SM/01/46

February 12, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Financial System Abuse, Financial Crime and Money Laundering—Background Paper**

The attached paper on financial system abuse, financial crime and money laundering provides background information for the informal question and answer session tentatively scheduled on Wednesday, February 21, 2001.

A list of questions that Executive Directors may wish to consider in preparation for, and to stimulate discussion at, the informal question and answer session is being circulated in FO/DIS/01/15 (2/12/01).

Questions may be referred to Mr. H. Evans (ext. 34918) and Mr. Gajdeczka (ext. 37124).

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INTERNATIONAL MONETARY FUND

Financial System Abuse, Financial Crime and Money Laundering—Background Paper

Prepared by the Monetary and Exchange Affairs and Policy Development and Review Departments

In Consultation with Legal and other Departments

Approved by Jack Boorman and Stefan Ingves

February 9, 2001

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I. INTRODUCTION

1. At its September, 2000, meeting the International Monetary and Financial Committee (IMFC), requested that the Fund prepare a joint paper with the World Bank on their respective roles in combating money laundering and financial crime, and in protecting the international financial system. Moreover, the Fund was specifically asked "to explore incorporating work on financial system abuse, particularly with respect to international efforts to fight against money laundering into its various activities, as relevant and appropriate." (See Annex I). The purpose of this paper is to present background information prior to the forthcoming consideration of this requested joint paper with the World Bank.

2. The IMFC recognized that the Fund has to play its role in protecting the integrity of the international financial system from abuse through its efforts, *inter alia*, to promote sound financial systems and good governance.[1] The World Bank, consistent with its development mandate and areas of comparative advantage, plays an important role in assisting countries in legal reforms, often in the context of national anti-corruption programs, and in the design and implementation of capacity building programs (e.g., in the context of legal and judicial reform, establishing protection of shareholders' rights) and the promotion of governance and transparency principles and practices in the financial sector.[2]

3. This paper is organized as follows. Section II reviews current usage and suggests interpretations of various terms such as financial system abuse, financial crime, and money laundering. The empirical evidence on the macroeconomic impact of financial system abuse, focusing on money laundering, is discussed in Section III. The work of other relevant bodies on these issues, especially the Financial Action Task Force (FATF), is presented in Section IV.

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[1] This encompasses, *inter alia*, the Fund's role in the promotion, development, and implementation of internationally agreed standards and codes (see *Assessing the Implementation of Standards: A Review of Experience* (SM/01/11, January 12, 2001), and promotion of sound financial systems (Summing Up by the Acting Chairman, *Financial System Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward*, BUFF/00/190, December 14, 2000, and *Offshore Financial Centers—The Role of the IMF* (SM/00/136, June 23, 2000, and BUFF/00/98, July 14, 2000)). The Board paper on the *Review of the Fund's Experience in Governance Issues*, scheduled for Board discussion on February 14, 2001 reviews the operational experience with governance issues in the context of the framework and objectives of the 1997 Guidance Note on Governance.

[2] *The role of the World Bank Group in Promoting the Integrity of Financial Markets*, SecM-2000-566, September 21, 2000.

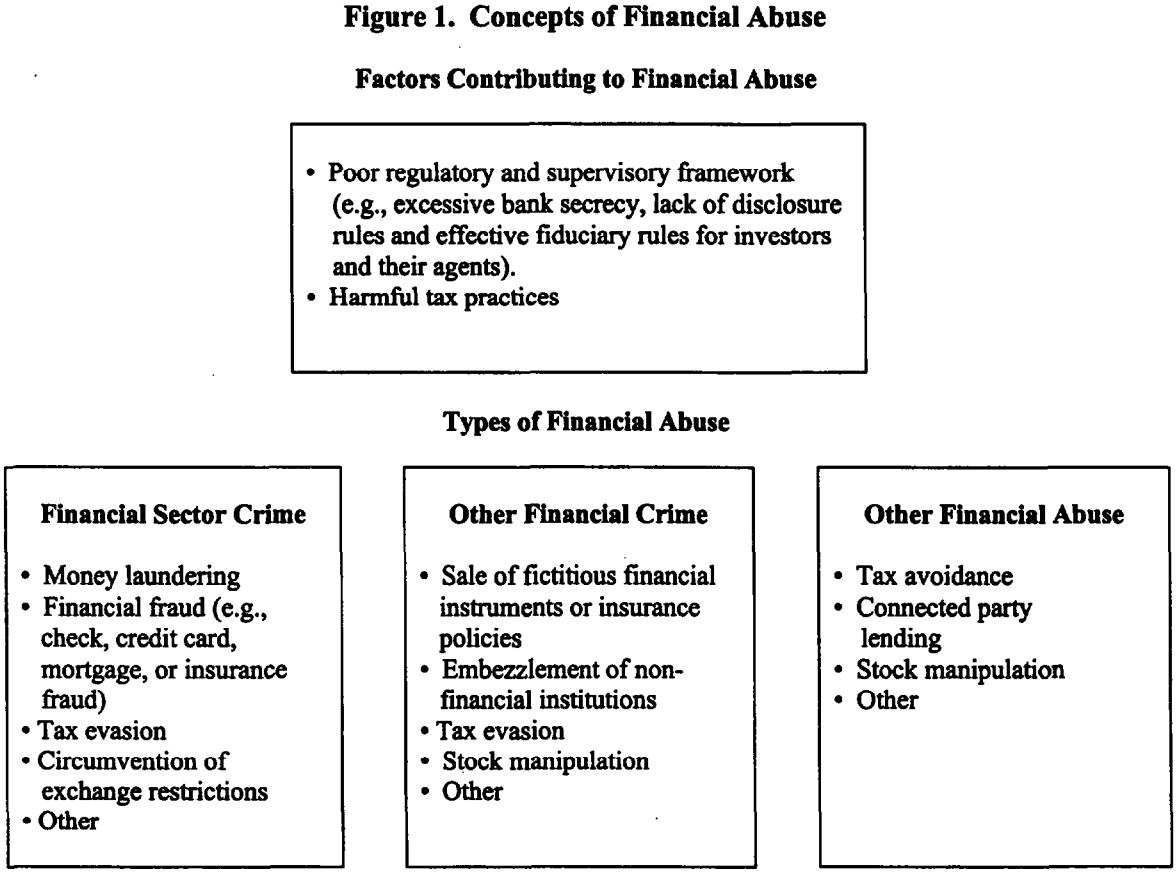
II. What is Financial Abuse and Financial Crime

4. While there seems to be broad agreement on the meaning of such concepts as money laundering, corruption, and tax evasion, the terms financial abuse and financial crime are far less precise, and in fact are sometimes used interchangeably. To assure clarity, including for the operational implications for the Fund and the Bank, definitions are provided below.

5. Usage of these terms (see Annex I) suggests that, among them, financial abuse has the broadest meaning, encompassing not only illegal activities that may harm financial systems, but also other activities that exploit the tax and regulatory frameworks with undesirable results (see Figure 1). When financial abuse involves financial institutions (or financial markets), it is sometimes referred to as financial sector abuse. Financial crime, which is a subset of financial abuse, can refer to any non-violent crime that generally results in a financial loss, including financial fraud. It also includes a range of illegal activities such as money laundering and tax evasion. Money laundering refers to activities involving the processing of criminal proceeds to disguise their association with criminal activities.

6. More precise definitions of financial abuse, financial crime, money laundering, and related concepts are presented below.

Figure 1. Concepts of Financial Abuse



Financial abuse

7. Usage of the terms financial abuse and financial crime, indicate that its meaning varies on different occasions.[4] To clarify usage, it is helpful to distinguish clearly between factors or incentives that facilitate or encourage financial abuse, such as poor regulatory and supervisory frameworks and weak tax systems, and activities that constitute financial abuse. Accordingly, the concept of financial abuse is interpreted in a very broad sense, as including illegal financial activities, many of which have the potential to harm financial systems, and legal activities that exploit undesirable features of tax and regulatory systems.

8. Countries also have different legal characterization of specific acts, such as money laundering, corruption, and tax evasion. For example, considerable variation exists among countries as to which crimes may give rise to proceeds that may be laundered. The concept of corruption is also not uniformly defined. For example, in some countries so-called "facilitation" or "grease" payments given to induce foreign public officials to perform their functions are not illegal, while in others, these are treated as illegal bribes.[5] Agreement is also absent as to other types of financial crime. Some countries consider very low tax rates as abusive or harmful tax competition while others do not.[6] Differences also exist on what is "excessive" in "excessive bank secrecy."[7] Differences exist among jurisdictions as to what

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[4] Annex I provides examples from international usage. As regards national usages, the Edwards Report, commissioned by the United Kingdom in 1998, discusses money laundering, tax evasion, drug trafficking, and fraud as well as illegal capital flight under the general title of financial crime and money laundering. (See Home Department, *Review of Financial Regulation in the Crown Dependencies*, Command Paper, November 1998, Chapters 14 and 15.) The International Narcotics Strategy Report of the U.S. Department of State discusses money laundering along with other financial crimes and tax evasion, and stresses that excessive bank secrecy laws make financial systems vulnerable to abuse from criminal activities, ranging from terrorism to tax evasion. (See U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, Money Laundering and Financial Crimes, March 1999.)

[5] This difference among jurisdictions is reflected in the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Officials in International Business Transactions ("OECD Anti-Bribery Convention"), which in requiring signatories to make the bribery of foreign public officials a crime excludes facilitation payments. See Article 1, OECD Anti-Bribery Convention (entered into force February 15, 1999); Article 1, Commentaries on the OECD Anti-Bribery Convention (adopted by the Negotiating Conference on November 21, 1997).

[6] See Annex II for the OECD concept of harmful tax competition.

