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## Combating Predicate Crimes Involved in Money Laundering

How successful have the anti-money laundering (AML) regimes of the United States and other countries been in controlling crime, particularly “predicate” offenses that give rise to money-laundering activities? While previous chapters have primarily focused on describing the phenomenon of money laundering and the structure of regimes to combat it, this chapter moves to assessing those regimes, starting with a look at implementation of the enforcement pillar in the United States and other industrialized nations. The emphasis is on intermediate measures of performance such as the number of suspicious activity reports, prosecutions, convictions and incarcerations, seizures, and forfeitures. A model of the market for money-laundering services is used to link interventions to outcomes, although conceptual and empirical complexities limit the utility of the model, particularly in generating performance measures. The chapter ends with some indicative calculations that suggest that enforcement efforts have yet to make money laundering a particularly risky business in the United States.

### Enforcement and Predicate Crimes

Until September 11, 2001, the primary emphasis of money-laundering enforcement in the United States and elsewhere was on reducing predicate offenses—initially the sale of illegal drugs, but more recently a wide array of crimes. Critical to the prevention pillar of those efforts is the flow of required reports that are intended to generate investigative information. More important are the number and characteristics of criminal prosecu-

tions and convictions for money laundering, and the application of associated penalties such as seizures and forfeitures.

## **Suspicious Activity Reports**

In the United States, SARs have replaced currency transaction reports as the primary source of information from financial institutions and other reporting sources (such as casinos and currency exchange bureaus) to assist anti-money laundering efforts. Although CTRs still play a role—more than 13 million of them were filed in 2001 and 1.5 million were at some point identified in the course of a criminal investigation (FinCEN 2002)—SARs at this point are viewed by professionals in the enforcement field as more informative.

According to the US Financial Crime Enforcement Network (FinCEN 2003b), the number of SARs filed in the United States increased from 52,000 in 1996 to 288,000 in 2003 (figure 5.1). Little information is available on the underlying suspected activity, as 48 percent of SARs filed between April 1, 1996, and June 30, 2003, were characterized only as “violations of the Bank Secrecy Act (BSA)/Structuring/Money Laundering,” which is not very informative. The only other large category was check fraud, which accounted for 12 percent of the filed reports.

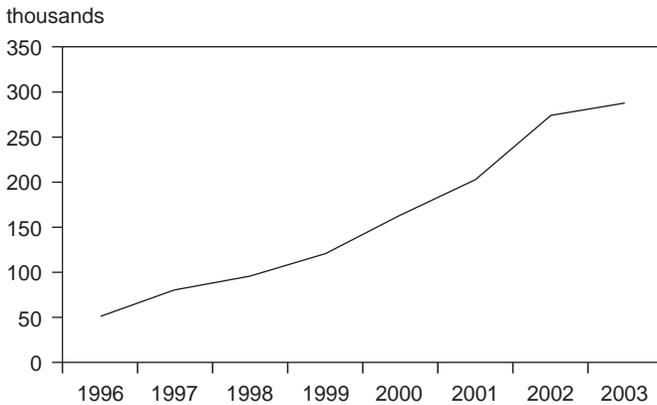
The number of SARs related to terrorism predictably increased sharply following September 11. Whereas in September 2001, 27 SARs mentioned possible terrorism, another 1,342 were filed in the following six months. However, this number had decreased again within another year. In the six months beginning October 2002, only 290 terrorism SARs were filed.

An encouraging trend has emerged with regard to the party initiating terrorism-related SARs. In the six months after September 2001, 85 percent of these SARs were filed due to apparent matches with the names of individuals or entities provided to institutions by government agencies. But from October 2002 to March 2003, most such SARs were a result of due diligence processes of financial institutions themselves, independent of any government-published lists. Several banks created internal watch lists to alert tellers and other employees to customers' previous suspicious behavior.

Though 69 financial institutions have filed SARs related to terrorism, over half of the reports from October 2002 to March 2003 came from just three banks. Sixty-eight terrorism SARs (23.4 percent) were reported directly to law enforcement authorities, meaning that the violation was ongoing and required immediate attention.

The number of SARs filed, like most other criminal justice outputs, is an inherently ambiguous indicator of changes in enforcement. A rise in the number of SARs may reflect either an increase in money laundering or increased stringency of the AML regime. The rate of increase in recent years is so large that, with a caveat as to quality, there is good reason to believe that it is the stringency of the regime that has intensified. There are

**Figure 5.1 Suspicious activity reports filed, 1996–2003**



Source: Financial Crime Enforcement Network (FinCEN 2004).

no events that would explain a comparable increase in the incidence of money laundering.

SARs are of variable quality. An enforcement official described one bank as encouraging the filing of SARs with a low threshold but providing minimal information about the transaction—in other words, the purpose was to protect the bank against charges of violating reporting requirements, with little focus on assisting the government. If banks and other regulated firms feel a greater need to protect themselves against government sanctions by filing reports, the increase in numbers may not indicate improved diligence. Moreover, the increase may be weakening the effectiveness of the regime in the process by lowering the signal-to-noise ratio. On the other hand, another bank was described as having invested in training its staff to file reports only when there was indeed reasonable suspicion and to make the reports informative. Such discrepancies in efforts point to the need to examine not merely the number of filings but the extent to which they have resulted in detection and punishment of money-laundering offenses.

For the 6½-year period ending October 31, 2002, 940,000 SARs produced 70,000 direct referrals to federal law enforcement agencies, of which almost half were to the FBI. Unfortunately, there is no information on how many resulted in or contributed to cases.

The US General Accounting Office (GAO) has periodically attempted to ascertain the results of the SAR filings in terms of prosecutions and convictions. An early study (GAO 1998) found that state officials reported “limited or no investigative actions” from materials supplied by FinCEN. Even today, the extent to which information provided by SARs has helped to make criminal cases is unclear. Another GAO study (2002) that examined

### **Box 5.1 Detecting money laundering through failures to file suspicious activity reports**

Two relatively small US banks were fined in 2002 for failure to file suspicious activity reports (SARs). In September, the US Financial Crime Enforcement Network (FinCEN) imposed a \$100,000 civil penalty against the Great Eastern Bank of Florida, which had total deposits of \$55 million. Great Eastern failed to alert authorities about the questionable activities of at least 20 different customers. Among the unreported activities were structured deposits, transfers immediately following large deposits, and the deposit of large numbers of sequentially ordered money orders and travelers' checks. In some cases, when Great Eastern did file SARs, the reports lacked the relevant information that would have provided assistance in an investigation. FinCEN determined that Great Eastern's violations were willful because the bank had been on notice to improve its compliance with the anti-money laundering (AML) rules after the Federal Deposit Insurance Corporation (FDIC) repeatedly found material deficiencies in the bank's AML program.

