MONEY LAUNDERING: AN INSIGHT INTO THE MODUS OPERANDI WITH CASE STUDIES

AUTHORS’ NAME: Arvind Giriraj (IV Year BA LLB Hons.)

Prashant Kumar Mishra (IV Year BA LLB Hons.)

ABSTRACT

This article examines definitions of "money laundering" and the conceptual and actual role its regulation plays in dealing with various sectors of the economy, as well as the procedural aspects of the same. It gives an insight into the history of this process. Then it goes on to discuss the three steps involved into money laundering. If laundering is prevented, incentives to become major criminals are diminished. It identifies and critiques three aspects of harm arising from laundering: facilitating crime groups’ expansion, corroding financial institutions, and extent. It gives some infamous instances when this menace was unearthed. Then it deals with the various legislations in force to curb this process. It concludes that much detected laundering involves the same out-of-place judgments the police use, but though the proportion of routine and suspicious activity reports that yield arrests may be low, they do generate some important enforcement actions. Nevertheless, the impact of anti laundering efforts on enforcement resources, organized crime markets, or drug consumption levels remains modestly understood at present. The authors have tried to give an insight into money laundering with solution to curb this menace.
INTRODUCTION

Money Laundering refers to the conversion or "Laundering" of money which is illegally obtained, so as to make it appear to originate from a legitimate source. Money Laundering is being employed by launderers worldwide to conceal criminal activity associated with it such as drug / arms trafficking, terrorism and extortion. But in simple terms it is the Conversion of Black money into white money.

Money laundering is the criminal practice of filtering ill-gotten gains or “dirty” money through a series of transactions, so that the funds are “cleaned” to look like proceeds from legal activities. Money laundering is driven by criminal activities and conceals the true source, ownership, or use of funds. The International Monetary Fund has stated that the aggregate size of money laundering in the world could be somewhere between 2 and 5 percent of the world’s gross domestic product.

Money Laundering has a close nexus with organised crime. Money Launderers amass enormous profits through drug trafficking, international frauds, arms dealing etc. Cash transactions are predominantly used for Money Laundering as they facilitate the concealment of the true ownership and origin of money. Criminal activities such as drug trafficking acquire an air of anonymity through cash transactions.

The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, mobsters, terrorists and con artists. Drug traffickers are in serious need of good laundering systems because they deal almost exclusively in cash, which causes all sorts of logistics problems. One important aspect of money laundering is the tendency and need for perpetrators to operate cross border schemes for the purpose of concealment and/or to take advantage of the uneven developments in the national anti money laundering regimes.
Banks and financial institutions are vulnerable from the Money Laundering point of view since criminal proceeds can enter banks in the form of large cash deposits. Bank officials therefore need to exercise constant vigilance in opening of accounts with large cash deposits and in checking suspicious transactions.

**HISTORICAL EVOLUTION**

Efforts to launder money and finance terrorism have been evolving rapidly in recent years in response to heightened countermeasures. The international community has witnessed the use of increasingly sophisticated methods to move illicit funds through financial systems across the globe and has acknowledged the need for improved multilateral cooperation to fight these criminal activities.

‘Money laundering’ as an expression is one of fairly recent origin. The original sighting was in newspapers reporting the Watergate scandal in the United States in 1973. The expression first appeared in a judicial or legal context in 1982 in America.

Money laundering as a crime only attracted interest in the 1980s, essentially within a drug trafficking context. It was from an increasing awareness of the huge profits generated from this criminal activity and a concern at the massive drug abuse problem in western society which created the impetus for governments to act against the drug dealers by creating legislation that would deprive them of their illicit gains. The term "money laundering" is said to originate from Mafia ownership of Laundromats in the United States. Gangsters there were earning huge sums in cash from extortion, prostitution, gambling and bootleg liquor. They needed to show a legitimate source for these monies.

As a 1993 UN Report noted: The basic characteristics of the laundering of the proceeds of crime, which to a large extent also mark the operations of organised and transnational crime, are its global nature, the flexibility and adaptability of its operations, the use of the latest technological means and professional assistance, the ingenuity of its operators and the vast resources at their disposal.

In India money laundering is popularly known as Hawala transactions. It gained popularity during early 90’s when many of the politicians were caught in its net. Hawala is an

---

alternative or parallel remittance system. The Hawala Mechanism facilitated the conversion of money from black into white. "Hawala" is an Arabic word meaning the transfer of money or information between two persons using a third person\(^2\). The system dates to the Arabic traders as a means of avoiding robbery. It predates western banking by several centuries.

**METHODOLOGICAL PHASES:**

The basic money laundering process has three steps:

1. *Placement* - At this stage, the launderer inserts the dirty money into a legitimate financial institution. This is often in the form of cash bank deposits. This is the riskiest stage of the laundering process because large amounts of cash are pretty conspicuous, and banks are required to report high-value transactions.

