MIB THESIS

Title:

THE GLOBAL ANTI-MONEY LAUNDERING REGIME: AN ASSESSMENT OF EFFECTIVENESS

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ABSTRACT

Money laundering is the most commonly occurring form of financial crime. This has been facilitated by the presence of diverse technology that has made money laundering easier. Globally, money laundering is a major concern since it is linked to terrorist financing and corruption of the financial systems. In response, the international community has strengthened the AML/CFT structures following the terrorist act in the Unites States in September 2011. The thesis presents an analysis of the AML regulations and the challenges that national governments and the international community face when combating money laundering. The main research question is: Is the current international anti-money laundering regime sufficiently robust to effectively control and limit the phenomenon of international money laundering? This report explains the negative effects of money laundering to the economies of countries, the international trend-setters of the AML regulations and the challenges faced during the implementation of AML policies. After properly studying the literature, there seems to be major challenge during the implementation of the AML regulations making money laundering a pressing issue in both developing and developed countries. To facilitate the implementation of AML framework, nations should create a framework for exchange of information. As much as it’s a challenge, there is need for evaluation of the effectiveness of the AML structure particularly due to the changes providing new techniques for money laundering.

Contents

LIST OF ABBREVIATIONS

AML	Anti-money laundering
CFT	Combating the Financing of Terrorism
FATF	Financial Action Task Force on Money
FIC	Financial Intelligence Centre
FIU	Financial Intelligence Unit
IMF	International Monetary Fund
OFC	Offshore Centers
OECD	Organization for Economic Co-operation and Development
UN	United Nations
UK	United Kingdom

INTRODUCTION

Money laundering is a widespread practice in many nations today. It entails fraudulently legitimizing an individual's income and property, an enormous business that results from enterprises generating large cash turnover. Indeed, a wide range of criminal and grave offenses including smuggling of goods, drug-trafficking, racketeering are only operational due to the proceeds of monies that are conveniently laundered (Gill & Taylor , 2004).The diverse technology available today has made money laundering easier. Dirty money is infiltrated by smugglers in the financial system of any country. Since technological advancement is accessible in all countries, it is easy to relocate capital between accounts in different off-shore centers, keeping funds untraceable.

Globally, laundering is a major concern as it facilitates crime by promoting crime groups, diversifying and promoting their growth. Criminals opt for offshore accounts where the affected country has several limitations accessing financial information. Money laundering is an example of a financial crime where illegal capital flow is incorporated into a genuine economic system. To detect such actions, the Financial Action Task Force (FATF) was established by G-7 in 1989 to act as a temporary group to develop and implement anti-laundering policies. Several common law jurisdictions and many civil laws have also criminalized funds laundering.

This thesis presents a study regarding International Standard Setters of International Money Laundering initiatives against money laundering, emphasizing the rise of transparency in the financial system and analyzing the consequences for governments as well as the private sector. My research question is: Is the current international anti-money laundering regime sufficiently robust to effectively control and limit the phenomenon of international money laundering? In this regard, while the AML regulations enacted by various international bodies over the last decades have provided a robust and sound platform to combat the practice of money laundering, it is unlikely that any set of regulations, no matter how well-designed, could solve this complex and multi—faceted problem. The first step of this investigation is to examine the available literature, find historical actions and their positive or negative effects on economies, then compare these procedures to current international standards and determine their effectiveness.

1.0CONCEPTUALIZATION OF MONEY LAUNDERING

1.1 Introduction

Article 3 of Vienna convention in 1988 describes this activity as: "The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences established in accordance with subparagraph a) of this paragraph (with relation to narcoterrorism) or from an act of participation in such offence or offences" (UN, 1988).Current dynamism and trends regarding international trade have also resulted in organized crime specialization with money laundering as the final step of financial delinquency. This activity seeks to eliminate traceable roots of fraudulently obtained funds with the intention of creating a legitimacy aspect. Capital is later brought back into the legal market as clean money. Those involved take advantage of the multiple legal gaps and legitimate organization's failure to detect mismatches. But how is money laundered?

First, perpetrators need to be smart enough due to the changing financial investigation tactics put into place. Smurfing is one such technique which involves taking a large sum of money and breaking it into smaller amounts which can be deposited with less suspicion by the authorities. Traffickers also manage to use underground banking systems where the money can be deposited with no trace. Individuals involved in criminal activities may also employ different professionals in areas such as law, tax advisory and accounting who later inject the black capitals in formal financial institutions. Additionally, because of the nature of operations and a lack of a substantial charitable activities' legislation, it is very challenging to detect irregular financial activities. Institutions can accumulate money by donations and membership fees, and funds can be spent to directly or indirectly support terrorist groups and illegal activities.

