup>The President’s Commission on Organized Crime, “The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering”, in *Briefing of the 1970 Currency and Foreign Financial Transactions Reporting Act: Hearing before the Sub-commission on Financial Institutions Supervision, Regulation and Insurance of the House Commission on Banking, Finance, and Urban Affairs*, 99<sup>th</sup> Cong, 1<sup>st</sup> session (1985).

process of concealing, disguising, moving, or using money known to be the proceeds of crime. These activities aim to convert money from being illegitimate (dirty money) to being legitimate (clean money) through the three aforementioned steps. Money laundering uses the principles of hiding, moving, and investing.<sup>26</sup> First, the money is hidden from the direct association of the crime. It then is moved through financial and non-financial institutions to other jurisdictions. Finally it is invested into legitimate businesses so that it can be used just like any other form of capital. Another expression for describing money laundering activities is: get it out, cover it up, and bring it back to the legitimate economy in order to take maximum advantage of it.

Money laundering is also used as an instrument for connecting the informal/illegal economy to the formal/legal economy.<sup>27</sup> Here in this context, criminals launder the ill-gotten gains, and then, moving them into the formal economy. However, this kind of conduct could also be done by means of capital flight and tax evasion in which the money is derived from legitimate sources.<sup>28</sup> This is to say that the sources of funds laundered can be obtained not only from illegal assets such as drug trafficking or corruption, but also from legal assets such as capital flight or tax evasion.<sup>29</sup>

1.2.2. An Overview of the Legal Perspective

In the legal perspective, money laundering is understood as being formulated in a number of legal instruments such as conventions, agreements, legislations, or regulations. Various definitions of money laundering in those legal instruments consist of the elements that construct its definition. These elements involve the subject of crime, the elements of criminal acts, and the types of criminal liability. Figure 2 below elaborates on the legal perspective of money laundering which stem from the 1988 Vienna Convention, the 1990 Strasbourg Convention, the 1991 European Community Council Directive, and the 2000 Palermo Convention.

The United Nations Convention against Illicit Traffic in Narcotic Drugs	The European Convention on Laundering, Search, Seizure and Confiscation of	The European Community Council Directive on Prevention of the Use of the	The United Nations Convention against Transnational Organized
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<sup>26</sup>The United Nation’s International Money Laundering Information Network (IMOLIN), The United Nations, 2006.

<sup>27</sup>Kris Hinterseer, *Criminal Finance: The Political Economy of Money Laundering in a Comparative Legal Context*, (The Hague-London-New York: Kluwer Law International), 2002. p.11. See also Antoinette Verhage & Paul Ponsaers, “Power-seeking crime? The Professional Thief versus the Professional Launderer”, *Crime, Law & Social Change*, 2009, p.401.

<sup>28</sup>Kris Hinterseer (2002), *Ibid*, p.11

<sup>29</sup>*Ibid*.

and Psychotropic Substances (1988) <sup>30</sup>	Proceeds from Crime (1990) <sup>31</sup>	Financial System for the Purpose of Money laundering (1991) <sup>32</sup>	Crime (2000) <sup>33</sup>
<p>The conversion or transfer of property, knowing that such property is derived from any offence or offences established in accordance with subparagraph a) of this paragraph, or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions;</p> <p>The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph a) of this paragraph or from an act of participation in such an offence or offences;</p> <p>The acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offence or offences (drug-related crimes) or from an act of participation in such offence or offences.</p> <p>The possession of equipment or materials or substances listed in Table I and Table II, knowing that they are being or are to be used in or for the illicit cultivation, production or</p> <p>Publicly inciting or inducing others, by any means, to commit any of the offences established in accordance with this article or to use</p>	<p>. The conversion or transfer of property, knowing that such property is proceeds, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of the predicate offence to evade the legal consequences of his actions;</p> <p>The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is proceeds; and, subject to its constitutional principles and the basic concepts of its legal system;</p> <p>The acquisition, possession or use of property, knowing, at the time of receipt, that such property was proceeds;</p>	<p>The conversion or transfer of property, knowing that such property is derived from criminal activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequence of such actions;</p> <p>The concealment or disguise of the true nature, source, location, disposition, movement, right with respect to, or ownership of property, knowing that such property is derived from criminal activity, or from an act of participation in such activity.</p> <p>The acquisition, possession, or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity.</p>	<p>The conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action;</p> <p>The concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime;</p> <p>The acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime;</p>

<sup>30</sup>The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988), article 3(b).

<sup>31</sup>The European Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime (1990), article 6(1).

<sup>32</sup>The European Community Council Directive on Prevention of the Use of the Financial System for the Purpose of Money laundering (2001), Article 1.