2. *Layering* - Layering involves sending the money through various financial transactions to change its form and make it difficult to follow. Layering may consist of several bank-to-bank transfers, wire transfers between different accounts in different names in different countries, making deposits and withdrawals to continually vary the amount of money in the accounts, changing the money's currency, and purchasing high-value items (boats, houses, cars, diamonds etc.) to change the form of the money. This is the most complex step in any laundering scheme, and it's all about making the original dirty money as hard to trace as possible.

3. *Integration* - At the integration stage, the money re-enters the mainstream economy in legitimate-looking form -- it appears to come from a legal transaction. This may involve a final bank transfer into the account of a local business in which the launderer is "investing" in exchange for a cut of the profits. At this point, the criminal can use the money without getting caught. It's very difficult to catch a launderer during the integration stage if there is no documentation during the previous stages.

Following are the various measures adopted all over the world for money laundering, even though it is not exhaustive but it encompasses some of the most widely used methods.

- *Structuring deposits*

\(^2\) http://www.amlcft.com/ last accessed on 5\(^{th}\) November, 2008.
This method is also known as *smurfing*. In this method large amount of money is broken into smaller, less-suspicious amount.

- **Overseas banks underground/ alternative banking**
  Money launderers often send money through various "offshore accounts" in countries that have bank secrecy laws, meaning that for all intents and purposes, these countries allow anonymous banking. A complex scheme can involve hundreds of bank transfers to and from offshore banks.

- **Shell companies**
  These are fake companies that exist for no other reason than to launder money. They take in dirty money as "payment" for supposed goods or services but actually provide no goods or services; they simply create the appearance of legitimate transactions through fake invoices and balance sheets.

- **Investing in legitimate business**
  Launderers sometimes place dirty money in otherwise legitimate businesses to clean it. They may use large business like brokerage firms or casinos that deal in so much money it's easy for the dirty stuff to blend in, or they may use small, cash-intensive businesses like bars, car washes, strip clubs or check-cashing stores.

It gives an overview as to how this menace has developed into transnational business involving various sophisticated techniques and procedures. The ill-effects of money laundering are unimaginable and have been discussed in next section.

**Effects**
Ill-effects of money laundering are seen all over the world on almost all the sectors of life. More noticeable are economic effects which are on a broader scale. Developing countries often bear the brunt of modern money laundering because the governments are still in the process of establishing regulations for their newly privatized financial sectors. This makes them a prime target\(^3\). In the 1990s, numerous banks in the developing Baltic states ended up with huge, widely rumoured deposits of dirty money. Bank patrons proceeded to withdraw

their own clean money for fear of losing it if the banks came under investigation and lost their insurance. The banks collapsed as a result.

Other major issues facing the world's economies include errors in economic policy resulting from artificially inflated financial sectors. Massive influxes of dirty cash into particular areas of the economy that are desirable to money launderers create false demand, and officials act on this new demand by adjusting economic policy. When the laundering process reaches a certain point or if law enforcement officials start to show interest, all of that money will suddenly disappear without any predictable economic cause resulting in that financial sector to fall apart. Laundered money is usually untaxed, meaning the rest of us ultimately have to make up the loss in tax revenue.

The negative economic effects of money laundering on economic development are difficult to quantify. It is clear that such activity damages the financial-sector institutions that are critical to economic growth, reduces productivity in the economy’s real sector by diverting resources and encouraging crime and corruption, which slow economic growth, and can distort the economy’s external sector – international trade and capital flows – to the detriment of long-term economic development. Money laundering also facilitates crime and corruption within developing economies, which is the antithesis of sustainable economic growth. Money laundering reduces the cost of doing business for the criminal element, thereby increasing the level of crime.

Money laundering can also be associated with significant distortions to a country’s imports and exports. On the import side, criminal elements often use illicit proceeds to purchase imported luxury goods, either with laundered funds or as part of the process of laundering such funds. Such imports do not generate domestic economic activity or employment, and in some cases can artificially depress domestic prices, thus reducing the profitability of domestic enterprises.

**Instances: Case Studies**

Money laundering is the process that takes place every day in every part of the world. Here are few instances when they were unearthed and resulted in a great lesson for our policy makers.
**Russian Money Laundering Scandal**

This scandal became public during the summer of 1999, with media reports of $7 billion in suspect funds moving from two Russian banks through a U.S. bank to thousands of bank accounts throughout the world. Two Russian banks deposited more than $7 billion in correspondent bank accounts at a New York bank. After successfully gaining entry for these funds into the U.S. banking system, the Russian banks transferred amounts from their New York bank correspondent accounts to commercial accounts at the bank that had been opened for three shell corporations. In February 2000, guilty pleas were submitted by a bank employee and spouse and the three corporations for conspiracy to commit money laundering, operating an unlawful banking and money transmitting business in the United States.