Later that year, Broadway National Bank (BNB) of New York City pled guilty to charges of failing to file SARs, failing to have an anti-money laundering program in place, and permitting the structuring of transactions. According to convicted money launderer Joseph Vershish, the laxness of the BNB staff was well known among those of his profession. Management did not question the origins of cash or ask to know their customers' business locations, and would readily authorize transfers just a few days after large or structured deposits. Security guards would even warn "smurfs" (couriers) of the presence of government agents. The bank's biggest client was convicted drug dealer Alfred Dauber, who alone laundered millions of dollars through BNB. The bank paid a \$4 million fine, a significant but not crippling amount for a bank with \$89 million in total deposits. Since 1998, BNB has been operating under a cease-and-desist order by the Office of the Comptroller of Currency and has established and implemented an effective AML program, according to that agency.

all SARs involving credit cards during a two-year period from October 1, 1999, to September 30, 2001, found 499 such filings, of which 70 were referred to law enforcement agencies (39 federal, 31 state or local). But the GAO noted that FinCEN was unable to report whether any of these referrals resulted in criminal prosecutions.

The requirement itself to file SARs can indirectly generate useful information. Box 5.1 describes two instances in which it was the failure to file by two small banks that provided information that led to penalties against them.

## **Prosecutions and Convictions**

Available data on money-laundering charges in the United States—which come from judicial sources for the federal level and from surveys of inmates in federal and state prisons—cover the number of persons charged, convicted, and imprisoned in federal courts.<sup>1</sup> Charges can be brought against

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1. Judicial data on state court convictions are not available, although the inmate survey presented in more detail below reinforces a general impression that there are few convictions in state court on such charges.

**Table 5.1 Defendants charged with money laundering, 1994–2001**

Year	Money laundering as any charge	Money laundering as primary or secondary charge	Percent with money laundering as primary or secondary charge
1994	1,907	1,341	70
1995	2,138	1,487	70
1996	1,994	1,457	73
1997	2,376	1,619	68
1998	2,719	1,831	67
1999	2,656	1,885	71
2000	2,503	1,771	71
2001	2,110	1,480	70

Source: Bureau of Justice Statistics (2003).

both the customer who seeks to have money laundered and the provider of the service, although the data do not distinguish between these two types of offenders.

### Federal Prosecutions and Convictions

Data on prosecutions and convictions in federal cases are available from the Administrative Office of the Courts (AOC) and the US Sentencing Commission. The data sets are different because the US Sentencing Commission data reflect only those who were sentenced in a given year,<sup>2</sup> while the AOC data reflect all matters related to a criminal charge that were conducted in a given year. For example, some of those convicted in 1999 were not sentenced until 2000. The analysis presented here refers primarily to the AOC findings (Bureau of Justice Statistics 2003), although US Sentencing Commission data are also used to provide some additional insights.

Table 5.1 shows that the total number of defendants charged with money laundering rose from 1994 to 1998 and then fell sharply through 2001. Slightly more than 2,100 persons were charged with money laundering offenses in 2001, compared with more than 2,700 in 1998. Only 22 businesses were criminally convicted in 2001, and for about 30 percent of those charged with money laundering, the offense was not one of the two most serious charges. Table 5.2 shows the number of convictions for which money laundering was the lead offense, which is not necessarily the offense with the highest statutory penalty but normally the one that generated the investigation. In the vast majority of these cases (81 to 88 percent, depending on the year), those charged were convicted.

What predicate crimes generate money-laundering convictions? In this respect, there is a significant difference between those charged with money

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2. These data were accessed online at the National Archive of Criminal Justice Data of the Inter-University Consortium for Political and Social Research, [www.icpsr.umich.edu/NACJD/index.html](http://www.icpsr.umich.edu/NACJD/index.html).

**Table 5.2 Adjudications and convictions in cases with money laundering as the most serious offense, 1994–2001**

Year	Adjudications	Convictions	Percent convicted
1994	1,159	933	81
1995	1,073	906	84
1996	1,241	1,080	87
1997	1,245	1,108	89
1998	1,370	1,199	88
1999	1,571	1,371	87
2000	1,527	1,329	87
2001	1,420	1,243	88

Source: Bureau of Justice Statistics (2003).

laundering as the lead offense and those for whom it was a secondary offense. For about 60 percent of the first group (which constitutes two-thirds of the total), a property offense (embezzlement or fraud) was the predicate crime and for only one in six was the predicate crime a drug offense. However, among the smaller group whose lead charge was not money laundering, about 90 percent were charged with drug trafficking. That is probably the consequence of differences in maximum statutory sentences. Drug offenders face longer sentences than those convicted of money laundering, so drug-money launderers are more likely to be charged with the drug offense if they had any involvement beyond pure money laundering.

The vast majority (84 percent) of those charged with money laundering in 2001 were charged under Title 18 sections 1956 and 1957, which cover the transfer or transportation of criminally derived money or property with the intent to conceal or disguise its illicit nature or origin. The other 16 percent were charged under sections of Title 31 that address monetary reporting/recording offenses such as cash smuggling, structured transactions, and failure to file required reports.

US Sentencing Commission data in table 5.3 provide another view on the same matter, since they include other charges that resulted in convictions. Crimes identified in these data are different from the predicate crimes, in that they may involve an individual who laundered money from a fraud committed by someone else but was also convicted of embezzlement in his or her own right.<sup>3</sup> Of the 1,543 defendants sentenced under one or more money-laundering statutes in 2000, 828 were also convicted of one or more other criminal offenses, and 715 were sentenced only for money laundering. Of the latter, 125 individuals were also charged either with a conspiracy, which might have included a crime other than money laundering, or with being the principal offender. Thus, nearly half of those convicted may have been involved only in the laundering and not in other aspects of the crimes,

3. Data are not available to compare predicate offenses and these other charges.

**Table 5.3 Other offenses for which convicted federal money launderers were sentenced, 1995, 2000**  
(numbers in parentheses indicate percent of total cases)

Offense	1995	2000
Number of cases involving money-laundering statutes <sup>a</sup>	1,155	1,543
Also charged with drug trafficking	351 (30)	467 (30)
Also charged with fraud	151 (13)	258 (17)
Also charged with smuggling (non-drug)	32 (3)	59 (4)
Also charged with racketeering	31 (3)	37 (2)
Also charged with embezzlement	22 (2)	25 (2)
Also charged with tax evasion	15 (1)	23 (2)
Charged with no other crimes	568 (49)	715 (46)
Percent of drug cases also charged with money laundering	2	2
Percent of fraud cases also charged with money laundering	2	1
Percent of smuggling cases also charged with money laundering	1	2
Percent of racketeering cases also charged with money laundering	4	4
Percent of embezzlement cases also charged with money laundering	1	1
Percent of tax evasion cases also charged with money laundering	3	6

a. Includes Title 18 sections 1956 and 1957 (money laundering), and Title 31 sections 5316 (cash smuggling), 5324 (structuring transactions to evade reporting requirements), and 5313 (failure to file currency transaction report).