1.2 Money whitening process

1.2.1 Introduction

The Financial Action Task Force (FATF) has described that laundering takes place in four distinct stages. The first step is referred to as the placement stage. It represents the primary entry of ‘dirty cash’ in the financial system. It is a crucial stage as it relieves the criminal from the bulk cash and places the money in a legal financial system. During this juncture, the delinquents' risk of being caught increases as managing large amounts of money may raise the alarm. Several methods facilitate this stage. They include gambling, repayment of loans using illegal cash, smurfing where money launders perform multiple financial transactions to evade reporting requirements, and currency smuggling where money is moved in bulk across borders by packing the money in carriers or as cargo. Cash is also placed through currency exchanges where criminals purchase foreign currencies using the proceeds of their wrongdoings. Resources can also be converted into other assets like gold, precious stones or exchanged into other currencies of larger denominations to facilitate transportation and avoid detection. The use of non-bank institutions is also prevalent where smugglers launder a large sum of money by using cash in casino ships or obtaining refunds of un-used flight tickets. Others also invest in government bonds.

A common way of infiltrating 'dirty money' in the financial system is offshore finance. This refers to institutions that host independent economic activities and are separated from the current institutions by legislation and/or geography (Mitsilegas and Bill, 2007). Typical examples of offshore financial activities include the practice of offshore banking, offshore companies, offshore funds and captive insurance among others. The examples of locations where offshore institutions reside include Bermuda and Cayman Islands where most institutions specialize in captive insurance business while institutions in British Virgin Islands specialize in offshore company registration. Many of these institutions are located in areas with minimal authority, in small island economies or in microstates. Secrecy is one of the main attractions to money launders as the offshore banks specialize in international private banking.

The second stage of money laundering is the layering or structuring stage. This step involves global movement of the money. The main purpose is to separate illegal money from the source. Criminals may move the funds from one country to another or they may also divide money into portions and place them in various overseas banks. Launders are also keen to move money several times to elude detection at all costs. The final stage is integration. In this stage the main aim is to reunite the criminal with the money from legitimate sources. This is done by paying for certain goods or services that have never existed or investment in legal activities where funds' origins are difficult to detect, like the real estate market.

1.2.2 Offshore Financial Centers as Money Laundering Havens

1.2.2.1 What are offshore financial centers?

Offshore centers have a very broad meaning and various definitions are attached to them. In fact, there is no specific definition to the term. Essentially, offshore financial centers are territories where the financial sector is separated from the international regulatory bodies and capital is mainly from by non-residents. The separation from the international regulatory bodies enables OFCs to operate under secrecy. This makes them good destinations for tax evaders and money launderers. The Caribbean is a good spot for OFCs because of its proximity to Unites States and Latin American countries. The Caribbean islands are only a short flight from the major financial centers of the East Coast yet they are far from the reach of some American regulations (Davis, 2008). When coupled with the ideal geographical destination, the Caribbean has become a hot spot for many OFCs. Similarly, other locations for OFCs are Hong Kong, Switzerland and Dubai among others. Reputable offshore financial centers play a legitimate and integral role in international trade. The zero tax structure also allows for financial planning and risk management and acts as mediums of global trade. OFCs have support from both United States and UK since they help them diversify their economies and facilitate the British Eurobond market (Mceledon, 2010). Following the G20 meeting in 2009, offshore centers have been subject to increased scrutiny. Particularly, the initiatives spearheaded by FATF, OECD and IMF have had a significant effect on the offshore centers. Accordingly, the offshore centers have strengthened their internal controls to guard against efforts to curb money laundering. Most of the OFCs became prominent because of their structures that have assisted in minimizing the exposure to tax, hence they are referred to as tax havens. Pressure groups suggests that OFCs engage in unfair tax competition by having very low tax burdens to the customers and have further argued that such financial centers should be forced to tax their own citizens and their economic activity at a higher level (Mceledon, 2010). In most cases, offshore centers attract people because of their low involvement on regulations. For instance, many capital market bonds use OFCs as mediums to issue them to minimize the amount of regulatory procedures associated with issuing of bonds. The minimal regulations present in the facilities make them attract money launderers. Besides, offshore jurisdictions offer high levels of confidentiality to their clients. The OFCS also act as a conduit of international trade and facilitate international capital flows. Therefore, they are becoming effective mediums for investment into emerging markets. Despite the use of the OFCs for legitimate reason, they are also used for illicit purposes. Individuals can use OFCs for creditor avoidance. This occurs when a person is evading the effect of bankruptcy by transferring assets and cash into anonymous offshore accounts that are untraceable. Individuals also use OFCs to unlawfully evade tax by failure to declare profits made by offshore vehicles that they own. On this basis, money launders use the OFCs to inject money into the financial institutions.