[7] Bank secrecy or customer confidentiality is rightfully expected by bank customers and normally is protected by law. It embodies some level of protection of confidentiality of information on individual and business affairs from others, including from government. However, bank supervisors normally have access to such information but cannot share it with government agencies. Banks separately provide information on interest income to tax authorities.

acts constitute crimes, which raise questions as to which domestic laws one country may help another in enforcing. For example, some countries maintain a broad range of exchange controls (e.g., capital controls), violations of which are financial crimes. These financial crimes may not, however, be crimes in other countries.

Financial crime

9. No internationally accepted definition of financial crime exists.[8] Rather, the term expresses different concepts depending on the jurisdiction and on the context. This paper interprets financial crime in a broad sense, as any non-violent crime resulting in a financial loss. When a financial institution is involved, the term financial sector crime is used.

10. Financial institutions can be involved in financial crime in three ways: as victim, as perpetrator, or as an instrumentality.[9] Under the first category, financial institutions can be subject to the different types of fraud including, e.g., misrepresentation of financial information, embezzlement, check and credit card fraud, securities fraud, insurance fraud, and pension fraud. Under the second (less common) category, financial institutions can commit different types of fraud on others, including, e.g., the sale of fraudulent financial products, self dealing, and misappropriation of client funds. In the third category are instances where financial institutions are used to keep or transfer funds, either wittingly or unwittingly, that are themselves the profits or proceeds of a crime, regardless of whether the crime is itself financial in nature. One of the most important examples of this third category is money laundering.

11. Financial institutions can be used as an instrumentality to keep or transfer the proceeds of a crime. In addition, whenever a financial institution is an instrumentality of crime, the underlying, or predicate, crime is itself often a financial crime.[10] There is a growing perception in many key jurisdictions that the most rapidly growing category of predicate crimes are financial, although illegal drug trafficking remains a major predicate crime. Although the circumstances vary from country to country, the preeminence of financial crimes as predicate offenses is found mainly: (i) in major financial centers, and (ii) in the location of a financial institution (e.g., where the criminal profits are laundered) which may be a different location from where the predicate crime was committed.

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[8] Annex III surveys the evolving forms of financial crime.

[9] Those entities whose main activity is financial intermediation are considered financial institutions. This includes a broad range of institutions such as banks, insurance companies, securities firms, brokers, and pension funds. Governments also can be involved in financial crime, when they suffer a loss of revenue, or, on the contrary, facilitate evasion of other countries' taxes.

[10] Predicate crimes are crimes whose proceeds are laundered (see Annex IV).

Money laundering

12. As noted above, money laundering is frequently referred to as a financial crime.[11] It is generally defined as "transferring illegally obtained money or investments through an outside party to conceal the true source."[12] This activity may prevent law enforcement from uncovering or confiscating the proceeds of crime, or using the proceeds as evidence in a criminal prosecution.[13] Such processing may involve disguising the beneficial owner of either the actual criminal proceeds or of other property that might be subject to confiscation. Money laundering can be done with or without the knowledge of the financial institution or counterparty to financial transactions, although to be guilty of the crime of money laundering, actual or implied knowledge is required.

13. The number and variety of transactions used to launder money has become increasingly complex, often involving numerous financial institutions from many jurisdictions, and increasingly using non-bank financial institutions (e.g., bureau de change, check cashing services, insurers, brokers, traders). In addition, because predicate crimes are often financial crimes, laundered proceeds may not be cash but other financial instruments.[14] Also, the use of non-financial businesses and markets for laundering appears to be

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[11] Because money laundering involves an attempt to evade confiscation of the proceeds (as well as any monetary fines that might also be levied), and may involve tax evasion as well (see also Annex II).

[12] Definitions of money laundering have been adopted in common vocabulary, see Oxford English Dictionary, Second Edition, 1989, p. 702. With the exception of what constitutes a specified unlawful activity, there are no significant differences in the definition of money laundering across institutions. FATF defines money laundering as "the processing of criminal proceeds to disguise their illegal origin" and the International Organization of Securities Commissions (IOSCO) as "a wide range of activities and processes intended to obscure the source of illegally obtained money and to create the appearance that it has originated from a legitimate source." (See, FATF, 1996, The Forty Recommendations (see www.oecd.org/fatf/40Recs_en.htm), and IOSCO Technical Committee, 1992, *Report on Money Laundering*, October, No. 25.)

[13] The majority of countries already have in place or are in the process of preparing anti-money laundering legislation. According to the United States State Department International Narcotics Strategy Report for 1999, 110 out of 164 (67 percent) governments or jurisdictions surveyed had criminalized money laundering of illegal narcotics activities.

[14] This implies that traditional money laundering that starts when cash (often from narcotics trafficking) is deposited in one or more banks may no longer be the most common. Increasingly, other institutions and mechanisms are involved, sometimes at different stages of the money laundering process. These include not only businesses that provide bank-like services such as bureau de change, check cashers and money transmission services, but also securities and commodities brokers and life insurance companies.

increasing, including not only illegitimate institutions such as shell companies created as laundering instrumentalities, but legitimate companies where illicit funds are intermingled with legitimate funds. Money laundering methods are diverse and are constantly evolving. They range from trade-related operations to on-line banking. Money launderers may also operate outside financial systems, for example, through alternative remittance systems.[14]

14. Other financial crimes can be associated with, or exist in parallel with, money laundering, for example, corruption, fraud, or the control of a financial institution by organized crime. Upon the receipt of criminal proceeds, criminals may seek to launder them through the financial system. This, in turn, may also require a series of fraudulent activities such as counterfeiting invoices and the corrupting of bank employees. Thus, a whole chain of criminal or illegal activities may culminate in the flow of criminal money through the financial system.[15] Tax evasion, a form of financial crime, is facilitated by the existence of jurisdictions that have low tax rates, maintain relatively lax financial regulations and practices and that do not share information on client accounts with the tax authorities of relevant jurisdictions.

III. The Economic Effects of Financial Abuse, Financial Crime, and Money Laundering

15. Financial system abuse has potentially negative consequences for a country's macroeconomic performance, impose welfare losses, and may also have negative cross-border negative externalities. Globalization and financial market integration in particular facilitates financial abuse. This section briefly reviews the very limited empirical and indirect evidence on the magnitude of financial system abuse, financial crime, and money laundering.[16]

16. Trust underpins the existence and development of financial markets. The effective functioning of financial markets relies heavily on the expectation that high professional, legal, and ethical standards are observed and enforced. A reputation for integrity—soundness, honesty, adherence to standards and codes—is one of the most valued assets by

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[14] For example, black market peso exchange system, the so-called hawala or hundi system of informal banking found in South Asia, and East Asian system originally based on chits or tokens (see FATF, *Report on Money Laundering Typologies*, 1999-2000, February 3, 2000).

[15] For example, a U.S. State Department's Report viewed bribery and corruption as "important factors in criminal exploitation of financial systems and institutions" (see The U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, Money Laundering and Financial Crimes, March 1999).

[16] Tax competition, or harmful tax practices and their impact, will be addressed in a future staff paper.

investors, financial institutions, and jurisdictions.[17] Various forms of financial system abuse may compromise financial institutions' and jurisdictions' reputation, undermine investors' trust in them, and therefore weaken the financial system. The important link between financial market integrity and financial stability is underscored in the Basel Core Principles for Effective Supervision and in the Code of Good Practices on Transparency in Monetary and Financial Policies, particularly those principles and codes that most directly address the prevention, uncovering, and reporting of financial system abuse, including financial crime, and money laundering.[18]

17. Financial system abuse may have other negative macroeconomic consequences. For example, it could compromise bank soundness with potentially large fiscal liabilities, lessen the ability to attract foreign investment, and increase the volatility of international capital flows and exchange rates. In the era of very high capital mobility, abuse of the global financial system makes national tax collection and law enforcement more difficult. Financial system abuse, financial crime, and money laundering may also distort the allocation of resources and the distribution of wealth and can be costly to detect and eradicate.[19] A common theme in research is that "if crime, underground activity and the associated money laundering take place on a sufficiently large scale, then macroeconomic policymakers must take them into account."[20]

18. Economic damage can arise not only directly from financial system abuse, but also from allegations that affect the reputation of a country, or from one country's actions against perceived financial system abuse in another economy. Such allegations or actions can through reputational effects affect the willingness of economic agents, particularly those outside the country, to conduct business in a given country (e.g., inward investment, banking correspondent relationships) with adverse consequences. One recent example includes the impact of the lists published by the FSF, FATF, and OECD, whether or not such listing was deserved. On the other hand, jurisdictions benefit from the economic activity and income attracted by lax regulatory and tax practices.

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[17] Webster's Third New International Dictionary of the English Language, Third Edition, 1993, p. 1174.

[18] These would include the Basel Core Principles 14, 15, 18, 19, and 21. The guidelines on central bank internal governance and audit on the conduct of public officials, and on the accountability and assurances of integrity by financial institutions contained in the Code of Good Practices on Transparency in Monetary and Financial Policies. More generally, see *Experience with Basel Core Principles Assessments* (SM/00/77, April 12, 2000),for a discussion of the motivation and experience with Basel Core Principles Assessments (BCPA).

[19] Taxes and regulations also can distort the allocation of resources.

[20] Quirk, P., *Macroeconomic Implications of Money Laundering* IMF Working Paper, WP/96/66.

19. Activities underlying financial system abuse and financial crime are, by definition, concealed and therefore their direct observation by the macroeconomist or statistician is not possible. In the absence of hard statistical data and appropriate methodology, indirect methods have been used to estimate the potential volume of such activities. Estimates have used two different types of information—inference based on available macroeconomic data and direct information collected by law and tax enforcement agencies. Both approaches have problems and neither is particularly robust. Thus, an adequate measure of financial system abuse remains illusive.