<sup>33</sup>The United Nations Convention against Transnational Organized Crime, 2000, Article 6(2).

narcotic drugs or psychotropic substances illicitly;			
Participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences establish in accordance with this article	Participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counseling the commission of any of the offences established in accordance with this article.	Participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing paragraphs.	Participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counseling the commission of any of the offences established in accordance with this article.

**Figure 1: Legal Perspective of Money Laundering**

When carefully observing the scope of money laundering that has been elaborated on in those legal instruments, it is obvious that although there are different ways to define money laundering, the elements that construct the definitions remain relatively the same or even in identical fashion. All instruments establish the same *actus reus*, which include the conversion or transfer of property; the concealment or disguise of the true nature, source, location, disposition, movement, right with respect to, or ownership of property; the acquisition, possession, or use of property; the participation in, association to or conspiracy to commit, attempts to commit, and aid, abet, facilitate, and console.<sup>34</sup>

With respect to *mens rea*, or the mental element of money laundering offences, all instruments create *knowing* or *intent* as an essential element to punish a defendant.<sup>35</sup> It means that the prosecutor must prove the actual knowledge of the defendant that they have known the funds were derived from a specified crime. In the level of implementation, it is recognized that proving this kind of mental element is not an easy task. Realizing this problem, the United Nations Vienna Convention of 1988 and the forthcoming international instruments considered ‘knowledge, intent, or purpose may be inferred from objective factual circumstances’.<sup>36</sup> This means that the mental element of laundering offences has been extended not only to the subjective intent of the defendant, but also to the objective circumstances surrounding the case. By this formulation, there has been a shift of a mental element of money laundering from actual knowledge to constructive knowledge. Thus, it has been assumed

<sup>34</sup>*Actus reus* is criminal conduct(s) of the defendant that construct the elements of crime as formulated in a legislation. It is the essential elements that have to be proved by a prosecutor before the judge passes a sentence to the defendant.

<sup>35</sup>*Mens-rea* is a criminal responsibility of a defendant that also has to be proved by a prosecutor in a judicial proceeding. Generally, there are two types of criminal responsibility: subjective and objective responsibility. Subjective responsibility consists of three kinds of fault: intention, recklessness and negligence. Objective responsibility describes the fault based on the fact in surrounding the case..

<sup>36</sup>See for example, the United Nations Convention on against Illicit Traffic in Narcotic Drug and Psychotropic Substances (1988), Article 3(3).



that the laundering offences might be committed while the defendant either *knew* or *reasonably ought to have known* that the proceeds concerned were derived from a specific crime.

Regarding the predicate offence of money laundering, the Vienna Convention considered drugs-related crimes as predicate offences.<sup>37</sup> However, because of the changing characters of money laundering offences over time, the subsequent international or regional agreements such as the FATF<sup>38</sup>, the 1990 Strasbourg Convention<sup>39</sup>, the European Community Directive 1991, 2001, and 2005<sup>40</sup>, and the Palermo Convention of 2000<sup>41</sup> considered extending the scope of predicate offences to all serious crimes generating significant amounts of illegal funds. Meanwhile, at a domestic level, countries have various classifications in considering the predicate offences of money laundering. In principle, some scholars classified three main models for identifying predicate crimes. These are the all crimes approach, the list approach, and the threshold approach.<sup>42</sup> The first model considers all crimes as predicate offences of money laundering. The Netherlands, for example, follows this approach. The second model makes a list of offences considered as predicate crimes. This approach is followed by the majority of countries, including Indonesia, China, and the United States of America. Finally, the third model considers all offences punishable by a sanction beyond a certain threshold.

The different classifications underlying the crime of money laundering could affect the success of implementing and enforcing money laundering legislations. Two kinds of difficulties might be identified. The first one is the

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<sup>37</sup>Predicate crimes in this context are defined: (a) the enumeration of a list of serious offences under national laws, such as drug trafficking, smuggling, illegal arms sales, prostitution, corruption, tax evasion, terrorism, embezzlement and gambling; or (b) reference to all serious offences under national laws, which carry a specified penalty of imprisonment, or both. *See* FATF, The Forty Recommendation I (2003). Cited in Herbert V. Morais, "Fighting International Crime and Its Financing: The Importance of Following A Coherent Global Strategy Based on the Rule of Law", *Vilanova Law Review*, Vol.50, 2005, p.591.

<sup>38</sup>Financial Action Task Force on Money Laundering, Annual Report 1989-1990. Recommendation 5 reads: 'Each country should consider extending the offense of drug money laundering to any other crimes for which there is a link to narcotics; an alternative approach is to criminalize money laundering based on all serious offenses, and/or on all offenses that generate a significant amount of proceeds, or on certain serious offenses'.

<sup>39</sup>The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (1990), article 2(4).

<sup>40</sup>Directive 2001/97/EU of the European Parliament and of the Council of 4 December 2001-Amending Council Directive 91/308/EEC on prevention of the use of financial institution for the purpose of money laundering.