1.2.2.2 The role of OFCs in money laundering

Money launderers use OFCs as avenues of placing money in the economic systems. Money laundering is a major illegal activity that the offshore centers facilitate. Money laundering and offshore centers are intertwined in such a way that it is impossible to mention one without the other. Concealing money is a major objective for money launderers, hence the OFCs become an ideal place to conceal their funds because of their secrecy. Particularly, the OFCs are involved in the layering stage of the money laundering process. During this stage, the money in the banks is moved to the offshore centers where there are fewer regulations. In these centers, the money is discretely transferred to other business around the world. The criminals create fake transactions that aim at distancing the money from the original source (Davis, 2008).The money can be transferred several times through many accounts around the world to create a trail that is difficult for the authorities to follow. The OFCs serve various roles in the money laundering process. First, they create a barrier between the authorities and where the funds are generated. Secrecy is another role that OFCs play in the money laundering process. Secrecy is used for legitimate purposes, however; it entices people to use it for illicit purposes. It makes money difficult to track due to the confidentiality that the facilities offer.

1.3 IMPACTS OF MONEY LAUNDERING

1.3.1 Increased crime and terrorist financing

Laundered money is used to fund and facilitate criminal activities. The practice promotes crimes such as drug dealing, illegal arms trafficking, racketeering and terrorism among others. Laundering makes illegal activities profitable. Notably, corruption increases money laundering hence increasing laundering in developing countries where corruption rates are high. Corruption facilitates money laundering by professionals such as lawyers, accountants and employees in financial institutions. The presence of a weak anti-money-laundering policy provides a loophole for this crime. Complex financial systems are commonly targeted by individuals laundering money. Following the terrorist attack in the United States on September 11, 2011, international organizations such as the UN embraced the importance of curbing financing of terrorism. This paved way for the strengthening of the Counter Terrorism financing Network (CFL) that prevents terrorist financing.

1.3.2 The economic effects of money laundering

The criminals use leading companies as havens for laundering where the illicit activities are integrated into the legitimate business. For example, in the United States, pizza parlors act as a haven for organized crime such as drug trafficking. Often, these front companies are compelled to sell their products and services at a relatively lower price below the actual cost of production. Therefore, the front companies have a competitive advantage over the legitimate firms in the area (MacDowell, 2001). As an outcome, the legitimate business finds it difficult to compete against the front companies and may eventually shut down. In the long run, the private sector is crowded with criminal organizations that ignore the principles of legitimate business (MacDowell, 2001).

The integrity of financial institutions is adversely affected by money laundering. There is a gray area between the non-corrupt and the totally corrupt financial institutions where bank failure is closely associated to criminal activities. This is because it is difficult for corrupt financial institutions that rely on money laundering to manage their assets and liabilities. Particularly it is difficult for them to maintain their liquidity position since huge sums of cash are deposited at a go and are later withdrawn suddenly without the management noticing. For example, the S&L crisis in Unites States in the 1990s was facilitated by money laundering, bribery and fraud (Levi& Reuter, 2006).Money laundering not only affects banks but also affects other financial institution such as insurance, security and investment firms. Involvement in money laundering further tarnishes the image of the financial institution involved pose legal risks to the institutions. As a result of crime, some contracts with fraudulent customers are unenforceable making the company suffer huge losses. The bank directors risk criminal prosecution for involvement in money laundering regardless of whether they are directly involved or not. Usually, the bank officials are under pressure to bring customers into the firm which facilitates their involvement in the money laundering process. Arguably, most western banks survive due to the proceeds of laundered money (MacDowell, 2011).