20. The macroeconomic approach is not designed to arrive directly at an estimate of magnitude of money laundering or other forms of financial system abuse. Rather, it seeks to assess the magnitude of economic activities not generally counted in official GDP—the underground economy—encompassing a wide range of activities, both illegal and legal that go far beyond the likely scope of financial abuse (including activities where no money changes hands, activities concealed because they are against the law, and activities concealed because the resulting income is not declared to the tax or benefit authorities).[22] The size of underground economies has been estimated to range from 5 percent to 85 percent of official GDP, depending on the country and the methods used.[23] While proceeds from such activities could potentially be associated with financial system abuse, estimates of the underground economy overstate to an indeterminate extent the magnitude of financial system abuse, including money laundering.

21. Another approach to estimating the magnitude of financial abuse uses information about expenditures and prices involved in criminal activity that has been collected in the course of law enforcement (micro-data). The most publicized of such estimates have been for global money laundering by the FATF. On the basis of information about final sales of some illegal drugs (about US$120 billion a year in the United States and Europe in the late 1980s) and extrapolating worldwide and generalizing to include all drugs, and subsequently assuming that 50-70 percent of that amount would be laundered, the FATF estimated that money laundering could reach about 2 percent of global GDP. According to another micro-data based estimate, in one FATF member country, a law enforcement agency prosecuted 1,233 cases, with a total value of US$1.6 billion. A study of Australia estimated money laundering in 1995 at nearly US$3 billion or about ¾ percent of GDP.[24] Given that law

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[22] This estimated discrepancy might also indicate deficiencies in statistical practices used by individual countries to estimate GDP rather than an estimate of the traditional underground economy.

[23] Macroeconomic estimates are based largely on money demand and electricity consumption methods to estimate the size of the underground economy. Annex V reviews the underlying methodologies and measurements of underground activity. Representative work in this area is far from convincing or conclusive.

[24] See FATF, 1996-97 Report on Money Laundering Typologies, available on the website at: www.oecd.org/fatf/pdf/TY97_en.pdf

enforcement based estimates use actual data on reported crimes, and that reported crimes are a subset of all crimes, the real magnitude of money laundering is significantly underestimated.

22. Evidence on financial fraud is also limited. According to a study prepared for the European Commission, fraud in the European Union is estimated to range between 0.2 and 2 percent of GDP.[25] Serious cases of financial fraud, such as Barings, Drexel and Sumitomo and Daiwa cases, each involved losses exceeding US$1 billion. In some cases, there was damage to individual financial markets and the reputations of the companies, markets, and supervisors involved, although the macroeconomic impact was not significant.[26] Fraud by banks, as in the cases of BCCI and Meridien, contributed to considerable losses to depositors in a few countries, and seriously damaged the banking systems of some of the smaller African countries.[27]

23. The costs associated with other elements of financial system abuse, including the damage caused by abuse of poor regulatory frameworks which may contribute to financial crises or undermine confidence in financial system, are even more difficult to identify. The fiscal and output losses from financial crises have been extensively documented.[28] These losses relate to the total costs of the crises—usually caused by a combination of macroeconomic shocks and a fragile financial system—and it is not possible to disentangle the cost of abusing weak regulations on its own. Similarly, difficulties are encountered in estimating the macroeconomic effects of tax evasion and harmful tax competition, and corruption.[29]

24. In sum, the empirical evidence on the magnitude of financial system abuse, financial crime or money laundering is limited but significant impact on individual countries cannot be

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[25] *Fraud without frontiers*, 1997 study by Deloitte Touche for the European Commission.

[26] See for example Instefjord, N., Jackson, P., and Perraudin, W., in an article entitled *Securities Fraud* in Economic Policy No.27, October, 1998.

[27] See IMF staff background paper for the July 2000, Board discussion of *Offshore Financial Centers*, SM/00/136, Supplement 1.

[28] See for example Lindgren, C.J., et al, 1999, *Financial Sector Crisis and Restructuring—Lessons from Asia*, IMF Occasional Paper No. 188, (Washington: IMF); Sundararajan, V. and Baliño, T.J., *Banking Crises: Cases and Policy Issues*, IMF, 1991, and Lindgren. C.J., *Bank Soundness and Macroeconomic Policy*, IMF, 1996. Also see Klingebiel, B., and Klingebiel, D., *Bank insolvencies: cross-country experience*, World Bank Policy Research Working Paper 1620, 1996.

[29] See Tanzi, V., *Globalization, Technological Developments and the Work of Fiscal Termites*, IMF Working Paper, WP/00/181. On corruption, see Graf Lambsdorff, J., *Corruption in Empirical Research—A Review*, Transparency International Working Paper, November 1999.

ruled out. Measurements based on reported crimes underestimate the actual magnitude of financial system abuse, while estimates based on the underground economy clearly exaggerate it.

IV. Countering Financial Abuse and Crime: What Others Are Doing

25. Since the late 1980s, the growing concerns about drug trafficking and the uses made of globalization facilitated by the advancements in communication technology have led to direct and indirect approaches by different international institutions and the international community to combat financial crime and money laundering. The nature and activities of the principal multilateral organizations involved in countering financial system abuse are summarized below and presented in greater detail in Annex VI.

26. The FATF and affiliated regional organizations lead the international efforts in directly combating money laundering. Members of the FATF engage in annual self-assessments and in periodic mutual evaluations of members' anti-money laundering efforts. In June 2000, the FATF identified 15 non-member jurisdictions that it considers as "non-cooperative with international efforts against money laundering." Assessments are based on the review of compliance with the FATF's *Forty Recommendations* (a list of anti-money laundering measures, see Annex VII). Since the FATF is a voluntary task force and not a treaty organization, its recommendations do not constitute a binding international convention.

27. Fund staff has participated, as observers, in most FATF plenaries since 1980. At the request of the FATF, Fund staff made a statement at the June1996 FATF Plenary on the macroeconomic impact of money laundering, and the Managing Director made a statement at the February 1998 FATF plenary.[30] The FATF has recently agreed to share results from their exercises with Fund staff conducting financial assessments, in the context of FSAP and OFC assessments. At a recent IMF Executive Board meeting, the possibility was raised that the FATF could be invited to prepare ROSC modules on Fund members' observance of the FATF's *Forty Recommendations.* Some members of the FATF have asked that the Fund's Article IV surveillance and program conditionality include anti-money laundering considerations.[31] The FATF President, in a letter to Fund management, suggested that the FATF *Forty Recommendations* be adopted as the anti-money laundering standard.

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[30] The background material for this statement has been subsequently published in Peter Quirk's paper, *Macroeconomic Implications of Money Laundering* IMF Working Paper, WP/96/66. At a February 1998 FATF Plenary, Michel Camdessus made a statement on the importance of international countermeasures to money laundering (see, IMF external website).

[31] The possibility was raised that the FATF could be invited to prepare ROSC modules on members' observance of the FATF's Forty Recommendations. The mechanism exists to invite the FATF, or any other group, into the ROSC process, and this could be considered at the forthcoming Board

(continued...)

28. Annex VII, which shows in detail the relationship between the FATF *Forty Recommendations* and banking and other financial sector supervisory principles, demonstrates that of the 40 recommendations, 25 recommendations relate to the financial sector and their substance is in one form or another included by the supervisory principles of the Basel Committee on Banking Supervision, the IOSCO and the International Association of Insurance Supervisors (IAIS). The remaining 15 recommendations relate to the criminalization of money laundering, the seizure of the proceeds, and international cooperation in the investigation, prosecution and extradition of crime suspects.

29. Other direct efforts to counter financial crime are undertaken mainly by the International Criminal Police Organization (Interpol) and national financial intelligence units (FIUs).[31] The United Nations takes part in the direct efforts through the United Nation's Office for Drug Control and Crime Prevention Global Program Against Money Laundering (UNDCCP), which monitors weaknesses in global financial systems and assists countries in criminal investigations.[32]

30. Recently, the international community's awareness of financial system abuse has been heightened by the work of the FSF. In May 2000, the FSF classified 42 OFCs into three groupings, and called on the Fund to take the lead in assessing OFCs adherence to internationally accepted standards and codes.

31. Indirect efforts to counter financial system abuse focus on the preconditions for the proper functioning of financial systems and the formulation and enforcement of relevant laws. These efforts encompass general standards for the supervision and regulation of banks, securities markets, and insurance, as incorporated in the standards developed by the Basel Committee, the IOSCO, and the IAIS. The substance of relevant FATF recommendations is incorporated in the principles of supervision of the Basel Committee and other international supervisory standard-setters.[33]

32. Banking, insurance, and securities markets supervisors are involved in both indirect and direct efforts to combat financial system abuse. Supervisors in different countries exchange information (often based on a network of memoranda of understandings) about

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discussion of the policy paper on financial system abuse. See also *Assessing the Implementation of Standards: A Review of the Experience and Next Steps*, scheduled for Board discussion on January 29, 2001.

[31] See Annexes VI and VIII.

[32] See also the United Nations Convention Against Transnational Organized Crime, adopted in December 2000.

[33] Annex VII gives details of the relationship between the FATF *Forty Recommendations* and the financial supervisory principles and other relevant organizations.

individual banks, insurance companies, or agents in the securities markets, with a view to uncover unsound and illegal activities such as securities fraud, insider trading, or misreporting. Supervision is also exercised over the internal mechanisms to control risks, particularly operational risks, which also contributes to countering fraud and other forms of financial crime.

33. Out of concern over the potential impact of tax-induced distortions in capital and financial flows on welfare and on individual countries tax bases, the OECD initiated coordinated action for the elimination of harmful tax practices.[35] In May 1998, the OECD issued a report on Harmful Tax Competition including a series of 19 recommendations for combating harmful tax practices, established a Forum on Harmful Tax Practices, and proposed Guidelines for Dealing with Harmful Preferential Regimes in Member Countries (Annex II). In June 2000, OECD issued a list of countries it considers as engaged in harmful tax practices.