Source: US Sentencing Commission (2003).

although there is no way to know whether they were customers or providers of money laundering. More than two-thirds of these “pure” money launderers were sentenced under Title 18 statutes as opposed to Title 31.

Table 5.3 shows that for both 1995 and 2000, 30 percent of all defendants convicted of money laundering were also convicted of drug offenses. Of 255 cases in 2000 where a Title 31 offense was one of the charges, 223 (87 percent) had no non-money laundering charges, while 218 (85 percent) had nothing besides Title 31 charges.

Interestingly, of all persons convicted of drug offenses in federal court, only 2 percent were also convicted of money laundering. This figure was not much different from that for those convicted of fraud who were also convicted of money laundering (2 percent in 1995 and 1 percent in 2000). The dominance of drugs among secondary charges for money laundering reflects the dominance of drug offenses in the federal criminal justice system. About 60 percent of federal prison inmates have been convicted of drug offenses.

Money-laundering sentences averaged about 36 months, substantially less than the average of approximately 48 months for all those convicted in federal court (Bureau of Justice Statistics 2003). Seventeen percent of those sentenced under the guidelines were given longer sentences because they had leadership roles. About 20 percent of the cases involved more than \$1 million

in funds (US Treasury 2002, 5). The mean sentence for cash/monetary instrument smuggling (Title 31) was 19.6 months; for structuring transactions, 13.4 months; and for failure to report currency transactions, 8.5 months. These figures are consistent with the conjecture that most of these cases are pure money laundering, usually with a low-level offender who does nothing else but some illegal legwork for the “predicate criminal”; once again though it must be emphasized that the role may be delivering the funds to the launderer rather than providing the actual service.

## Inmate Survey

The federal court data reviewed above have significant limitations because not every successful money-laundering investigation results in a conviction for money laundering, as opposed to some other offense. For example, the prosecutor may drop the money-laundering charge in return for a plea to another charge related to the predicate offense itself. The fact that money-laundering charges usually result from investigations that began with another crime (Joseph 2001) reinforces the concern about the comprehensiveness of the figures. Fortunately, some other data throw light on how many money launderers are in prison, regardless of the offense associated with the inmate’s conviction.

Approximately every five years, the Bureau of Justice Statistics interviews a large sample (about 18,000 in 1997) of inmates in both federal and state prisons. The questionnaire includes items on their criminal activities, not restricted to those for which they were convicted. These data provide an important supplement to the administrative data. Questions in the most recent (1997) survey concerning money laundering have been analyzed by Jonathan Caulkins and Eric Sevigny (of Carnegie-Mellon University and the University of Pittsburgh, respectively), who reported the relevant results of their work in personal communication with the authors. Note that although these data are not directly comparable to any year of court data, since most of those incarcerated in 1997 were convicted in an earlier year, table 5.3 showed little change in the pattern of convictions from 1995 to 2000.

Among federal prison inmates, 3,030 (2.8 percent of the total population) reported that they were serving time for a money-laundering conviction. Two-thirds of those had some drug involvement and another 18 percent reported forgery/fraud convictions.<sup>4</sup> Including those who said that they laundered drug money but were not convicted on that charge, federal prisons in 1997 contained an estimated 4,416 money launderers (5 percent of

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4. Some of the discrepancies between the inmate survey and the court data may reflect the longer sentences of drug offenders; thus the prison population of money launderers will be richer in drug-money launderers than the population entering prison.

the total population). Among those who said that they laundered drug money, only about one-sixth (467) were estimated to have had no other involvement with drugs.

None of the state prison inmates reported that they were currently serving time for a money-laundering offense. However, an estimated 6,368 state prison inmates (0.6 percent of the total population) self-reported that they did launder money, and in every case they reported that the money involved came from drug offenses. This finding that only drug offenders have laundered money is an artifact of the questionnaire, since only inmates reporting drug convictions were asked about money-laundering activities. Only about 100 reported that they were money launderers exclusively; the others said they were also drug dealers. Again, this response may be a consequence of the way the questions were asked.

Many persons who launder money are in prison for other offenses, particularly for drug offenses. Thus, though there appears to be a negligible number of state-level convictions for money laundering, the self-reported inmate data suggest there are actually more money launderers in state prison than in federal prison; money laundering may have been a minor part of their drug-dealing activities and they may have been customers rather than providers of money-laundering services.

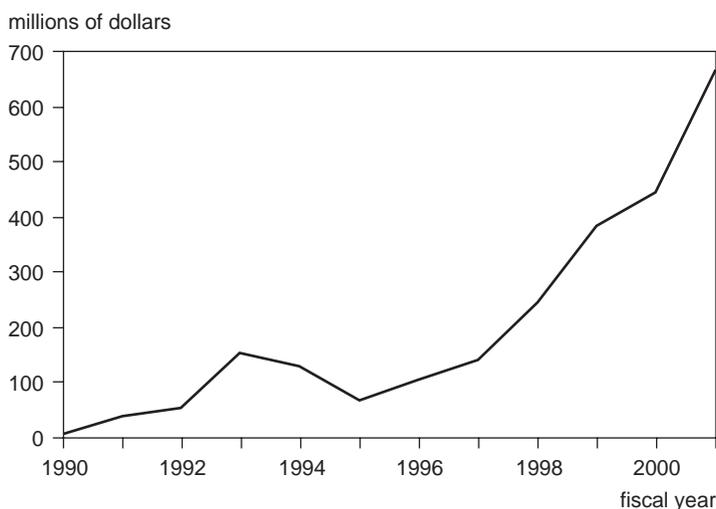
In the federal system, the court statistics (both from the AOC and the US Sentencing Commission) do not suggest a dominant role for drugs. However, the inmate survey suggests that most of those in prison on money-laundering charges were in fact involved in drug dealing. There do not appear to be many stand-alone money launderers in the prison system.