Estimates by the former managing director of the International Money Fund indicate the magnitude of the money laundered is about two to five percent of the world gross domestic product (MacDowell, 2011). In developing countries, these proceeds may dwarf the government budgets and result to loss of control of the economy policy by the government. Money laundering has therefore adversely affected the currencies and interest rates in the affected counties. This is due to the fact that launderers reinvest where they are less likely to be undetected and in most cases, that is where the rates of returns are higher. A major consequence is that money laundering can cause instability in a country due to misallocation of resources from artificial distortions in asset and commodity price. Thus, money laundering can result in variations in the demand for money and increase the volatility of international capital flows, exchange and interest rates. The unpredictable nature of money laundering coupled with the loss of policy control may cripple effectiveness of economic policies.

In simple terms, money launders are not interested in generating profit but rather in protecting their money. Hence, they 'invest' in activities that are not beneficial to the economy of a country. The majority of the individuals redirect funds from high-quality investments to low-quality investments to conceal their proceeds, thus economic growth can suffer. Accordingly, when these launderers abandon such industries, they cause them to collapse, thereby negatively affecting the economy (Crime and Misconduct Commission, 2005).

1.3.3 Increase in social costs

There are several costs and risks that are associated with money laundering. Ideally, money laundering facilitates criminal activities. It creates a way where drug traffickers, terrorists and other criminals expand their activities. In the long run, this elevates costs to government as a result of increasing law enforcement. Another socio-economic effect of money laundering is that it transfers economic power from the market, citizens and government to the delinquents. Generally, this brings about a major challenge. The complex nature of money laundering requires international cooperation and the set global standards to curb the vice.

2.0 REGULATION OF MONEY LAUNDERING

2.1International regulation of money laundering

International money laundering law sets the pace for all the countries in their fight against money laundering. The establishment of international jurisdiction authorities such as the G7s Financial Action Task Force (FATF) has promoted the international response to combat money laundering. FATF is a policymaking body that currently has a membership of 31 countries and territories and two regional organizations. FATF gives a report on the money laundering trends helping the member states to keep track the new techniques used by criminals among other developments in the area of money laundering. The signing of 1998's UN declaration against money laundering was developed to prevent the illicit drug trade. There is a need for global structures with compatible legislation coupled with mutual legal assistance to facilitate financial investigation and confiscation of any proceeds of crime. Over decades, United States has been at the forefront in placing anti-laundering measures to disrupt drug trade. They have received support from other countries such as United Kingdom, France and Australia. The Egmont Group of Financial Investigation Units has aimed at fostering cross-national co-operation since the 1990s. Nevertheless, there is a slow progression of the adoption of FAFT as a guideline to anti-money laundering. As a result, in 2000, the Non-Cooperating Countries and Territories Initiative was established with its principal jurisdiction targeted at blacklisting the counties that are not adopting FAFT and posing severe sanctions for them.

2.2 International Standard Setters of International Money Laundering Policies

2.2.1The United Nations

The United Nations was the first organization to fight the issue of money laundering. Currently, the UN has a 191 member states as its members. This has made it easier for the United Nations to create awareness on the various ways of thwarting money laundering. Moreover, the United Nation operates the Global Program against Money Laundering (GPML)headquartered in Vienna, Austria. The United Nations has the jurisdiction to adopt international treaties that have the effect of law in the country once the country has signed and implemented the convention.

Through the United Nations Drug Control Program, the UN initiated the Vienna Convention, an international agreement to combat money laundering and drug trafficking. It mainly deals with provisions to fight illegal drug trade and the related law enforcement issues (Aldridge, 2008). The convention defines money laundering and advocates for the criminalization of money laundering. To date, 169 countries are part of the convention.

The Palermo convention has also been a big contribution in the fight against money laundering. It obligates each ratifying country to criminalize money laundering. Further, it obligates the countries to formulate regimes to facilitate the detection of money laundering including record keeping and reporting any suspicious transaction. The Palermo convention also facilitates the exchange of information among law enforcement authorities both domestically and internationally. Besides, it also fosters international cooperation among member states.

The Global Program against money laundering (GPML), for instance, is a research project that aims to increase the effectiveness of the global action against money laundering. The GPML assists member states create legal frameworks that support anti-money laundering legislation. It also develops institutional capacity particularly with the creation of finance intelligence units. Hence, the GPML acts assist in disseminating information and providing technical assistance in formulating and improving a country's AML infrastructure.