[35] The Fund is not directly involved in the OECD work on "harmful tax practices." For information on this issue, see OECD, *Harmful Tax Competition, an Emerging Issue*, 1998; and subsequent developments listed on the OECD website www.oecd.org, including the June 2000 listing of 35 jurisdictions as tax havens. In December 2000, the list of these jurisdictions was revised.

CITATIONS ON FINANCIAL SYSTEM ABUSE

The IMFC Communiqué of September 24, 2000:

"The Committee recognizes that the Fund has to play its role as part of the international efforts to protect the integrity of the international financial system against abuse, including through its efforts to promote sound financial sectors and good governance. It asks that the Fund explore incorporating work on financial system abuse, particularly with respect to international efforts to fight against money laundering, into its various activities, as relevant and appropriate. It calls on the Fund to prepare a joint paper with the World Bank on their respective roles in combating money laundering and financial crime, and in protecting the international financial system, for discussion by their Boards before the Spring meetings and asks them to report to the Spring IMFC/Development Committee meetings on the status of their efforts."

"The Committee reiterates that the Fund has a central role to play in bringing together the efforts of other global institutions to strengthen the international financial system in helping to ensure that all countries can benefit from globalization. It agrees that the Fund can best contribute to this global effort and strengthen its overall effectiveness by:

— continuing to deepen its collaboration with other agencies and bodies. In that regard, it welcomes the initiatives of the Managing Director and the President of the World Bank to strengthen cooperation and complementarity between the two institutions;

— promoting, within the context of the Fund's mandate, international financial and macroeconomic stability and growth of member countries, the Fund must sharpen the focus of work in its core areas of responsibility: macroeconomic stabilization and adjustment; monetary, exchange rate, and fiscal policies and their associated institutional and structural aspects; and financial sector issues, especially systemic issues relating to the functioning of domestic and international financial markets."

The G-7 Communiqué of September 23, 2000:

"We have made significant progress in recent months in the international fight against financial system abuse, including money laundering and corruption, in particular through the work of the FATF (establishing a first list of non-cooperative jurisdictions). We re-affirm our strong support for the efforts by the OECD (addressing harmful tax practices), and FSF on OFCs, and by the FATF for the inclusion of its recommendations among the priority international financial standards. We commit to pursue the review of additional non-cooperative countries and territories in the FATF. We are prepared to provide, where appropriate, our technical assistance to jurisdictions that commit to making improvements to their regimes. We are committed, where dialogue to ensure compliance with international standards had demonstrably failed with countries listed as non-cooperative by the FATF, to defining an appropriate and comprehensive set of counter measures. These would include the possibility to condition or restrict financial transactions, in order to protect the international

financial system against abuse and to condition or restrict assistance by the international financial institutions to those jurisdictions. We have already issued advisories to our banks and other financial institutions to demonstrate our commitment in this field. We call on the IMF, the World Bank and the regional development banks to fully integrate the fight against financial system abuse in their surveillance exercises and programs. We urge the IMF and World Bank to prepare a joint paper on their respective roles in combating financial abuse and to protect the international financial system, for discussion by their Boards before the Spring meetings and ask them to report to the Spring IMFC/Development Committee meetings on the status of their efforts."

The Managing Director's Report on Progress in Strengthening the Architecture of the International Financial System and Reform of the IMF of September 19, 2000:

"Illicit activities and abusive market behavior, sometimes facilitated by ineffective supervision of internationally active intermediaries, can undermine market integrity and contribute to international vulnerabilities. Many aspects of the work on architecture will complement work underway on market integrity issues in other for a. Among the initiatives that will help address market integrity concerns are those to: help members implement internationally recognized standards, assess observance of standards, including those in offshore centers; improve supervision and strengthen domestic financial systems, including by undertaking comprehensive assessments of vulnerabilities and developmental needs; and measures to ensure greater transparency in policies and data."

Secretary Summers' Statement to the IMFC of September 24, 2000:

"Abuse of the global financial system is a clear case of a "global public bad" – indeed, it is the dark side to international capital mobility. The international community has begun to take action against financial system abuse, including the public release of three lists of uncooperative or problematic jurisdictions, and has called on the international financial institutions to join in this effort.

Assisting in this effort should be seen as an integral part of the IFI's mandate to protect the integrity of the international financial system. Money laundering activities have the potential to cause serious macroeconomic distortions, misallocate capital and resources, increase the risks to a country's financial sector, and hurt the credibility of integrity of the international financial system. Both the IMF and the World Bank already help countries develop and reform their financial systems, improve governance and fight corruption. They are therefore well placed to encourage and support members now on any of the three lists noted above to get off them, and to help keep members off lists in the first place. This does not mean that the Fund or Bank should engage in law enforcement activities, which are certainly outside their mandates. But both can play a greater role in fighting abuse and preserving the integrity of the international financial system.

We therefore urge the IMF and the World Bank, consistent with their mandates, to institutionalize the fight against financial abuse and to report on their efforts by the time of the spring meetings. To initiate this effort, the Fund and the Bank should prepare as soon as possible a joint report on their roles in protecting the integrity of the financial system against abuse. In our view, the Fund could incorporate work on this issue into various activities, including technical assistance, surveillance, financial sector assessments, and lending conditionality, where relevant and appropriate. We believe country programs and loan operations should incorporate, as appropriate, preconditions and performance criteria designed to help countries make real and measurable progress in combating money laundering. ROSCs offer a flexible process for incorporating assessments of countries' observance of the FATF Forty Recommendations as another separate module."

The G-20 Communiqué of October 25, 2000:

"In particular, we agree to: ... strengthen our efforts to combat financial abuse, including money laundering, tax evasion and corruption, given its potential to undermine the credibility and integrity of the international financial system, cause serious macroeconomic distortions, and jeopardize national financial sectors. Market integrity is an important pre-condition for financial stability, and we look forward to the joint paper by the IMF and World Bank asked for by the IMFC on their respective roles in combating financial abuse and in protecting the international financial system."

The G-24 Communiqué of September 23, 2000:

"Ministers agree that the Fund, in collaboration with the World Bank, must focus on systemic issues relating to the functioning of financial markets.

Ministers recognize the positive aspects of the development of international codes, standards, and best practices in the spheres of data dissemination, fiscal transparency and transparency in monetary and financial policies, and the management of debt as well as reserves. However, they note that the participation of developing countries in discussions on the development of these standards and codes has been limited, and they call for a more inclusive process. Ministers continue to underline the voluntary nature of implementing such codes and standards, taking into account the particular institutional capacities and stage of development of each country. They also stress the importance of the availability of appropriate technical assistance where needed. Ministers find the application of codes and standards to be highly asymmetric. Standards in the area of transparency are being pressed upon developing countries without a commensurate application of corresponding obligations for disclosure by financial institutions, including currently unregulated highly leveraged institutions. Ministers would insist that any monitoring of standards and codes within the corresponding competencies of the Bretton Woods Institutions should be done on a strictly symmetric basis. Moreover, compliance with such standards and codes should not be prematurely integrated into the Article IV consultation process and must not become a condition for use of IMF resources."

The Board's Conclusions on the OFC Discussions, BUFF/00/98 of July 14, 2000:

"Directors stressed that effective anti-money laundering measures are important for the integrity of the financial system, as well as for fighting financial crime. They noted that such measures are part of the core supervisory principles covering all financial sectors, and are included in the assessments by the IMF and World Bank staff in joint FSAP reports and in Basel Core Principle Assessments. Directors also noted that anti-money laundering measures are being assessed and promoted by the FATF, whose efforts include law enforcement measures, which would not be appropriate for the Fund to assess. However, a few Directors called for intensified cooperation with the FATF, including in order to explore the possibility of preparing Reports on Observance of Standards and Codes modules that would also cover money laundering issues. A few Directors also underscored the importance of more effective cross-border collaboration among national supervisors, *inter alia*, to combat money laundering."

OECD INITIATIVES ON HARMFUL TAX PRACTICES

In May 1998, the OECD issued a report on Harmful Tax Competition (the 1998 Report), which adopted a series of 19 Recommendations for combating harmful tax practices,[36] established a Forum on Harmful Tax Practices, and proposed Guidelines for Dealing with Harmful Preferential Regimes in Member Countries, with a view to providing coordinated action against harmful tax practices that by distorting capital and financial flows could erode individual countries' tax bases, and reduce welfare.

The Forum on Harmful Tax Practices assesses existing and proposed preferential tax regimes in member and non-member countries by examining the effectiveness of tax and non-tax counteracting measures, as well as whether a particular jurisdiction is a tax haven. The 1998 Report set out "features of tax regimes which suggest that they have the potential to constitute harmful tax competition." The main factors include: (i) low or no taxes on the relevant income; (ii) the regime is ring-fenced from the domestic economy; (iii) lack of effective exchange of information; and (iv) lack of transparency. The Forum is also exploring the possibility of extending its mandate to incorporate other topics that may be relevant to the subject of harmful tax practices. These topics include restricting the deductibility of payments made to tax haven entities, imposing withholding taxes on payments to residents of countries with harmful preferential regimes, and the application of transfer pricing rules and guidelines.

The Guidelines on Harmful Preferential Regimes in Member Countries aim at preventing member countries from adopting new measures or extending the scope and/or strength of existing ones that are considered harmful tax practices (standstill provision). At the same time, they recommend that current harmful tax practices be eliminated within a five-year time span (roll-back provision). These Guidelines also indicate the Forum on Harmful Tax Practices as the appropriate venue for member countries to coordinate their national and international responses to harmful tax practices.

On June 19, 2000 the OECD announced that Bermuda, Cayman Islands, Cyprus, Malta, Mauritius, and San Marino had committed to eliminate harmful tax practices and to observe international tax standards for transparency, exchange of information and fair tax competition by end-2005. On June 26, 2000 the OECD released a list of 35 jurisdictions that are considered tax havens under the above-mentioned criteria, as well as the results of its review of OECD member country preferential regimes. On June 29, 2000 a symposium of 29 member countries and 30 other countries was organized to consider a coordinated response to the challenges posed by harmful tax practices. Talks in Barbados held during January 8-9, 2001 led to agreement between the OECD and a number of regional authorities on very broad principles of transparency, non-discrimination and exchange of information.