<sup>41</sup>The United Nations Convention against Transnational Crime (2000), Article 2(a).

<sup>42</sup>D. Masciandaro, E. Takets, B. Unger, *Black Finance*, (UK: Northampton, MA, USA, 2007). Cited in Leonardo Borlini, "Issues of the International Criminal Regulation of Money Laundering in the Context of Economic Globalization", Paolo Baffi Centre Research Paper Series No.2008-34, 2008, p.29.

difficulty in proving that the proceeds are derived from a specified crime. The second one is the difficulty in conducting international cooperation. For the former, the difficulty arises when the prosecutor proves the relationship between the criminal proceeds and the crime underlying it. For the latter, the difficulty arises when the 'dual criminality' principle should be implemented. Under this principle, countries that carry out international cooperation should have the same predicate offence(s) underlying the crime of money laundering. The consequence of this principle is that cooperation between two countries could not be carried out if one of them does not consider any crime as predicate offence(s). This condition can impact on the effectiveness and efficiency of international cooperation mechanisms due to the lack of dual criminality.

With respect to the subject of money laundering, it can be categorized into four main categories. First of all, a money launderer is the main offender who launders the money itself. Secondly, anyone who helps a criminal to launder the proceeds of his crime is also considered a money launderer. Thirdly, people can become money launderers by possessing money known to be or suspected of being criminal activity proceeds. The final category is a person who helps to create a money laundering scheme even if that person does not actually take part in it, such as accountants, notaries, or lawyers who recommend a tax evasion scheme.

### 1.3. The Mechanism of Money Laundering

It is recognized that the purpose of money laundering is to disguise funds from illegal activities so that it can be integrated into the formal economy.<sup>43</sup> It is also recognized that for achieving this goal, money laundering has its proceeds follow three basic steps, which involve placement, layering, and integration.<sup>44</sup> Placement refers to the process of transferring the proceeds of crime into a financial system. The idea of the placement stage is to transform cash as

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<sup>43</sup>See i.e., Gilmore, William C. *Dirty Money: The Evolution of International Measures to Counter Money Laundering and the Financing of Terrorism*, 3<sup>rd</sup> ed. rev. and expanded, Council of Europe Publishing, 2004, p.29. Bonnie Buchanan, "Money Laundering: A Global Obstacle", *Research in International Business and Finance* 18, 2004, p.117. Elizabeth V. Mulig and L. Murphy Smith, "Understanding and Preventing Money Laundering", *Internal Auditing*, Sept/Oct. 2004, p.22; Billy Steel, "Money Laundering: A Brief History", available at [http://www.laundryman.u-net.com/page1\\_hist.html](http://www.laundryman.u-net.com/page1_hist.html). James R. Richard, *Transnational Criminal Organization, Cybercrime, and Money Laundering*, (Boca Raton London, New York, Washington DC: CRC Press, 1998), p.48, 53-55. Wilmer Parker, "Nowhere to Run; Nowhere to Hide - The Long Arm of the U.S. Law Enforcement" in Barry Rider and Michael Ashe (Eds), *Money Laundering Control*, (Ireland: Round Hall Sweet & Maxwell, 1996), p.312.

<sup>44</sup>Almost all books and articles that elaborate the process of money laundering activities which involve placement, layering, and integration. For example, See William C. Gilmore (2004), *Ibid*, p.29.

quickly as possible into other types of assets in order to avoid detection. This stage is aimed at severing the direct association or the nexus between illegal funds and the underlying crime. At this stage, illegally obtained money is manipulated into a less suspicious form. This could be done by depositing illegal cash directly into a financial institution, or by purchasing expensive goods that are resold with payments via cheques, and then investing them in financial institutions. Another method is by using front companies through operating restaurants, hotels, or casinos. The perpetrators can also use other tools such as an insurance agent, travel agency, the security sector, real estate agency, or the underground banking system to conceal the illicit sources of funds. Through these methods, the illicit funds can be integrated with *clean* money before placing them in the financial institution. This stage is the riskiest for the criminals because it is easy to detect through a paper trail.

Layering is the second stage of the laundering process. This stage concerns the movement of money out of the country through a series of complex financial transactions.<sup>45</sup> Such transactions are designed to disguise the audit trail and provide anonymity to blur the origin of the proceeds. In other words, through this stage, the perpetrators separate the proceeds from its sources through complex financial transactions. To achieve this purpose, the perpetrators use offshore banks,<sup>46</sup> shell companies,<sup>47</sup> or tax havens<sup>48</sup> in conjunction with offshore jurisdictions<sup>49</sup> to make it virtually untraceable. These intermediaries are relatively safe from detection by law enforcement agencies because they have weak anti-money laundering legislations.