2.2.2The Financial Action Task Force on Money Laundering

The Financial Action Task Force on Money Laundering was formed in 1989 by G-7 countries. The main purpose of the intergovernmental body is to establish and promote an international response to combat money laundering. Due to the increase of terrorism financing through the illegal money, in October 2001, the FATF expanded its mission to include combating the financing of terrorism. The FATF is a policy making body that incorporates legal, financial and law enforcement experts to achieve national legislation and provide AML and CFT reforms. In addition, the intergovernmental body works closely with the other international bodies to fight the issue of money laundering. Currently FATF consists of 31 member states and two regional organizations. The three primary functions of FATF are to monitor member's progress in implementing AML, reviewing and reporting laundering trends, and promoting the adoption and implementation of FATF anti-money laundering standards globally. Further, the FATF has developed a set of forty recommendations comprising a comprehensive AML framework designed for universal application by countries around the world. The forty recommendations are a set of principles of action that allow a country's flexibility in implementing the FATF according to its constitutional requirements (Financial Action Task Force, 2004). In this regard, the forty recommendations have acted as a reference for the international community on anti-money laundering standards and regulations. Ideally, the forty recommendations ask for action by each country if it wants to be viewed by the international community as one embracing and meeting the international standards on anti-money laundering. Often, the progress of the member states is closely monitored to ensure that they comply with the forty recommendations. Monitoring of the progress takes place in two distinct steps, which involve self-assessment and mutual evaluations. Ultimately, if a member state fails to comply with these recommendations, the membership of the country risks being suspended. One of the core functions of the FATF is to report on the money laundering trends and techniques. The FATF works by issuing annual reports on money laundering through its Typologies report. The reports are vital as they provide information on the current techniques criminals use to launder money not only to the member states, but to all countries globally.

The FATF also identifies non-cooperative countries and territories (NCCT) to encourage all countries to adopt anti-money laundering measures. An NCCT country is encouraged to make progress in remedying the deficiencies. If the country fails to make sufficient progress, FATF member states impose actions against the country, which seek to limit the business transactions with the entities within the NCCT. Eventually, the FATF member countries may terminate any financial transactions with such a country.

Consequently, countries have made effort to be taken off the NCCT list since it causes major problems to their financial institutions and business with regard to international transactions. The FATF, alongside the International Monetary Fund and World Bank, has adopted an assessment methodology for the financial sector and offshore center programs. According to Schott (2006), the methodology comprises of institutional AML/CFT framework for a country and relevant elements from the United Nations Security Council Resolution and International conventions. The adoption of this comprehensive assessment methodology has facilitated a more uniform approach in conducting assessments in rating the country's performance.

2.2.3 The Basel Committee on Banking Supervision

This Basel committee was formed in 1974 by the central bank governors hailing from a group of ten countries. The Basel committee formulates supervisory standards and guidelines on a wide scope of bank supervisory issues. The guidelines are formulated with the anticipation that each country will take the required steps to implement them in a way that best suits the country. The committee has three guidelines regarding the money laundering issue. To this effect, the Basal committee issued a statement of prevention. It acts as a to- do-list that assists bank managers in suppressing money laundering through the banking system (Schott, 2006).The committee considers it an essential step towards combating money laundering since banks facilitate the money laundering process. The statement of prevention provides principles that facilitate proper customer identification, cooperation with law enforcement authorities, high ethical standards, and compliance with the laws, principles and policies to adhere to the statement. Therefore, the bank should make reasonable efforts to determine the identity of all customers requesting financial services. Secondly, the banks should ensure that business transactions conform to ethical standards and adhere to the relevant laws pertaining financial transactions. The bank should as well not offer services to individuals who they believe are associated with money laundering. The statement emphasizes that banks should work with the law enforcement authority and must report any cases of money laundering. Proper training on the bank policies should equally be provided to allow for detection of money laundering. These are the grounds ensuring that the Basel committee provides a comprehensive blueprint for an efficient bank supervision system.