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[36] Luxembourg and Switzerland abstained. See http://electrade.gfi.fr/cgi-bin/OECDBookShop.storefront/EN/product/231998041E1 for the 1998 Report.

WHAT IS FINANCIAL CRIME—A SURVEY OF CONCEPTS

There is no single, broadly accepted understanding of the meaning of the term 'financial crime.' Rather, the term has been used to describe a number of different concepts of varying levels of specificity.

At its absolute broadest, the term has occasionally been used to refer to any type of illegal activity that result in a pecuniary loss. This would include violent crimes against the person or property such as armed robbery or vandalism.

At its next broadest, the term has often been used to refer only to *non-violent* crimes that result in a pecuniary loss. This would include crimes where a financial loss was an unintended consequence of the perpetrator's actions, or where there was no intent by the perpetrator to realize a financial gain for himself or a related party (e.g. when a perpetrator hacks into a bank's computer and either accidentally or intentionally deletes an unrelated depositor's account records.) Also, the term has occasionally been used slightly more narrowly to refer only to instances where the perpetrator intends to benefit from the crime. Either way, criminal fraud (i.e. the act of illegally deceiving or misrepresenting information so as to gain something of value) for personal benefit is undoubtedly the most common.

The term has been used in a more narrow sense to refer only to those instances where a non-violent crime resulting in a pecuniary loss crime also involves a financial institution. Financial institutions can play one of three roles: (i) perpetrator, (ii) victim, or (iii) knowing or unknowing instrumentality of crime. Of these, the most common are probably when the financial institution is a victim of fraud and when it is used as an instrumentality for money laundering.[37] Some of the more common examples of the former include credit card fraud, check fraud, mortgage fraud, insurance fraud, pension fund fraud, and securities and investment fraud.[38]

With the ongoing development and increasing sophistication of commercial and financial enterprises, coupled with the consequences of globalization, the range and diversity of financial crime is likely to increase.

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[37] The question has been raised as to whether money laundering itself necessarily results in a financial loss. However, it has been argued that money laundering involves an attempt to evade confiscation of the proceeds (as well as any monetary fines that might also be levied), and also frequently involves tax evasion as well, either of which would result in a loss to the public budget.

[38] Some of the more common examples of financial crimes that may not necessarily involve a financial institution as include bankruptcy fraud, health care fraud, cellular phone fraud, antitrust fraud, telemarketing fraud, and certain advance fee schemes.

The Financial Crimes Division of the United States Secret Service has recently drawn attention to four areas of particular concern.[39] These include the fraudulent use of fictitious negotiable instruments, desk top publishing, identity fraud through use of the internet, and advance fee fraud.

- *fictitious negotiable instruments.* These are instruments that have been fraudulently produced and have no underlying or intrinsic value. They are negotiated, often with supporting fraudulent documentation (e.g. the Indonesian promissory note, the Philippine victory note, and the Georgian IMEX bank certificate) to underwrite loans or to be sold to individual investors, pension funds, or retirement accounts. A common form includes so-called "prime bank instruments."

- *desk top publishing.* Improvements in the quality of computers and printers, as well as the decrease in prices for such equipment, has made it easier to manufacture virtually undetectable fictitious checks, bonds, securities, and other counterfeit instruments and obligations. These can then be used for fraudulent purposes.

- *advance fee fraud.* This type of financial crime is associated with organized criminal enterprises (often operating from outside the borders of the country in which the fraud is perpetrated) who use a method known as the over-invoicing contract scheme. A company or individual typically receives an unsolicited letter by mail from an alleged foreign government official seeking the assistance of a reputable local company or individual into whose bank account he can deposit large amounts of money, alleged to be the result of over-invoiced government contracts. Once the victim has committed to the scheme, an unforeseen tax or fee payable to the foreign government arises, which the victim has to pay by making deposits into a bank account, alleged to belong to the foreign government.

- *identity fraud through use of the internet.* Hackers have become increasingly sophisticated with respect to gaining access to computers of financial institutions and have been able to download personal and financial information (such as credit card and checking account numbers), and to perpetrate account take-over schemes and other similar fraud. Despite encryption technology, individuals with access to internet access codes can still perpetrate a myriad of fraud using the identity of someone else.

In particular, the emergence of electronic commerce, together with developing computer technology, has focused attention on identity fraud and sophisticated identity theft. Not only does this increase potential harm and loss for unsuspecting victims, but it also opens up new avenues for organized crime enterprises to start operating outside of the banking system and financial sector.

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[39]Based on testimony by the Financial Crimes Division, Hearing of the Senate Banking, Housing and Urban Affairs Committee on Financial Instruments Fraud, September 16, 1997.

PREDICATE CRIMES

Predicate crimes are crimes whose proceeds are laundered. In most countries, however, only the laundering of the proceeds of certain crimes (sometimes known as 'specified unlawful activities' or SUAs) is illegal. In some countries, the range of SUAs is quite extensive, and may include all major crimes whether committed domestically or offshore. In others, the range is more limited. For example, under British law both official corruption and tax evasion, even when committed abroad, are SUAs, while under U.S. law they are not.[40]

A principal reason for such a difference is that the main purpose of anti-money laundering laws is to reduce the incidence of predicate crimes. In the past, countries often applied their anti-money laundering laws only to those crimes that they believed generated sufficient profits such that seizing those profits would materially reduce the incidence of the crime. In addition, especially when considering which foreign crimes to include as SUAs, countries often would only include those crimes that had pernicious affects in their own countries. Until recently, the most important of these crimes was narcotics trafficking. The first multilateral attempts to fight money laundering focused largely on this predicate crime, although consideration was also given to other serious offenses.[41]

As the 1990s progressed, non-drug related crimes were becoming increasingly important as predicate crimes to money laundering. The 1995 FATF Report noted that while narcotics trafficking remained "the single largest generator of illegal proceeds . . . in some countries, financial crime (bankruptcy and financial fraud, advance fee fraud, etc.) is believed to be as important a source of criminal funds." Canada, Denmark, France, Switzerland, the United Kingdom, and the United States now report that a majority by value of all proceeds is being generated by financial crime, while other members of the FATF have reported that while perhaps not constituting a majority, financial crime is becoming increasingly important as a predicate offense. A number of countries, including the United States, Switzerland, and Australia, have also reported that a majority of suspicious transactions reports from financial institutions relate directly to various types of financial fraud, and not to money laundering.[42]

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[40] Article 7 (Money Laundering) of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (February 15, 1999) requires that signatories include bribery of a foreign public official as an SUA *only if* bribery of a domestic public official is already a SUA.

[41] For example, The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (December 20, 1988) bound the signatories to include narcotics trafficking only, while the1990 Council of Europe Convention on the Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime (Council Directive 91/308) stated that other, non-narcotics-related crimes "such as organized crime and terrorism" should be included. The 1990 FATF Report on Money Laundering suggested that each country should consider including "all serious offenses ..." while noting the primacy of narcotics trafficking.

[42] This information has been compiled from country reports for the 2000 FATF Typologies Exercises and from oral reports at the 2000 FATF Plenary Meeting.

THE ESTIMATION OF THE SIZE OF THE UNDERGROUND ECONOMY [43]

This note provides a brief review of the methodologies used in economic literature to estimate the size of the underground economy and reports on the estimates of such "shadow" activities in developing, transition, and OECD countries.

A. Methodology

Two methods have most often been used to estimate the size of the "shadow" or underground economy: a direct and an indirect approach..

The direct approach includes studies using detailed information obtained in the course of criminal investigations, along with tax records and other government data sources, and build up estimates sector by sector for the underground economy. An early (1974) U.S. study which excluded the proceeds of tax evasion estimated value-added in illegal activities at 4-9 percent of GDP. More recent work within an FATF ad hoc group formed in 1997 to estimate the magnitude of money laundering has focused its efforts along these lines, including gathering together available national and international data in relation to drug consumption, production, and pricing. A study for Italy estimates turnover in illegal activities in 1990 at 2 percent of GDP.[44] The respective value-added figures for Australia, Canada, and the Netherlands are three-quarters of 1 percent, 2-3 percent, and less than 1 percent of GDP.[45] However, the existing data sampling at national levels is thought to be too narrow at present to provide a sufficiently reliable basis for estimation. The data tends to be marked by wide variability over time and between countries, and further work to improve the basis for data collection is required.

The indirect approach is based on macroeconomic indicators that contain information about the underground economy. Five indicators are usually considered: (i) the discrepancy between income and expenditure statistics, assuming that the income measure of GDP should be equal to the expenditure measure of GDP reported in the national accounts; (ii) the discrepancy between the official and actual labor force—assuming that a decline in participation to the official market may reflect increasing activity in the underground economy; (iii) the discrepancy between official GDP and total nominal GDP (transactions approach) assumes a constant relationship over time between the volume of transactions and

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[43] This note draws from Schneider and Enste (2000), which includes a discussion of the pros and cons of each of the empirical methods, as well as of the detailed estimates of the size of the underground economy in 76 countries. A reading list for further reference is included at the end of this note.

[44] Rey, G.M. *Economic Analysis and Empirical Evidence of Illegal Activity in Italy*, Istituto Nazionale di Statistica, no. 6, 1997.

[45] Van der Werf, R., and van de Ven, P., *The Illegal Economy in the Netherlands.*

official GDP (Fisher's quantity equation); (iv) the discrepancy between actual or "excess" demand for money and the demand for money that can be explained by conventional or normal factors (currency demand approach) considers that currency is the main (only) means of payment used to settle transactions in the underground economy; (v) the discrepancy between actual and official GDP estimated on the basis of electricity consumption—assumes that economic activity and electricity consumption move together, with an electricity/GDP elasticity close to one.