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<sup>45</sup>William C. Gilmore (2004), *Ibid*.

<sup>46</sup>Offshore resorts not only fulfill an essential role of tax havens for the globalized economy; typically company law is underdeveloped, company registers are incomplete, registering requirements and supervision is lax. Banking laws make it possible to escape the strict rules on customer identification developed and enforced otherwise, thereby accepting anonymous client. Finally it is part of the definition of the 'offshore haven' that mutual legal assistance is difficult to obtain, be it for legal or merely factual reasons. Increasingly it becomes evidence that offshore resorts are the 'black holes' of the world economy'. See Mark Pieth, "The Harmonization of Law against Economic Crime", *European Journal of Law Reform*, Vol.1. No.4, 1999, p.529.

<sup>47</sup>Shell company is a company not operated for itself: a company that has no independent assets or operations of its own, but is used by its owners to conduct specific business dealings or maintain control of other companies. See [http://encarta.msn.com/dictionary\\_1861733097/shell\\_company.html](http://encarta.msn.com/dictionary_1861733097/shell_company.html).

<sup>48</sup>Tax haven refers to a country offering very favorable tax laws for foreign businesses and individuals. See [http://www.investorwords.com/4899/tax\\_haven.html](http://www.investorwords.com/4899/tax_haven.html)

<sup>49</sup>Offshore financial center refers to countries or jurisdictions with financial centre that contain financial institutions that deal primarily with nonresidents and/or in foreign currency on a scale out of proportion to the size of the host economy. Nonresident-owned or -controlled institutions play a significant role within the centre. The institutions in the centre may well gain from tax benefits not available to those outside the centre. <http://stats.oecd.org/glossary/detail.asp?ID=5988>

Integration is the final stage of the money laundering process. At this stage, the criminal combines the newly laundered funds with that of a legitimate origin, making it more difficult to separate both.<sup>50</sup> Other techniques in the integration stage include buying letters of credit, bonds, securities, bank notes, bills of lading, and guarantees. Through this step, the illegal funds are introduced into the mainstream legitimate economy. After reaching this stage, the criminals are free to use the funds in various ways. The proceeds could be reinvested into a criminal enterprise and then used for conducting other crimes such as terrorism. The illicit funds could also be used to make investments in the legitimate economy.

#### 1.4. Final Remarks

This chapter explains the nature of money laundering activities in practical and legal perspectives. From a practical perspective, it was presumed that the acts of money laundering is not a new phenomenon but rather as old as civilization itself. From a legal perspective, the term ‘money laundering’ initially was introduced as a case in the United States of America, and then evolved through the enactment of legislations, such as the Bank Secrecy Act of 1970 and the Money Laundering Control Act of 1986. This then developed into having an international scope through the adoption of the United Nations Vienna Convention of 1988. Since that time, the term ‘money laundering’ spread to the rest of the world through the enactment of domestic legislations and regulations.

Regarding the issue of *actus reus*, the formulation of money laundering was initially developed by the Vienna Convention of 1988. Thereafter, other international instruments such as the Strasbourg Convention of 1990, the Palermo Convention of 2000, the Convention against Terrorist Financing of 1999, the Convention against Corruption of 2003 as well as domestic legal systems adopted similar or the same formulation. From this, it can be said that the formulation of money laundering started from an international sphere, and then shifted towards having a domestic scope. Within this context, money laundering can be categorized as ‘international crime’ as well as ‘transnational crime’. As an ‘international crime’, it was initially recognized by the United Nations treaties which then asked participating states to criminalize the crime. As a ‘transnational crime’, money laundering is a crime that is specifically concerned with the occurrence of the criminal activities in more than one jurisdiction.

Even though each country has similar or even identical fashion of the elements of *actus reus* and *mens rea*, they have different predicate offence(s)

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<sup>50</sup>William C. Gilmore (2004), *Supra* note 43.

underlying the crime of money laundering based on the approach they followed: all crimes approach, a list approach, and a threshold approach. This could occur because each country takes into account different characteristics regarding the crimes that potentially threaten its domestic affairs. In addition, each country also has different capabilities in proving the nexus between money laundering and its predicate offences. These differences lead to the problem in conducting interstate cooperation, especially when a dual criminality requirement is obligatory.

Comparing to the conventional crimes, conducting money laundering has a unique characteristic. The process of money laundering consists of three steps: placement, layering, and integration. Placement is the process of introducing the proceeds of crime into a financial system. Layering concerns the movement of money to a foreign country through a series of complex financial transactions. Lastly, in the integration stage, the criminal combines newly laundered funds with those of a legitimate origin, making it more difficult to separate and identify. It is worth noting that these steps can either be taken simultaneously throughout the course of a single transaction, or appear individually in separable forms. This matter will be analyzed in the following chapter\*\*\*\*