## **Financial Penalties**

Given the nature of money laundering as an offense, prosecution of it, unlike prosecution of a violent crime, can be expected to generate substantial financial penalties. The government may seize the laundered money and other assets of those charged and seek forfeiture upon their conviction. In some cases, these seizures and forfeitures can generate very substantial amounts—a prominent case involving a Bank of New York official in 1999 resulted in criminal forfeitures of \$8.1 million (US Treasury 2002, A-15). In 2001, the only year for which comprehensive data are available, total seizures and forfeitures were \$627 million (US Treasury 2002).

The federal government also levies other financial penalties. Figure 5.2 shows a substantial increase in the total amounts of fines and restitution, from \$100 million in 1996 to \$665 million in 2001. The data, provided by the US Sentencing Commission, reflect the growth in the size of the average penalty rather than the number.

**Figure 5.2 Total fines and restitution for money laundering in the United States, 1990–2001**



Source: US Sentencing Commission (2003).

The relevant metric to assess these figures is the total volume of funds laundered. Choosing an estimated total figure toward the lower end of the usual range, such as \$300 billion, implies that the current level of penalties—seizures, forfeitures, fines, and restitutions—is almost trivial, only four-tenths of 1 percent. However, if the total figure is only a few tens of billions—or at least if the forms of money laundering of greatest social concern are only a few tens of billions—then the level of penalties might be 1 to 3 percent, perhaps enough to have a modest deterrent effect on those tempted to commit the predicate crimes.

## **Enforcement in the United Kingdom and Other Nations**

We treat the United Kingdom separately not so much because of its importance in the international financial system but because it has been more advanced than any other nation, including the United States, in the analysis of its own AML regime. A study of the country's system for suspicious activity reports, funded by the British government (KPMG 2003), found an extraordinary increase in the number of SAR filings since 2000: from 20,000 in 2000 to a projected 100,000 in 2003. According to the study, the increase reflects the extension of AML requirements to lawyers and real estate agents. At least 6 percent of a sample of SARs disseminated by the UK National Crime Intelligence Service resulted in "a positive law enforce-

ment outcome (i.e., prosecution, confiscation, cash seizure, etc.),” while another 5 percent were still being used in an active investigation.<sup>5</sup> The study also noted, however, that there was little feedback from law enforcement agencies to the filing institutions.

In England and Wales, there were only 357 prosecutions for violation of money-laundering statutes in the 12 years from 1987–98 (KPMG 2003).<sup>6</sup> Though the UK Financial Services Authority has made AML a major priority, the sense of strategy in criminal investigations and prosecutions is lacking. That view was reinforced by a recent review of the AML regime in the United Kingdom by the International Monetary Fund, which found that enforcement was limited even though the structure and laws for it were in place (IMF 2003d).<sup>7</sup> The report went on to state: “Cases are generally considered for enforcement only when there is little chance that they will be seriously contested or complicated. . . . The Crown Prosecution does not prosecute any matters other than narcotic money laundering.” In 2000 and the first half of 2001, the report continued, there were only 18 “skilled-person” visits to financial institutions focusing on AML issues (IMF 2003d, 100, 102).

Finally, the IMF noted many financial and professional entities effectively out of the sight of regulators. Money service businesses in the UK had always been subject to the AML regime, but until November 2001 no regulatory agency had responsibility for assuring compliance. Even now, the UK Financial Services Authority has been mandated to provide only a “light touch” supervisory regime for money service businesses.

A report by the Performance and Innovation Unit (2000) of the UK Cabinet Office on the use of confiscation orders also found that the system performed poorly. For non-drug crimes in 1998, for example, only 136 confiscations were ordered and 6 million pounds collected—less than half of what was ordered to be confiscated. For drug cases the numbers were larger, but only 10 million pounds were collected in a market estimated to total some billions of pounds in revenues.

## Other Nations

The US Department of State (2003) provides the numbers of suspicious activity reports filed in other nations as reported by financial intelligence units in those countries. Table 5.4 shows the number of SARs for seven

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5. Given that the researchers were unable to track the ultimate use of most of the sample of SARs, this is the least favorable presentation of the data. By the most favorable analysis, one-third of SARs resulted in a law enforcement success, mostly as intelligence rather than evidence for prosecution.

6. Data were not available for Scotland and Northern Ireland.

7. The United Kingdom was one of the first jurisdictions to permit publication of the detailed findings of the IMF/World Bank review team.

Table 5.4 Suspicious activity reports by country, 1994–2002

Year	Australia		Belgium		France		Japan		Netherlands		Switzerland		United Kingdom		United States	
	SARs/1,000 population															
1994	—	—	942	0.09	—	—	6	—	3,541	0.23	—	—	15,000	0.26	—	—
1995	—	—	3,106	0.31	—	—	4	—	3,001	0.19	—	—	13,700	0.24	—	—
1996	—	—	4,480	0.44	—	—	5	—	2,574	0.17	—	—	16,120	0.28	52,069	0.20
1997	5,772	0.31	7,136	0.70	—	—	9	—	3,800	0.24	—	—	14,140	0.25	81,197	0.30
1998	6,877	0.37	8,754	0.86	—	—	13	0.0001	3,993	0.25	160	0.02	14,120	0.24	96,521	0.36
1999	6,541	0.35	7,995	0.79	1,665	0.03	1,059	0.01	10,803	0.68	303	0.04	14,500	0.25	120,505	0.44
2000	7,085	0.37	9,885	0.97	2,537	0.04	7,242	0.06	11,023	0.69	311	0.04	18,400	0.31	162,720	0.59
2001	7,247	0.37	10,902	1.06	—	—	12,372	0.10	20,282	1.27	417	0.06	—	—	203,528	0.73
2002	—	—	—	—	—	—	18,768	0.14	25,000	1.56	—	—	—	—	224,232 <sup>b</sup>	0.80

— = not available

a. Financial institutions in the Netherlands are required to report "unusual" transactions to the Dutch Financial Intelligence Unit, which then forwards the "suspicious" reports to law enforcement officials.

b. Includes only the first 10 months of 2002.