To overcome the pitfalls of these various indirect methods, in particular that the estimation procedure considers only one indicator to capture all effects of the shadow economy in the labor, production and money markets, a "model" approach has been developed. Its objective is to consider explicitly multiple causes and effects of the underground economy over time.[46]

B. Evidence

Schneider and Enste (2000) present estimates of the aggregate size of the underground ("shadow") economy in 76 developing, transition, and OECD countries, obtained by combining results from the various indirect estimation methods summarized above. Table 1 reports estimates of the underground economy for developing, transition, and OECD countries. They also report estimates of the underground economy based on the "model" approach for five OECD countries—they range from 6 to 11 percent of GDP during 1976-80. The information value of these aggregate estimates is compromised by both the weaknesses of the underlying methodologies and by the fact of combining estimates based on different methods, statistical approaches, and specifications across countries.

Table 1. The Underground Economy in Developing, Transition, and OECD Countries

Countries	Range (in percent of GDP)
Developing countries	
Africa	20-76
Central and South America	25-61
Asia	13-71
Transition countries	8-63
OECD countries	5-28

Source: Schneider and Enste (2000): range of average size estimated over different years and with different methodologies presented in various tables.

[46] See Frey, S., and Weck-Hannemann, H., (1984), and Aigner, Schneider, and Gosh (1988).

Others have estimated the size of the underground economy in individual developing and industrialized countries. In the case of **Bangladesh**, the estimate—currency demand approach—showed that the shadow economy had shrunk from 83 percent of recorded GDP in 1977 to about 40 percent in 1988-91, but had expanded again to 54 percent of recorded GDP by 1996 (Appendix to technical assistance report for Bangladesh). In the case of **Pakistan**, Shabsigh (1995) estimated—currency demand approach—the size of the underground economy to be about 23 percent of recorded GDP on average over 1974-1991, whereas Iqbal and Qureshi (1997), using the same approach, estimated it at 68 percent of GDP in 1996. In the case of **Canada**, Spiro (1996) estimated—currency demand approach—at 8 percent of GDP the size of the underground economy in 1993.

The above empirical evidence points to the difficulty in assessing non-observable economic variables. However, the magnitude of some of these estimates underscores the possible effects that un-observed transactions could have on macroeconomic variables.

Selected Reading List

Author	Year	Title	Source
FAD	1997	Toward Medium-Term Structural Reform and Improved Performance of the Revenue System	TA Report from Bangladesh
Aigner, Dennis Schneider, Friedrich Ghosh, Damayanti	1988	Me and My Shadow: Estimating the Size of the U.S. Hidden Economy from Time Series Data, in W. A. Barnett, E.R. Berndt and H. White (eds.), *Dynamic Econometric Modeling*, Cambridge (Mass.)	Cambridge University Press
Barthelemy, Philippe	November 1985	The Macroeconomic Estimates of the Hidden Economy: A Critical Analysis	University Aix-Marseille III
Feige, Edgar L.	1990	Defining and Estimating Underground and Informal Economies: The New Institutional Approach	World Development Vol. 18 No. 7 (Pergamon Press Plc)
Frey, Bruno S. Weck, Hannelore	1983	"Bureaucracy and the Shadow Economy: a Macro-Approach" in: Hanusch, H. (ed.), *Anatomy of Government Deficiencies*	Springer-Verlag, Berlin
Frey, Bruno S. and Pommerehne, Werner W.	1982?	Measuring the Hidden Economy: Though This Be Madness, There Is Method in it.	
Houston, J.F.	June 1987	Estimating the Size and Implications of the Underground Economy	Federal Reserve Bank of Philadelphia, Working Paper No. 87-9
Iqbal, Zafar & Qureshi, Sarfrz Kahn	1997	The Underground Economy in Pakistan	Pakistan Institute of Development Economics
Quirk, P.J.	June 1996	Macroeconomic Implications of Money Laundering	IMF, WP/96/66
Schneider, Friedrich and Enste, Dominik	February 2000	Shadow Economies Around the World: Size, Causes, and Consequences	IMF, WP/00/26
Shabsigh, Ghiath	October 1995	The Underground Economy: Estimation, and Economic and Policy Implications—The Case of Pakistan	IMF, WP/95/101
Spiro, Peter S.	April 1996	Monetary Estimates of the Underground Economy: A Critical Evaluation	Canadian Journal of Economics
Tanzi, Vito	December 1980	Underground Economy and Tax Evasion in the United States: Estimates and Implications	Banco Nazionale del Lavoro *Quarterly Review*

INTERNATIONAL ORGANIZATIONS INVOLVED IN COUNTERING FINANCIAL SYSTEM ABUSE, FINANCIAL CRIME, AND MONEY LAUNDERING

International efforts to combat financial system abuse, financial crime, and money laundering intensified in the late 1980s, sparked by the growing concerns about drug trafficking and the recognition that the internationalization of trade and finance and advancements in communication technology may facilitate money laundering. Since then, countering financial crime, and money laundering became an integral part of the agenda of many multilateral organizations.

The interagency response is led primarily by the Financial Action Task Force (FATF) and the affiliated regional organizations. Other international organizations, including those with a general mandate (such as the United Nations) and those with a specialized focus (particularly, the Financial Stability Forum and international standard-setting bodies of financial sector supervisors) also contribute. The nature and activities of the principal multilateral organizations currently involved in countering financial system abuse, financial crime, and money laundering is summarized in this Annex.

The Financial Action Task Force on Money Laundering and the Affiliated Multilateral Organizations

1. FATF

The FATF was established by the G-7 in 1989 with a mandate to examine measures to combat money laundering, largely in recognition of the enormous proportions of the drug problem. The FATF now includes 29 member countries and two regional organizations from the Americas, Europe, and Asia, as well as 18 observers (including the Fund and the World Bank).[47] Although located at the OECD, where it maintains a small secretariat, the FATF is independent of the OECD. The FATF is the principal anti-money laundering multilateral organization.

Since the FATF is a voluntary task force and not a treaty organization, its *Forty Recommendations* do not constitute a binding international convention. However, each FATF member undertakes a firm political commitment to combat money laundering by implementing the recommendations. Besides self-assessment exercises and mutual evaluations, the FATF, in close collaboration with its members and other organizations,

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[47] Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece; Hong Kong SAR; Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Kingdom of Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; the European Commission and the Gulf Cooperation Council.

conducts regular *typology exercises* to uncover new money laundering techniques and to develop strategies for countering them.

The FATF's anti-money laundering efforts summarized in the Forty Recommendations relate to the enforcement of criminal laws and to complementary measures in the financial sector, and international cooperation. The recommendations that apply to law enforcement can be grouped according to those for: (i) the criminalization of money laundering, (ii) the seizure and confiscation of money laundering proceeds, (iii) suspicious transaction reporting, and (iv) international cooperation in the investigation, prosecution and extradition of crime suspects. Recommendations dealing with financial sector regulations relate primarily to customer identification and record keeping requirements, which together are commonly referred to as "know-your-customer" standards.

FATF members are reviewed for their compliance with the FATF *Forty Recommendations* (issued in 1990 and modified in 1996) through mutual evaluation by their peers, where assessors from member countries carry out on-site assessments on implementation and prepare a detailed report on compliance. To date, most members have undergone two rounds of mutual evaluations, which are supported by annual self-assessments to track progress by individual countries in correcting deficiencies. Results from the mutual evaluations and the annual self-assessments are summarized in FATF publications. Although infractions are identified, the extent of noncompliance is not, and seldom has the FATF found it necessary to recommended punitive actions against its members.[48]

In addition to the mutual evaluations, the FATF evaluates non-FATF members' willingness to cooperate with FATF initiatives through its non-cooperative countries and territories (NCCT) exercise. The FATF also evaluates non-members (without their consent) vis-à-vis their compliance with 25 criteria which are based on the Forty Recommendations. This evaluation results in a list of the NCCTs. A listing by the FATF under the NCCT exercise has punitive consequences, as financial transactions with jurisdictions judged as non-cooperative, with relatively severe infractions, are subject to heightened scrutiny by financial institutions in FATF member countries.

A first round of the NCCT exercise has been completed and of 29 countries reviewed, 15 were judged non-cooperative. The list included a number of offshore financial centers in the Caribbean and Pacific, Israel, Lebanon, Panama, the Philippines, and Russia. That report calls on the jurisdictions to resolve the problems identified, and states that the FATF will help provide technical assistance in so doing. It should be noted that the FATF Secretariat

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[48] For example, Austria was non-compliant with the FATF *Forty Recommendations* on the issue of anonymous passbooks, a problem that had existed since the creation of FATF. Only in 1999 did the FATF move to sanction Austria by threatening its suspension and Austria changed the requirements to comply. The threat to sanction a member was apparently unprecedented.

does not normally itself provide much technical assistance, although its members do provide bilateral technical assistance.

2. Regional Anti-Money Laundering Organizations

In recent years, the FATF helped create a number of regional anti-money laundering organizations. These groups include the ***Caribbean Financial Action Task Force*** (CFTAF), the ***Select Committee of the Council of Europe*** (PC-R-EV) the ***Asia/Pacific Group on Money Laundering*** (APG), and the newly created ***Eastern and Southern Africa Anti-Money Laundering Group*** (ESAAMLG). Membership in these groups requires some kind of commitment to combat money laundering through endorsement of the Forty Recommendations, but not necessarily at the level of the "firm political commitment" as required by the FATF. These organizations also include self- and mutual assessment programs (though they are not requirements for membership) and typology exercises. These organizations have small secretariats and very few resources, and do not typically provide technical assistance. They were not involved in the preparation of the June 2000 FATF report on non-cooperating countries and territories.