**Operation Wire Cutter**

The U.S. Customs Service, in conjunction with the Drug Enforcement Administration (DEA) and Colombian Departamento Administrativo de Seguridad, arrested 37 people in January 2002 as a result of a two-and-one-half-year undercover investigation of Colombian peso brokers and their money laundering organizations. These people are believed to have laundered money for several Colombian narcotics cartels. Laundered monies were subsequently withdrawn from banks in Colombia in Colombian pesos. Investigators seized more than $8 million in cash, 400 kilos of cocaine, 100 kilos of marijuana, 6.5 kilos of heroin, nine firearms, and six vehicles.

**Wire Remittance Company**

Both a wire remittance company and a depository institution filed SARs outlining the movement of about $7 million in money orders through the U.S. account of a foreign business. The wire remittance company reported various persons purchasing money orders at the maximum face value of $500 to $1,000 and in sequential order. They received amounts ranging from $5,000 to $11,000. The foreign business identified by the wire remittance company also was identified as a secondary beneficiary. The money orders cleared through a foreign bank’s cash letter account at the U.S. depository institution.

---

5 Ibid.
The Indian cases involved that of Ketan parikh who brought the stock market to fall and many Indian politicians who received kickbacks for performing their executive functions through Hawala channels. The Hawala Mechanism left virtually no paper trail, which would attract investigations\(^7\). The profits generated from Hawala were surreptitiously invested in real estate, gilt edged securities etc., to launder them. The list is unending and there is dire need to control these forces.

**PREVENTION**

The combating of money laundering presupposes the existence of capacity and resources at national level. In India Prevention of Money-Laundering Act, 2002 has been passed which came into effect since 1st of July, 2005. As per *Section* 3 of the Act, Offence of money-laundering covers those persons or entities who directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property, such person or entity shall be guilty of offence of money-laundering.

*Section* 4 of the Act prescribes punishment for money-laundering with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees and for the offences mentioned in paragraph 2 of Part A of the Schedule, the punishment shall be upto ten years.

*Section* 12 (1) prescribes the obligation on Banking companies, financial institutions and intermediaries (a) to maintain certain records detailing the nature and value of the transaction which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month; 12 (b) to furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed and to (c) verify and maintain the records of the identity of all its clients, As per *Section* 12 (2), the records referred to in sub-*Section* (1) as mentioned above, is required to be maintained for a period of ten years from

---

\(^7\) Objectives and Principles of Securities Regulation at [http://newrisk.ifci.ch/144440.htm](http://newrisk.ifci.ch/144440.htm)
the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

An effective anti-money laundering program will help minimize exposure to transaction, compliance, and reputation risks. Such a program should include account opening controls and the monitoring and reporting of suspicious activity. The Reserve Bank of India's extensive Anti-Money Laundering (AML) guidelines has become effective from March 2006. The AML norms such as "Know Your Customer" emphasize that banks must keep a record of their customers' backgrounds in order to reduce and control the risk of money laundering. The Money Laundering Control Act of 1986 further defined money laundering as a federal crime. The USA PATRIOT Act of 2001 expanded the scope of prior laws to more types of financial institutions.

CONCLUSION

Money Laundering is a serious threat to financial system of all countries and it leads to destruction of the country’s sovereignty and character. The combating of money laundering has assumed an urgent impetus at both national and international levels as a result of the scale that money laundering has begun to assume, especially with respect to the financing of terrorist acts. The efforts being made to combat money laundering are beginning to bear fruits in that it is now taking centre stage in all jurisdictions. No one wants to be left behind mainly due to the consequences of such a situation – those lagging behind might find it difficult to transact and do business with the rest of the complying world.

The negative economic effects of money laundering on economic development are difficult to quantify, just as the extent of money laundering itself is difficult to estimate. Nonetheless, it is clear from available evidence that allowing money laundering activity to proceed unchallenged is not an optimal economic-development policy because it damages the financial institutions that are critical to economic growth, reduces productivity in the economy’s real sector by diverting resources and encouraging crime and corruption, and can distort the economy’s international trade and capital flows to the detriment of long-term economic development.

Developing countries’ strategies to establish offshore financial centres as vehicles for economic development are also impaired by significant money laundering activity through OFC channels. Effective anti-money-laundering policies, on the other hand, reinforce a
variety of other good governance policies that help sustain economic development, particularly through the strengthening of the financial sector. Despite the positive developments, the criminals are constantly devising more elaborate and evasive means to circumvent anti money laundering efforts.

We have to understand that it is problem not only for the government of the country but for the people at large. Public awareness is necessary as masses do not understand the problem itself. Our education system should be able to inculcate the ideologies that our future generation does not get involved in this process. There needs to be a vigilant mechanism and our judiciary needs to punish these criminals early to send out a message that money laundering is not tolerable to this democratic society.

REFERENCES