Sources: SARs: Financial intelligence units in Australia (Australian Transaction Report and Analysis Center—AUSTRAC); Belgium (Belgian Financial Intelligence Processing Unit—CTIF-CFI); France (Unit for Processing Information and Action against Illegal Financial Flows—TRACFin); Japan (Japan Financial Intelligence Office—JAFIO), the Netherlands (Office for the Disclosure of Unusual Transactions—MOT); Switzerland (Money Laundering Reporting Office—MROS); the United Kingdom (National Criminal Intelligence Service—NCIS), and the United States (FinCEN). Population: CIA *World Factbook*, 1992–2001; UK National Statistics Online, 1987–1991.

nations and the United States from 1994–2001. The numbers have such a range as to suggest that very different processes generate them in different nations. For example, Mexico reported 500,000 SARs in 2002, while Argentina reports only 200, yet no one would assert that the Mexican banking system is three orders of magnitude more aggressive in this respect or that money laundering is so much rarer an event in Argentina.<sup>8</sup>

Nations do indeed differ in their approach to the reporting of suspicious activities. For example, in Switzerland the emphasis is on the customer rather than the transaction, and great discretion is given to the reporting institution, in sharp contrast to the United States (Pieth and Aiolfi 2003). The Netherlands saw an 81 percent increase in 2002 over the previous year in the number of “subjective unusual transaction reports,” largely due to the increase in the reporting of international money transfers. Suspicious transaction reports in that country rose 25 percent over the same one-year period, from roughly 20,000 to around 25,000. Unlike in other nations, Dutch financial institutions (as well as casinos and credit card companies) are required to file “subjective unusual transaction reports” rather than SARs with their financial intelligence unit, the Meldpunt Ongebruikelijke Transacties (MOT—Office for the Disclosure of Unusual Transactions). The MOT in turn decides whether to forward these cases in the form of suspicious transaction reports to law enforcement authorities. The strategy appears to be designed to encourage institutions to file a report if they have any doubt at all about a transaction, and let MOT sort the wheat from the chaff. In 2000, a Suspicious Transactions Intranet went into operation in the Netherlands, allowing police to view all such reports since 1997.

In February 2000, Japan expanded the scope of predicate offenses to include all serious crimes. It also overhauled its suspicious transaction reporting system by creating a financial intelligence unit to analyze and disseminate SARs, cooperate with law enforcement officials, and exchange information with units in other jurisdictions. Previously, the Ministry of Finance received the reports but was not required to take any of the aforementioned actions. With these changes, the number of SARs in Japan rose from 13 in 1998 to nearly 19,000 in 2002, more than 12,000 of which were deemed useful in law enforcement investigations.<sup>9</sup>

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8. These countries are not included in table 5.4 but are cited in US State Department (2003).

9. The latter figure has to be taken with some skepticism, since both the share of all SARs and the total number useful to law enforcement seem extraordinarily large. The actual figure suggests a reporting system that, though new, is effective at identifying only questionable transactions, and an enforcement system that is unusually energetic in pursuing these reports. On the other hand, a 2004 report on Japan by the IMF/World Bank (IMF 2004b) noted “the effective application of legal powers appears to be limited, as evidenced by the low numbers of investigations and prosecutions, which may be due, *inter alia*, to the limited resources allocated and to the insufficient level of coordination among the different agencies involved in anti-money laundering and combating the financing of terrorism.”

In Australia (population of 20 million), where every international transaction must be reported, the country's financial intelligence unit—the Australian Transaction Report and Analysis Center (AUSTRAC)—reported 7 million such transactions in 2001, among them 1.7 million deemed by AUSTRAC as “significant,” a broader notion of “suspicious” than that used in the United States. Actual SARs in 2001 numbered only 7,000.

Data on money-laundering convictions and sentences are available for only a few countries. Petrus van Duyn (2003) reports that over 1993–2000 the Dutch police identified 159 criminal cases involving more than \$500,000 (about 1 million guilders at the time), an average of about 20 cases annually; the population of the Netherlands is about 15 million.<sup>10</sup> Arie Freiberg and Richard Fox (2000) report that Australia's money laundering control efforts generate only about 20 convictions on such charges annually, and a German criminologist, Michael Kilchling (personal communication), reports a similarly small figure for Germany.

In summary, it appears that no other nation prosecutes money-laundering offenses as aggressively as the United States, which is a recurrent complaint of US officials involved in international money-laundering matters. Even with the creation of systems that generate large numbers of reports, there is little evidence of substantial criminal investigations that are consistently pursuing substantial cases against violators. The Netherlands, which has relatively sophisticated capability in criminal intelligence and investigation of organized crime, may be an exception, but even there the numbers for major cases remain small compared with the United States.

What might explain this apparent difference in anti-money laundering efforts between the United States and other wealthy nations with sophisticated financial and judicial systems? First, drug trafficking, central to the creation of the AML regime, has been a more significant problem in the United States than in any other industrial nation. Second, the United States launched a successful prosecutory campaign against the Mafia in the 1970s and 1980s that developed many of the legal tools and much of the organizational expertise for money-laundering prosecutions. Only in a very few other nations (notably Italy) has organized crime prosecution been prominent. Finally, the United States has a more aggressive law enforcement culture generally than do most other nations.

These differences between the United States and the rest of the world could be either exacerbated or reduced by the new concern with terrorist financing. While Western European nations have been generally responsive to the new terrorist threat and have collaborated with US agencies, the issue remains more prominent in the United States, which arguably has suffered from terrorism more directly than most other nations, with the most recent tragic exception of Spain in March 2004. However, a 2002 Eurobarometer

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10. A comparable number of cases in the United States on a per capita basis would be 400, rather than the actual figure of about 2,000.

poll suggested similarly high levels of concern about terrorism in the European Union and the United States, with 82 percent of Western Europeans fearing a terrorism incident (European Commission 2003, table 1.13).

## Outcome Measures and Analytic Frameworks

The intermediate performance measures mentioned so far in this chapter do not provide a basis for assessing the effectiveness of the AML regime. Considering the many ways and means to launder the proceeds of crime in the United States and globally, it can be reasonably assumed that no AML regime, consistent with smooth operation and low costs for the economy and financial system, can make laundering impossible. Zero tolerance may be a strategy, but the elimination of money laundering is not feasible, and subtler outcome measures are needed. This section deals with the problem of finding such measures of the effectiveness of the AML in reducing crimes other than terrorism and bribery/kleptocracy, since the bulk of AML activities have been devoted to such criminal activities as drugs, other illegal markets, and white-collar crimes.

Two broad mechanisms of the AML regime help reduce crime. First, customer due diligence and other elements of the prevention pillar can make it more difficult for offenders either to carry out the crime (for example, pay their suppliers) or obtain its full benefits. In this respect, the controls have a prospective effect. Second, suspicious activity reports and other back-end activities (such as those associated with reporting) can generate evidence of a crime, and SARs can also become evidence for investigations that have other origins. In this sense, SARs act retrospectively in that they not only increase the risk of criminal sanction but also provide the basis for seizure of criminal proceeds.