3. FATF Sponsored Organizations

Egmont Group of Financial Intelligence Units of the World (Egmont Group) was set up in 1995 with the sponsorship of the FATF, with the membership consisting of financial ***intelligence units*** (FIUs) from 40 jurisdictions.[49] FIUs are agencies responsible for receiving, analyzing, and disseminating disclosures of financial information concerning suspected proceeds of crime in order to counter money laundering. (See also Annex VIII.) The Egmont Group fosters communication among FIUs, has a secure website for sharing information, and has produced a model information sharing agreement. It also provides some technical assistance in setting up and running FIUs.

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[49] Aruba, Australia, Austria, Belgium, Bermuda, Bolivia, Brazil, British Virgin Islands, Bulgaria, Chile, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Greece, Guernsey, Hong Kong, SAR; Hungary, Iceland, Ireland, Isle of Man, Italy, Japan, Jersey, Latvia, Lithuania, Luxembourg, Mexico, Monaco, Netherlands, Netherlands Antilles, New Zealand, Norway, Panama, Paraguay, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, Taiwan, Province of China; Turkey, United Kingdom, United States, Venezuela.

4. Multilateral Organizations Not Affiliated with the FATF

Commonwealth Secretariat

The Commonwealth Secretariat, while not principally involved in money laundering issues, has prepared a Model Anti-Money Laundering Law, designed primarily for use in Commonwealth countries.

Financial Stability Forum

The FSF was convened in April 1999 to promote international financial stability through information exchange and international co-operation. In March and April 2000, the ***FSF Working Group on Offshore Financial Centers*** issued a report on the role of OFCs with respect to global financial stability. Among the market integrity standards four are relevant to money laundering, including access to and sharing of financial information and transparency of ownership structures. The FSF also published a classification of OFCs by the perceived quality of supervision and the degree of cooperation, in part to establish priority jurisdictions for assessment.[50] The FSF has called on the Fund to take responsibility for developing, organizing, and carrying out a process for assessing OFCs' adherence with these and other standards.[51]

In September 2000, the FSF and the Basel-based Financial Stability Institute hosted a seminar on ***Cooperation and Information Sharing Among Supervisory Authorities*** with experts from onshore and offshore financial centers. Fund staff participated in the seminar and provided an overview of the Fund's assessment and assistance program for OFCs.[52]

Inter-American Drug Abuse Control Commission (CICAD)

Set up in 1984 as an autonomous agency of the Organization of American States (OAS), CICAD is primarily involved in coordinating anti-drug programs of the OAS. In 1998, it published a model anti-money laundering law entitled Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Related Offenses.

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[50] FSF Press Release of May 26, 2000, *Grouping of Offshore Financial Centers*, available at www.fsforum.org.

[51] OFC issues were discussed by the Executive Board on July 10, 2000, and a voluntary exercise of OFC assessments involving Fund staff is underway (see SM/00/136, Supplement 1 and BUFF/00/98).

[52] See *Financial Stability Forum—An Update of Activities*, September 20, SM/00/244, October 27, 2000.

Interpol Bureau des Fonds Provenant d'Activités Criminelles (FOPAC)

FOPAC, a branch of the International Criminal Police Organization or Interpol, cooperates with police departments and multilateral organizations in gathering and disseminating information on the movement and laundering of proceeds of crime. It has also developed model legislation designed to make it easier to obtain the kind of evidence needed in criminal investigations and proceedings aimed at confiscation of the proceeds of crime, and is working with United Nations agencies (see below) to complete an automated compendium of information on the status of legislation and law enforcement in different countries. Jointly with FinCEN (the United States FIU), FOPAC is conducting studies in Eastern Europe and Asia on the status of emerging anti-money laundering legislation and investigations.

Offshore Group of Banking Supervisors (OGBS)

The OGBS was established in 1980 as a forum for supervisory cooperation among banking supervisors in OFCs, and comprises most of the larger offshore financial centers. It has participated in mutual evaluation exercises with regional anti-money laundering organizations, and provides some technical assistance with respect to the setting up of FIUs in OFCs.

United Nations Office for Drug Control and Crime Prevention (UNDCCP) and the United Nations Drug Control Program (UNDCP)

One of the early international initiatives on combating money laundering was the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the "Vienna Convention") adopted in 1988. While the Convention primarily focused on drug trafficking, it recognized that even those individuals or firms that are not directly involved in handling drugs but direct, finance, manage or profit from the criminal networks represent drug offenders. Signatories agreed to make money laundering a criminal offense and to eliminate obstacles to the effective investigation of money laundering. The Convention also emphasized the importance of international cooperation and exchange of information to combat drug trafficking. The enforcement mechanism of the Convention was based on the enhanced mutual assistance and extradition process. Recognizing that the main obstacle to the enforcement of the Convention are differences across national legal systems, the United Nations subsequently developed the Model Treaty on Mutual Assistance in Criminal Matters and the Model Treaty on Extradition to bridge gaps between national legislations.

Although, like the CICAD, United Nations offices continue to be primarily concerned with narcotics, they have recently devoted increasing attention to money laundering. Most of the anti-money laundering work is undertaken by the UNDCCP's Global Program Against Money Laundering, designed to monitor weaknesses in global financial systems related to money laundering, and to assist countries in criminal investigations by putting together a team of international investigators and providing technical advice for investigations. However, the UNDCP also funds technical assistance in anti-money laundering, and, along

with FOPAC, maintains an automated compendium of information on the status of legislation and law enforcement in different countries known as the ***International Money Laundering Information Network*** (IMoLIN). The UNDCP has drafted two model anti-money laundering laws, one for civil law systems and one for common law systems. In December 2000, the United Nations Convention Against Transnational Organized Crime and three protocols were adopted. The Convention was opened for signature at a meeting that was held in Palermo on December 12-15, 2000. It will remain open for signature at the United Nations headquarters in New York until December 12, 2002. Ratification of the Convention is a precondition for participation to the protocols. Article 1 of the Convention provides that its purpose is "to promote cooperation to prevent and combat organized crime more effectively." The Convention and the protocols require countries which sign and ratify them to take a series of measures against transnational organized crime. The Convention establishes four specific crimes to combat areas of criminality which are used in support of transnational organized crime activities: participation in organized criminal groups, money laundering, corruption and obstruction of justice. The protocols establish crimes with regard to the smuggling of migrants, the trafficking in persons and the illicit manufacturing of and trafficking in firearms. International cooperation under the Convention is effected through extradition, mutual legal assistance, law enforcement cooperation and collection and exchange of information.

5. International Standard-Setting Bodies in the Area of Financial Sector Regulation and Supervision and Accounting

Basel Committee on Banking Supervision

In the area of countering financial system abuse, financial crime, and money laundering, the Basel Committee has been active on several fronts. With regard to anti-money laundering guidance, the Basel Committee has issued a total of four papers, the last of which remains in draft.[53] The papers give special emphasis to the need for an adequate "know your customer" (KYC) program.

The first paper, the ***Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering***, highlighted key principles which seek to ensure that banks are not used to hide or launder the profits of crime: (i) customer identification; (ii) compliance with laws; (iii) cooperation with law enforcement authorities, and (iv) policies, procedures and training. The Statement noted in this context that "public confidence in banks, and hence their stability, can be undermined by adverse publicity as a result of

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[53] The four papers are (i) *The Prevention of the Criminal Use of the Banking System for the Purpose of Money-Laundering* (1988); (ii) *Core Principles for Effective Banking Supervision* (1997); (iii) *Core Principles Methodology* (1999); and (iv) *Implementing Know-Your-Customer Standards for Banks*. This last paper, which has not yet been issued, aims at strengthening "know your customer" rules for banks.

inadvertent association by banks with criminals. In addition, banks may lay themselves open to direct losses from fraud, either through negligence in screening undesirable customers or where the integrity of the loan officers has been undermined through association with criminals."

The Basel Core Principles for Effective Banking Supervision and the accompanying methodology, specifically, core principle 15, provide important guidance in assessing the adequacy of KYC requirements, suspicious transaction reporting, and sharing of information with other supervisors and law enforcement agencies, both domestic and foreign. (See also Annex VI.)

In the broader area of fraud and financial systems, the Basel Committee published in September 1998 two reports to bank supervisors. The reports on ***Operational Risk Management*** and on the ***Framework for Internal Control Systems in Banking Organizations*** (the Framework paper) are related in that excessive operational risk results from breakdowns or inadequacies in internal controls and corporate governance. Operational risk is defined as the risk that deficiencies in internal controls will result in unexpected loss. Internal control breakdowns have caused financial losses through error, fraud, or other unethical or overly risky behavior. Indeed, it was a failure of the control environment that allowed serious frauds to go undetected at Daiwa Bank, Sumitomo and Barings Bank, and in the recent money laundering case at the Bank of New York.

The Framework paper carries the message that internal controls are essential to maintaining reliable financial and managerial reporting and ensuring compliance with laws, regulations and bank's own policies. For the bank, internal control processes represent the best defense against fraud, misappropriation and errors in financial reporting. The paper identifies the five elements of internal control as (i) management oversight and the control culture; (ii) risk recognition and assessment; (iii) control activities and segregation of duties; (iv) information and communication; and (v) monitoring activities and correcting deficiencies.

International Organization of Securities Commissions (IOSCO)

As with other financial sector standard-setting bodies, IOSCO guidelines seek to prevent the use of securities intermediaries for purposes of financial crime.