2.3.4 The Egmont Group of Financial Intelligence Units

As part of the efforts against money laundering, governments have formulated agencies to analyze information submitted by covered entities and persons pursuant to money laundering reporting requirements. Such agents are referred to as financial intelligence units (Davidson, 2014). These units act as a focal point for the national anti-money money laundering since they allow for the exchange of information between financial institutions and law enforcement agents (Davidson, 2014). There is a need to exchange information since the money laundering affects all countries. The Egmont Group of Financial intelligence was formed in 1995 by several government units. The main aim of the group is to provide a forum for the financial intelligence units to enhance support for each of the country's AML programs and coordinate the AML initiatives. It provides support through the exchange of financial intelligence information and improving expertise by fostering better communication. Currently, the membership of Egmont Group consists of 94 jurisdictions. The members access a secure website which is strictly for the member, and this facilitates secure exchange of information. The group has produced materials which the public can access and has compiled cases about the fight against money laundering from its member FIUs.

2.3.5 The IMF and World Bank

The International Monetary Fund and the World Bank have been at the forefront in combating money laundering. Combating the financing of terrorism (CFT) was formulated through the establishment of the Offshore Financial Centre (OFC) program that was formulated in July 2000. The main purpose of the program was to provide voluntary assessment to the offshore financial centers and ensure their compliance with the various international standards on insurance, banking and other relevant sectors (Kyriakos-saad et al, 2005). The major aim of the program was to assess the potential vulnerabilities and threats to financial stability to the relevant offshore economies. The establishment of the OFC program was due to a call by the G-7 governments to take action against the abuse of the global financial system to guarantee integrity and credibility. The G-7 required the International financial institutions to reinforce governance and the existing anti-money laundering programs with the member countries. The IMF recognizes the importance of maintaining the integrity of the financial system hence it implemented this OFC program to fight financial crime, particularly money laundering (Schott, 2006).

The IMF recognizes the role of the Financial Action Task Force and the *Forty Recommendations* as an appropriate anti-money laundering standard. The Executive Board of the IMF further recognizes the vigorous national and international efforts, which include advocacy for a sound financial system. The terrorist attacks on

September 11, 2011 reinforced the determination of the IMF to combat money laundering since it finances terrorism.

The IMF reinforced the joint IMF-World Bank anti-money laundering policy so as to combat money laundering. Particularly, the IMF strategy was to expand the methodology for the assessment of the offshore centers, as well as onshore assessments of the Financial Sector Assessment Programs (FSAPs). The IMF further contributed to the revision of the *Forty Recommendations* and increased the technical assistance to correct any deficiencies that arise in a country's anti-money laundering regulations (Schott, 2006).The IMF reinforced the joint IMF-World Bank anti-money laundering policy so as to combat money laundering. Particularly, the IMF strategy was to expand the methodology for the assessment of the offshore centers, as well as onshore assessments of the Financial Sector Assessment Programs (FSAPs). The IMF further contributed to the revision of the *Forty Recommendations* and increased the technical assistance to correct any deficiencies that arise in a country's anti-money laundering regulations (Kyriakos-Saad et al, 2005).

In 2002, the IMF deepened its work on anti-money laundering and combating the financing of terrorism. This was through the amendment of the *Forty Recommendations* and the FATF special recommendations on financing terrorism. The significant changes included introduction of risk-based operation of customer due diligence, extension of the AML/CFT requirements especially customer due diligence, record keeping to certain non-financial businesses, specifying the minimal list of categories of predicate crimes for money laundering and prohibiting shell banks and improving transparency of legal persons and arrangements. The revised FATF came into effect in February 2004 and since, the new developments have assisted the IMF in the OFC assessments (Schott, 2006). The legislations by international standard setters such as the Basel committee on banking supervision have also assisted the IMF in meeting its objectives.

Following these revisions, the IMF affirmed its responsibility in assessing the commitment of the countries to implement AML/CFT laws. As such, the IMF-World Bank technical assistance has increased considerably, expanding the organization's focus to provision of assistance, drafting of the relevant laws and regulations, identification of preventative measures and the training and establishment of financial intelligence units. Currently, the IMF has technical assistance projects that benefit more than 130 countries. The IMF has so far delivered 200 new projects and trained 1000 officials on the aspects of AML/CFT (Schott, 2006).

2.3 Outcomes of anti-laundering measures

Given the importance of this matter, the progress has been remarkable since money laundering has been limited in most countries (Walker and Unger, 2009). The global legal landscape has changed in almost every country adopting anti-money laundering measures, including offshore financial centers. This has been facilitated by the adoption of the FAFT, and more and more countries have become world leaders in advocating for anti-money laundering legislations (Geiger and Wuensch, 2007; Walker & Unger, 2009). Still, money laundering techniques vary over time due to the varying skills set and contacts of the criminal. There is a need to identify and device mechanisms to understand and eliminate the current techniques that are used in money laundering.