In terms of crime control, the AML regime may generate two other benefits. First, it produces a form of condign punishment. Seizure of funds and incarceration of those who conspire to make the profits legitimate generates revenue for the government and punishes senior offenders. In some instances the only way to apprehend the principal offenders, who separate themselves from the predicate offenses, is to convict them of money-laundering offenses associated with predicate crimes that have been committed by others.<sup>11</sup> Such cases show that the law with respect to a wide range of predicate crimes applies to everyone. Second, AML systems may improve the efficiency of law enforcement, an effect distinct from reducing

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11. In a 1997 speech, then US Treasury Secretary Robert Rubin described money laundering as “the ‘Achilles heel,’ as it gives us a way to attack the leaders of criminal organizations. While the drug kingpins and other bosses of organized crime may be able to separate themselves from street-level criminal activity, they cannot separate themselves from the profits of that activity.” [www.usdoj.gov/criminal/press/VIcount.htm](http://www.usdoj.gov/criminal/press/VIcount.htm).

predicate crime. Even if they do not necessarily result in the government apprehending more offenders, the existence and tools of the AML system may permit the same number of offenders to be captured and convicted at lower cost.

## Market Model

A starting point for an assessment of the relationship between the AML regime and the reduction in predicate crime is to view money laundering as a market, with customers for, and suppliers of, money-laundering services. Specific AML interventions can then be linked to predicate crime reductions by how they affect the money-laundering market, particularly the price of services and, thus, the returns from crime, as illustrated by the analysis in chapter 4 of the five US National Money Laundering Strategies.

For example, if money laundering is more difficult (expensive), then drug dealers will face higher costs and charge higher prices for their services, thus reducing the consumption of drugs. Assume that prior to the creation of an AML regime, a high-level drug dealer charged his customers (themselves lower-level dealers) \$10,000 per kilogram of cocaine and received \$10 million annually in gross revenues. As a consequence of the barriers imposed by the AML regime, assume he now has to pay 10 percent of the proceeds to the money launderer and hence receives only \$9 million. Assuming competition between drug dealers, which seems a reasonable characterization of such a market, the \$10 million previously just compensated the dealer for risks (legal and otherwise) and other costs. In the face of reduced net returns, the dealer will raise prices to customers, and thus increase the retail price of cocaine, making the reduction in cocaine consumption a function of the elasticity of demand.

While combating drugs has been particularly prominent in the development of the AML regime, the same logic applies to other income-generating offenses such as fraud and gambling. By creating a probability of detection and punishment, the AML regime makes money laundering more risky for both customers and providers. It raises the price of the service and/or the costs of searching for the service (customers finding suppliers), which in turn reduces the return from the predicate crime and thus the quantity of these offenses.

What determines the demand for, and supply of, money-laundering services? The demand for money-laundering services can be thought of as a function of the following:

- *The volume of criminal revenues.* Since scrutiny of sources of criminal earnings for low earners is limited, and because low earners do not need to transform (launder) the money they make, it is probably only criminal incomes of more than perhaps \$50,000 annually that create a need for concealing the source.

- *The price of these particular money-laundering services relative to other methods of obtaining the benefit of the unimpeded use of these funds.* At very high prices, potential customers may be content to keep the money in mattresses (metaphorically) or transfer it in small and inconvenient bundles of cash across borders to locations with less stringent controls. Those offenders may be worse off than they would be with untrammelled access to money-laundering services, but they can continue to function, albeit at a lower level.
- *Other costs of laundering money, such as the time it takes to find a supplier and the risk of the search.* Both are influenced by the intensity of enforcement of the AML regime. Money-laundering customers face a risk of legal and financial penalties if they transact with unreliable suppliers. Some potential penalties are derivative of supplier-oriented risk; the launderer can mitigate the penalty by turning in the customer who has committed the predicate offense. In addition, the continuing presence of sting operations, in which the government simulates the behavior of a launderer, poses a separate risk to the customer. That risk may be manifested in the time it takes for customers to find a provider to whom they assign a low probability of being a government agent.

The supply of money-laundering services is determined primarily by the stringency of the AML regime. Absent the prevention pillar of the AML regime and with only a rudimentary enforcement pillar associated with tracing the proceeds of crime back to their source, the cost of laundering those proceeds would surely be low, but not zero. Prior to the 1970 Bank Secrecy Act, criminals could deposit the cash proceeds (no matter how large) from their crimes in local banks with no questions asked by the bank (placement), move them around the world (layering), and enjoy them at their leisure (integration).<sup>12</sup> Criminals and their banks were subject to ex post investigation, but in the absence of authorities having seizure and confiscation powers, and once the proceeds were safely outside the jurisdiction, risks would be minimal. Meyer Lansky, a well-known associate of the US mafia in its heyday, is only the most prominent of criminals who earned money by finding ways to launder earnings from gambling and other illegal markets so as to reduce the risk of the money being traced to its criminal source. He might be charged as an accomplice in the criminal act, but the actual money laundering was not an offense.

Today, it is reasonable to assume that money launderers face no costs other than those posed by law enforcement such as seizure of assets and incarceration. The time involved in actually laundering funds is minimal.

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12. Banks may have nonetheless preferred not to deal with criminal offenders, since a revelation that a particular bank provided services to a major drug dealer might well lead to some social condemnation, even during a time when there were no formal rules prohibiting such dealings.

Some of the price charged for money-laundering services may reflect skill in the methods used for hiding the origins of money, but one can assume that such skills are in ready supply and that enough of those with the skills can be persuaded to commit this crime for an appropriately high fee. Consequently, incarcerating, say, a few hundred launderers will not reduce the pool of competent labor substantially, though it may raise the price that has to be paid to obtain that labor, redistributing criminal income and inducing entry by new participants.

The effective cost of money-laundering services is not fully reflected in the price charged. In addition to search time, the effective cost includes reliability in a number of dimensions such as integrity (delivering the specified amount of money), timeliness (delivering the money when promised), and scope (having a variety of methods of delivery to different locations). Quality among suppliers may be differentiated, reflecting an institution's or an individual's capacity to deliver services reliably, a particularly important consideration in the criminal world. Thus, an observed reduction in prices may reflect a shift from higher- to lower-quality money-laundering services.

## **Multiple Markets**

An important analytic complexity is that there may be more than one market for money-laundering services, depending on the predicate offense and the amount that needs to be protected. For example, as was illustrated in chapter 3, laundering \$1 million in drug revenues from the United States to Mexico may require a higher percentage payment than laundering the same amount in a bankruptcy fraud, simply because the launderer of drug moneys incurs risks of more serious penalties from law enforcement as well as greater potential physical risks (violent retaliation for failure to protect assets). If the transaction involves actual cash, it may also be more expensive (per dollar) to launder large sums than small, for the same reasons. For non-cash operations, the relationship between size and cost may go the other way.