In October 1992, the President's Committee of IOSCO passed the ***Resolution on Money Laundering***, which, *inter alia*, stated that each member should consider: (i) the extent to which customer identifying-information is gathered and recorded by financial institutions under its supervision; (ii) the extent and adequacy of record keeping requirements; (iii) the system of reporting suspicious transactions; (iv) procedures in place to prevent criminals from obtaining control of securities and futures businesses; (v) the means to ensure that

securities and futures firms maintain appropriate monitoring and compliance procedures; (vi) the most appropriate means to share information.[54]

IOSCO Objectives and Principles, which were issued in September 1998, emphasize market integrity as a function of securities sector supervision. (This emphasis is in contrast to that in Basel Core Principles and IAIS Core Principles, which focus banking and insurance sector supervision on overseeing individual firms and institutions rather than entire markets.) IOSCO Objectives and Principles also outline key measures which help counter financial crime, specifically financial fraud and money laundering. Securities supervisors are urged to have appropriate domestic legislation in place and require market participants to implement internal controls and policies designed to minimize the risk of the use of the institution as a vehicle for financial crime. Supervisors are also required to have sufficient enforcement powers and to be able to cooperate with their counterparts in other countries, including sharing information with them. Besides money laundering, IOSCO principles also cite insider trading and price manipulation as examples of financial crime.

International Association of Insurance Supervisors (IAIS)

In October 2000 IAIS consolidated and issued ***Insurance Core Principles***. Like Basel Core Principles and IOSCO Objectives and Principles, the insurance principles cover the role of supervisors in dealing with financial fraud and money laundering. In particular, they emphasize the importance of information sharing with foreign counterparts. In contrast to Basel and IOSCO Principles, however, IAIS Principles do not require introducing special regulation or maintaining internal controls to address financial crime and money laundering. Instead, the principles urge insurance supervisors to keep abreast of investigations of financial crimes by the relevant bodies.

International Federation of Accountants (IFAC)

IFAC was formed in 1977 and represents national accounting organizations from 113 countries. One of its primary functions is to issue international standards of auditing (ISAs) for acceptance and application by IFAC member organizations.

In the area of fraud, IFAC has issued guidance on the role of auditors in detecting fraud and errors in financial statements, primarily the ISA 240 standard for fraud and error. ISA 240 establishes that auditors are to obtain reasonable assurance that financial statements are free from material misstatement whether caused by fraud or error. Presently, ISA 240 is being revised and strengthened. The revised draft requires that auditors make a specific fraud risk assessment when performing audits and that the assessment be documented. The revised

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[54] International Association of Securities Commissions, A Resolution on Money Laundering, passed by the President's Committee, October 1992, available at www.iosco.org/resolutions/resolutions-document06.html.

draft provides examples of risk factors that could indicate the presence of fraud and identifies specific actions that the auditor should take when errors fraud is suspected. Additional IFAC guidance is provided in ISA 200, which sets out the objectives and general principles governing an audit and the requirement that auditors use "professional skepticism".

5. Self-Regulatory Initiatives in the Banking Sector

The Wolfsberg Principles

In October 2000, eleven large international banks, in cooperation with Transparency International, agreed to a set of ***Global Anti-Money Laundering Guidelines for Private Banking*** (known as the Wolfsberg Principles). This code, which is for guidance, focuses on KYC requirements, client files, suspicious activities, and monitoring accounts in ways which are consistent with supervisory principles.

THE FINANCIAL ACTION TASK FORCE—FORTY RECOMMENDATIONS AND THE FUND

This Annex provides an overview of how the work of FATF *Forty Recommendations* are partially incorporated in Fund work. As indicated in Annex XVI, the FATF *Forty Recommendations* cover law enforcement, regulation of the financial system and international cooperation. The recommendations for the regulation of financial systems significantly overlap with Basel Core Principles for Banking Supervision, and in line with the Fund Executive Board guidance, staff undertakes assessment of members' compliance with Basel Core Principles (BCP).[55] Also consistently with Board guidance, however, the law enforcement aspects of the FATF recommendations are considered as not appropriate for the Fund to assess.[56]

The FATF recommendations pertaining to the broad areas of law enforcement by general category relate to (i) the criminalization of money laundering (FATF 1, 4, 5 and 6); (ii) the seizure and confiscation of money laundering proceeds (FATF 7, 35 and 38); and (iii) the international cooperation in the investigation, prosecution and extradition of crime suspects (FATF 3, 31, 33, 34, 36, 37, 38, 39 and 40).

The Basel Committee's anti-money laundering guidance can be found in the Core Principles for Effective Banking Supervision, specifically Core Principle 15, which states that: "Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements." The BCP methodology used by assessors to review compliance with essential and additional criteria embodies the FATF recommendations that are relevant to the financial sector.[57] Below is a listing of the essential and additional criteria applicable to CP15 and linkages between the BCP criteria and the FATF recommendations.

Essential criteria applicable to Core Principle 15

1. The supervisor determines that banks have in place adequate policies, practices and procedures that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, by criminal elements. This includes the prevention and detection of criminal activity or fraud, and reporting of such suspected activities to the appropriate authorities.

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[55] See SM/00/136, Supplement 1 and BUFF/00/98.

[56] FATF Recommendation 30 refers to studies by the Fund and the BIS relating to money laundering.

[57] The Basel Committee's *Core Principles Methodology*, October 2000, available on the BIS Website: www.bis.org/publ/index.htm.

2. The supervisor determines that banks have documented and enforced policies for identification of customers and those acting on their behalf as part of their anti-money-laundering program. There are clear rules on what records must be kept on customer identification and individual transactions and the retention period. **(FATF 10, 11 and 12)**

3. The supervisor determines that banks have formal procedures to recognize potentially suspicious transactions. These might include additional authorization for large cash (or similar) deposits or withdrawals and special procedures for unusual transactions. **(FATF 14)**

4. The supervisor determines that banks appoint a senior officer with explicit responsibility for ensuring that the bank's policies and procedures are, at a minimum, in accordance with local statutory and regulatory anti-money laundering requirements. **(FATF 19)**

5. The supervisor determines that banks have clear procedures, communicated to all personnel, for staff to report suspicious transactions to the dedicated senior officer responsible for anti-money laundering compliance.**(FATF 15)**

6. The supervisor determines that banks have established lines of communication both to management and to an internal security (guardian) function for reporting problems. **(FATF 15)**

7. In addition to reporting to the appropriate criminal authorities, banks report to the supervisor suspicious activities and incidents of fraud material to the safety, soundness or reputation of the bank. **(FATF 14)**

8. Laws, regulations and/or banks' policies ensure that a member of staff who reports suspicious transactions in good faith to the dedicated senior officer, internal security function, or directly to the relevant authority cannot be held liable. **(FATF 16)**

9. The supervisor periodically checks that banks' money laundering controls and their systems for preventing, identifying and reporting fraud are sufficient. The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its anti-money laundering obligations. **(FATF 26)**

10. The supervisor is able, directly or indirectly, to share with domestic and foreign financial sector supervisory authorities information related to suspected or actual criminal activities. **(FATF 23 and 32)**

11. The supervisor determines that banks have a policy statement on ethics and professional behavior that is clearly communicated to all staff.

Additional criteria

1. The laws and/or regulations embody international sound practices, such as compliance with the relevant forty Financial Action Task Force Recommendations issued in 1990 (revised 1996). **(FATF 10-29)**

2. The supervisor determines that bank staff is adequately trained in money laundering detection and prevention.

3. The supervisor has the legal obligation to inform the relevant criminal authorities of any suspicious transactions.

4. The supervisor is able, directly or indirectly, to share with relevant judicial authorities information related to suspected or actual criminal activities. **(FATF 23)**

5. If not performed by another agency, the supervisor has in-house resources with specialist expertise on financial fraud and anti-money laundering obligations.

ANTI-MONEY LAUNDERING POLICIES: THE ROLE OF FINANCIAL INTELLIGENCE UNITS

Financial Intelligence Units (FIU) constitute a key element in policies to counter financial crime and money laundering. FIUs are national governmental authorities that receive, analyze, and disseminate financial information and intelligence for the purpose of uncovering and prosecuting crime. With some variation among jurisdiction, FIUs are statutorily empowered to receive a wide variety of financial information from diverse sources. These may include reports by financial institutions of large cash transactions, of some or even all offshore wire transactions, or of unusual or suspicious transactions identified as such by the institution. FIUs also typically have access to information from other domestic governmental sources, including those administering customs, tax, pension and criminal laws, as well as from foreign FIUs. A key task of FIUs is to analyze this information (along with information publicly available) to uncover evidence of possible financial crime for use by domestic (and often foreign) law enforcement and financial institution regulatory agencies.

Many national governments consider the effective use of FIUs to be an essential element of successful anti-money laundering efforts. However, to the extent that the predicate crime to laundering is itself a financial crime, FIUs play a double role in uncovering financial crime. In addition, it should be noted that FIUs have begun playing an increasingly important role in uncovering financial crime in cases where there is no laundering involved (i.e. where the institution is itself either a victim or a perpetrator of the crime, or where the institution is merely an ancillary instrumentality of the crime). Because FIUs provide a central gathering point for analyzing a broad range of domestic and foreign financial information, they may be particularly effective at uncovering patterns among large numbers of complex financial transactions that point to a possible financial crime. For example, reports of many FATF member countries conclude that a majority of the financial information received and analyzed by their FIUs does not point to possible money laundering, but rather to fraud against the financial institutions themselves, including wire and check fraud, credit card fraud, loan fraud, and embezzlement.

FIUs have far greater access than do individual financial institutions to relevant data. For example, FIUs can track suspicious transaction reports from all financial institutions required to make such reports, and can seek additional information from governmental and other sources with respect to those transactions. In addition, FIUs often develop special expertise to identify patterns among transactions, (e.g. offshore wire transfers) that suggest possible laundering. Combinations of information gleaned in these ways can sometimes uncover complex laundering schemes. If the transactions involve multiple jurisdictions, the ability to share information among FIUs (or other governmental authorities) from foreign jurisdictions also becomes more important.

If the underlying crime is a financial crime, effective anti-money laundering policies, by making laundering more difficult and by punishing the launderer and seizing the criminal proceeds, are likely to reduce the incidence of financial crime itself. In addition, FIUs can play an important role in detecting financial crime even where there is no money laundering involved, but where other criminal statutes may provide for punishment and seizure.