3.0 EXCHANGE OF INFORMATION

Article 26 of the Model Tax Convention does not clarify on how best to share information but rather gives different forms of exchanging information. In the past, information was only obtained on request. Nowadays, this is also present, but information can also be transferred spontaneously and automatically.

3.1 Spontaneous exchange of information

This involves providing relevant information to the contracting party upon request. This mode of exchange of information relies on the active participation of the cooperating countries. Local tax officials need to have the ability to pass information to the authority. Financial institutions also need to have the capacity to give information on instances of money laundering to governments.

3.1.1 Functioning of spontaneous exchange of information

Each country has different reasons to consider the automatic exchange of information. These may be the suspicion of money laundering or alleging the loss of tax revenue through tax avoidance. The checklist of the OCED concludes the identification of the person whom the information relates, the information about the payment or transaction, the gathered information and the explanation of why this information is thought to be important (OECD Committee on fiscal Affairs, 2006). The checklist is not only useful to get tax evaders but also to identify money launderers. Feedback between authorities will ensure transparency and supplement the fight towards curbing money laundering.

3.2 Automatic Exchange of Information

The Automatic Exchange of information was adopted in 2012. It is considered beneficial since the information is not provided when Government has intentions of sharing financial data but rather automatically. In May 2013, the European council agreed to give priority to efforts aimed at extending automatic exchange of information at a global level. The new directive is based on FACTA and the European Union (EU) savings directive commonly known as the CRS (Common Reporting Standard).

3.2.1 Benefits of the automatic exchange of information

AEOI is valuable as it allows for the exchange of necessary information for tax purposes. It is a great tool in ensuring cooperation and global transparency. It is a proactive tool as it informs the relevant countries of the wealth of the individuals that may be hidden in offshore accounts. Money launderers mainly use tax havens such as offshore accounts. Tax heavens are regions that provide an extensive variety of regulations offering tax rate benefits and high level of banking privacy to foreign and local companies. These offshore accounts protect money launderers as they provide customer confidentiality and protect monetary transactions (Mceledon, 2010). Since the inception of automatic exchange of information by OECD, there has been a widespread use of automatic exchange of information between countries. Particularly, within the EU many member states have created automatic exchange relationships with non-EU members providing a platform for timely reporting of non-compliance of tax. All of the EU countries receive information automatically from the treaty partners and 85 percent of them in turn send information to treaty partner's hence increasing transparency (OECD, 2012).The OCED has formulated a minimum standard and aims at implementing the global standard in 2017 in the committed jurisdictions. The OCED is working together with the G20 and the global forum to provide necessary tools to provide guidance and enhance global consistency. With the reduction in bank secrecy, it will be easier to catch money smugglers and bring them to justice. Governments will also reduce tax evasions and thus gain more tax income. The common reporting standard will thus increase the reporting requirements for the financial institutions and the new form of reporting will assist the countries to catch the money launderers.

4.0 Challenges of Implementation of AML Measures

The anti-money laundering efforts are commendable. However, their implementation has faced various challenges. AML instruments are essential as they ensure that the international community reacts to money laundering as a common global problem. The international instruments provide an agenda for converging national efforts to help fight against money laundering internationally. Nonetheless, it is important to note that various loopholes are present in the international and national level that hinders the proper implementation of anti-money laundering legislations. The implementation of the AML also faces various challenges that further hinder the efforts to combat money laundering. Some of the challenges include:

4.1 Technology

The rapid growth of technology has hindered the efforts to fight money laundering. Technology has not only improved the money laundering process but also provided the launderers with new techniques that are difficult to monitor. The speed at which technology is growing does not match up with the laws by the enforcement agencies (Dumitrache and Modiga, n.d). The techniques used to launder money evolve quickly thus making it hard for the institutions to cope. For example, the electronic payment systems offer anonymity and convenience of the funds. The bank institutions also have not regulated most of the new payment systems that are available giving the criminals a wide range of channels to place the ‘dirty money’ in the financial systems (Dumitrache and Modiga, n.d). The use of pre-paid cards, mobile payments, and internet payment products mean that money can exchange hands rapidly. Criminals may also propagate cyber-attacks that create vulnerabilities that facilitate money laundering. Corrupting the banking system via a cyber-attack is a new direction that the criminals are using to launder money (Levi and Reuter, 2006). Online systems are used by the criminals in the layering stage when they are carrying out transactions between different countries. The convenience of these systems has made them very attractive to money launderers. The presence of the online gambling systems where there are virtual casinos has also provided criminals ways to launder money. Besides, the emergence of online games has further made it difficult to combat money laundering. Online games such as Entropia Universe and Second Life provide an opportunity for the money launderers to conceal transfers of fraudulent income (Dumitrache and Modiga, n.d)