Launderers may also "specialize," either in terms of the kinds of funds they accept or the kinds of institutions with which they transact. Money laundering is also differentiated by phase; some launderers may not provide full-service operations. For example, a simple currency exchange bureau may only move money out of the United States (placement), but not provide for the layering of the money so that it can no longer be traced, or bring it back into the United States where the funds can be freely used with no questions asked (integration). Black market peso brokers, on the other hand, often serve both the supply and the demand ends of the market. They first export the narco-dollars to Colombia (or arrange to purchase them for resale in the United States), then exchange them for pesos for the cartels' domestic use, and lastly provide dollars to Colombian importers who wish

to avoid the costs and bureaucracy of obtaining dollars legally. Thus, the proceeds of drug sales in the United States may resurface, cleaned, in the accounts of US companies that sell their products to Colombian businesses.

One segment of the market for money-laundering services may consist of launderers employing a variety of methods for servicing customers, depending on the latter's specific needs. In this conventional market, the providers have multiple and independent customers and recruit agents (for example, bank officials and casino employees) to ensure that they can provide a range of services. Customers, who know other customers with whom they share information, shift among launderers depending on the price and quality of service. For example, there is anecdotal evidence that drug dealers, circumspect though they may be, do share information about money launderers.

Another segment of the market consists of almost accidental customer-agent relationships. Customers do not find professional money launderers whose principal activity is providing those services, but rather seek out corrupt employees of financial intermediaries who service only one or a small number of clients as a by-product of their legitimate occupations. Search costs are high for both sides, reflecting the risks of disclosing need or availability and the lack of any organizing focal point for the search. For example, in its *1997–1998 Report on Money Laundering Typologies*, the Financial Action Task Force (FATF 1998) referred to a financier who allowed a single drug trafficker to use his company to establish a source of funds. The trafficker gave cash to the financial officer to deposit in a company account, and the funds were then transferred to Monaco for the ostensible purpose of buying Goya paintings. The paintings were fakes and, moreover, were never shipped, and the drug trafficker was the beneficiary of the payments for the fake Goyas, receiving the million-dollar transfers. There was no evidence that the financier's business provided money-laundering services for other clients.

Both types of operations may be components of the market. Some customers in high-risk occupations (for example, cigarette smugglers) with continuing needs in a number of locations may seek out specialized launderers. Others who have a one-time need may be content to find an acquaintance capable and willing to provide the service to just one customer. There is also self-laundering, for example through acquisition of a small business that is on the "exempt" list at a bank (i.e., for which it is not necessary to file a currency transaction report for large cash transactions that are consistent with the regular pattern of the business). No one at the bank or any professional except perhaps a forgiving accountant needs to be involved, at least in the placement stage. The Egmont Group (2000), which provides accounts of investigations by financial intelligence units worldwide, tells of a Western European family of drug traffickers that ran a currency exchange bureau that served as both a cash-intensive front company and a means of laundering money.

As discussed in chapter 3, although professional money launderers certainly exist, they are surprisingly rare in reported cases. A great deal of the revenues from crimes is self-laundered. This is important for both policy and research purposes. The rationale behind the current AML regime is based in part on the implicit assumption that the regime provides tools to apprehend and punish a set of actors who provided a critical service for the commission of certain kinds of crime and who had previously been beyond the reach of the law—an assumption that makes the market model a useful heuristic device for analyzing the effects of laws and programs.

However, if money laundering is mostly done by predicate offenders or by nonspecialized confederates, then the regime accomplishes much less. There is no new set of offenders, just a new set of charges against the same offenders, and the potential gains from the additional tool represented by the AML regime, while valuable in increasing the efficiency of law enforcement, are likely to be substantially more modest than posited (Cuéllar 2003).

For research purposes, this implies that the market-model concept is a strained analogy. Price may not be well defined to most participants because the service is rarely purchased. Risk may also be hard to observe because it is derivative from participation in other elements of the crime. Assessing how interventions increase risks and prices for those transactions that do involve stand-alone launderers will have only modest value. Finally, stand-alone service providers may be scarce.

Thus, the market model may work well for some kinds of predicate offenses and offenders, but less well for others. How this element of heterogeneity in the money-laundering underworld affects the research agenda for improving AML regimes will be taken up in chapter 8.

## **Performance Measures**

To what extent does the market framework help assess the effectiveness of an AML regime in reducing predicate crime? While useful for analyzing some of the basic questions, the available data do not permit application for assessing effectiveness. One source of difficulty is that the price of money-laundering services itself is not an adequate indicator. Enforcement, as noted above, aims at both the demand and supply sides. Demand-side efforts such as stings against customers have the effect of lowering observed prices. By raising the nonmoney cost of purchasing money laundering, which includes some risk of arrest, incarceration, and financial penalties, such stings reduce demand. Supply-side efforts directed at the launderers should raise the price. Both efforts should reduce the quantity of laundering and the net returns from crime, the ultimate goal, but price can then only be interpreted along with estimates of quantity.

Quantity estimates, however, are not available, as there are no systematic estimates of amounts laundered, either through US institutions or

globally (chapter 2). The US Congress has pressed FinCEN to develop estimates with a documented analytical base, but no such estimates have been produced as yet. Nor is it likely that such estimates can be developed in the foreseeable future, given the lack of even the beginnings of a data collection apparatus to support this activity.

An alternative performance measure for assessing the effectiveness of the AML regime in controlling predicate crime is the volume of predicate offenses. Apart from the problem of developing a counterfactual—How much predicate crime would have occurred without the AML regime?—there is a fundamental problem of measuring predicate offense levels.

Consider again illegal drugs, the best studied of the activities generating a demand for money laundering. While there are a number of possible measures—total revenues, prices, or quantities consumed—none is precise enough to be useful for analytical purposes. For example, the error band around existing drug revenue estimates for the United States is very large, with an official estimate of \$50 billion in 1998 (Office of National Drug Control Policy 2000) that should be viewed as the center point of a uniform distribution from \$25 billion to \$75 billion. A decline of 25 percent in a five-year period would be hard to detect with confidence.

Alternatively, one might use drug prices, since the mechanism by which money-laundering controls are expected to reduce drug use is by raising the cost of distribution rather than by reducing demand. A recent National Research Council report (Manski, Pepper, and Petrie 2001) expressed considerable skepticism that the current system of data collection for prices could detect any but the very largest changes in prices. Moreover, there have been large revisions in the estimated prices for cocaine and heroin for a given year in successive estimation efforts, reinforcing the sense of frailty in those estimates.

A third potential measure is the number of dependent drug users. The AML regime is intended to support drug policy efforts to reduce this number. Estimates of the number of dependent users are also imprecise, though less so than estimates of quantities or prices. The official estimates (which are subject to frequent and substantial revisions) do not provide error bands, but any realistic assessment of their precision would suggest that a change of 5 percent would be difficult to detect.

Moreover, it is unlikely that the AML regime itself could have very large effects on the extent of drug use. Low-level drug dealers earn too little to require money-laundering services, yet they account for the bulk of total earnings. Price markups along the distribution system (conservatively estimated at 50 percent at each level) show that more than 60 percent of revenues go to low-level wholesalers and retailers, who are predominantly independent agents rather than employees of larger organizations. At the peak of the crack cocaine market in 1988, average annual earnings of retail drug dealers in Washington, DC, were estimated at \$28,000 (Reuter,

MacCoun, and Murphy 1990). More recent studies report much lower earnings (e.g., Bourgois 1995, Levitt and Venkatesh 2000).

High-level dealers, the only ones who need money-laundering services, account for no more than 25 percent of total drug revenues. Assume that in the current regime money launderers charge customers approximately 10 percent of the amount laundered. Now assume that an improved system raised the price for money-laundering services by half, to 15 percent. The result would be an increase in the price of drugs of only 1.25 percent, far too small to be picked up by existing monitoring systems. This is not an argument that money-laundering controls are neither effective nor cost effective, but only that their success cannot be empirically assessed this way.

The performance assessment situation is even less promising for criminal offenses other than drug distribution. Systematic estimates of the volume of these crimes or revenues are often not available or are effectively made up from thin air. It is implausible, for example, that one could reliably detect a reduction of 10 percent in the volume of (or revenues from) embezzlement or corporate fraud.

Performance measurement is an increasingly important component of responsive and responsible public policy, so the difficulty in finding credible measures of AML regime performance in reducing crime is a major problem. Perhaps more sophisticated versions of market models will help in this respect, but their utility has not been established.

## **Improving Criminal Justice System Performance**

This chapter noted earlier that AML regimes might have two other benefits in addition to controlling crime: improving the efficiency of the system or catching offenders who otherwise would escape. Mariano-Florentino Cuéllar (2003) concedes that such regimes might have improved efficiency in drug control and in reducing a few related criminal activities, but argues that they have failed in the second area. The US AML regime principally has been used to increase the penalties with which prosecutors can threaten predicate offenders. The regime has had little success in apprehending professional money launderers or high-level criminals.

The paucity of cases against stand-alone launderers and investigations that have their origin in money-laundering information supports the criticism that the AML regime has brought in few new offenders. There are no systematic data on the origins of cases against major criminals such as principal drug dealers, so it is impossible to tell whether more of them are being captured through money-laundering laws and investigations.

## **How Risky Is Money Laundering?**

However crude, an estimate of how risky money laundering in the United States has become as a result of the AML regime is helpful in assessing

regime performance. About 2,000 people are convicted of money-laundering offenses (primary or otherwise) each year in the United States. For the moment, assume that all of those convicted are providers of, rather than customers for, the service. This assumption imparts an upward bias to our risk estimate, since we know that some of those convicted are not stand-alone providers of money-laundering services.

To estimate risk, a figure for the total number of persons who launder money is also needed. No such estimate is available, so an indicative calculation is all that can be offered. Assume total US money laundered annually is near the low end of conventional estimates, say \$300 billion. Only 20 percent of those convicted are reportedly involved with laundering more than \$1 million, but that is the amount involved in the specific transactions detected, not an annual flow. If an average money launderer handles \$10 million per annum (which might generate a gross income of \$500,000 to \$1 million), then there would be 30,000 money launderers, and the probability of conviction would be about 6.7 percent (2,000/30,000). For comparison, there are estimates available that the probability of incarceration for selling cocaine in the late 1980s was approximately 25 to 30 percent (Reuter, MacCoun, and Murphy 1990). Though dated, these are the only such estimates for an illegal market.

This exercise is highly speculative; there are other assumptions that might generate a higher estimate of risk without overly straining plausibility. For example, in addition to those who were convicted of money laundering, there may be substantially more individuals for whom those charges were dropped in exchange for information about the predicate offense or for pleas to some other involvement in the predicate offense, even though the individual's principal role was money laundering. If half of those who were caught laundering money were convicted only on other charges, then the risk figure might rise to 13.3 percent. For money launderers with valuable legitimate labor market skills, that risk might generate a very high premium for their services. Compared with drug dealers with little education, such professionals require a higher incentive to risk the same amount of prison time.

These assumptions generously favor a finding that supports the effectiveness of the AML regime. Most of those convicted of money laundering are also convicted of other offenses, and many are probably customers rather than providers. The assumption that each money launderer handles an average of \$10 million per annum imparts a similar upward bias; actual cases point to launderers with much lower volume. That is certainly the case if many of them work for only one client. It is quite plausible that even now, with an elaborate regime in place, money launderers face a less than one in twenty probability of incarceration in the United States. The financial penalties collected by the federal government represent the most modest of taxes, even assuming low-end estimates of money laundering.

However, it must be reemphasized that this is not a complete assessment of the effectiveness of the AML regime. The figures employed cover only those individuals who were themselves involved directly in the money-laundering transaction. It may well be that SARs and other elements of the regime generate useful evidence against larger numbers of drug dealers, but that the final indictments and convictions are for the predicate crime alone. The lack of information on this possibility is a major omission in the current system of data collection.

## Conclusions

For both conceptual and empirical reasons, it is impossible to assess directly how much the current AML regime has reduced the volume of white-collar crime, drug dealing, and other illicit market activity. Little information is available about the prices charged by money launderers, and that price itself is a poor representation of the total client cost of money laundering. Even without having found enough data in the public domain to judge whether prices have risen for particular types of transactions, it would appear that money laundering is not a particularly risky business, given the record of federal convictions. Nor does it seem plausible that a more effective anti-money laundering regime would increase costs to criminal offenders, even drug dealers, enough to be observable with current data series.

The most useful assessment would be an index of the difficulty of laundering money, with difficulty measured as a combination of cost, risk, and inconvenience. Such an assessment would require the systematic collection of data on prices using everything from undercover operations to debriefing those arrested for purchasing or providing services. Such a data collection effort is part of the research agenda put forth in chapter 8.