4.2 Financial exclusion

According to the FATF (2011), financial exclusion is a challenge towards effective AML/CFT policies. Financial inclusion refers to the provision of adequate safe and affordable financial services to the vulnerable groups including low income earners, rural and undocumented persons who are excluded from the formal financial sector. It is also ensuring that a broader range of financial products is available to the disadvantaged groups. This challenge is mainly present in developing countries where the poor are excluded from the formal financial sector. Today, more than half the world's adult population lacks access to insurance, credit facilities, savings accounts and other formal financial services (FATF, 2011). Financial exclusion limits the ability of the vulnerable populations to manage their cash flows, build savings and capital and to mitigate economic shocks. Accordingly, it is estimated that less than 10% of poor people are able to access the formal financial services. In developing countries, the number of unbanked adults is estimated to be 2.7 billion while in developed countries the number of unbanked adults is 160 million. In 2005, it is estimated that a quarter of the population in the developing world was living in absolute poverty of USD 1.25 in a day. Immigrants are also affected by financial exclusion. In absence of formal banks, the underserved populations rely on informal ways to send money back home. In developing countries, there is a cash-based and parallel economy where money circulates outside the conventional financial system. The financially excluded individuals hence prefer these avenues since they are convenient. However, these channels are vulnerable to misuse by money launders because the channels are not controlled by the government. Ideally, the more attractive the underground economy is for legitimate transactions, the more available it is for illegal transactions. The underground providers act as a channel through which money launders place money in the financial system since they are undetectable by government authorities. Financial exclusion is thus encourages money laundering activities that cripples the implementation of AML measures (FAFT, 2011). Promoting the use of formal financial system is essential in ensuring a comprehensive and effective AML/CFT regime.

4.3 The costs associated with compliance

The implementation of anti-money laundering laws is also a challenge in low income countries in the developing world. There are several compliance costs that countries and their financial institutions are required to incur as they implement the AML regulations. Most developing countries have small economies, thus adding additional cost to them is strenuous. Due the low income levels, these countries are unable to effectively implement the AML laws; laundering legislations also require banks to comply with activities such as record keeping, internal control and the reporting of suspicious transactions. In order to easily detect illicit transactions, banks invest and develop internal controls procedures and human resources. Training of staff is another cost that the banks incur. The FATF recommendations recommend entities to develop an efficient process of customer identification. These obligations increase the cost of financial products hence increasing the number of people financially excluded. The increase in the financial costs is a disincentive to customers especially the disadvantaged individuals who may turn to unconventional channels of accessing cash. In developing countries, most of the financial systems are small and immature making it hard for them to invest in the costs needed in implementing the AML regulations. What's more, most institutions yearn to increase their profit share thus may be less selective in the business they conduct making them vulnerable to money laundering.

The current regulatory climate has some strict rules put in place to guide financial institutions. However, there is no evidence indicating that the massive costs imposed on banks are effective in reducing money laundering. In July 2015 for example, Banamex USA paid a fine amounting to $140 million for allegedly having weak anti-money laundering policies while in 2014, Standard Charted paid a fine of $300 million for purported weakness in its AML monitoring system in its New York's branch (Saperstein et al, 2015). These are examples of a trend where regulators place huge fines on banks even if the regulators do not identify any instances of money laundering in the entities. Most international banks spend enormous amounts of money to finance anti-money laundering compliance. Current estimates indicate that HSBC devotes USD 750 million to USD 800 million for compliance (Saperstein et al, 2015).The fight against money laundering has shadowed the core business of banking such as providing loans and banking services. The regulators have shifted focus to how much the entities spend on compliance as opposed to the effectiveness of the compliance efforts (Saperstein et al, 2015). This is a challenge to the implementation of the AML regulations. In any case, the regulators have performed little empirical research to justify the presumption that high costs assist the AML strategies.

The increase in the costs has made the banks retreat from high-risk regions. This 'de-risking' has reduced the transparency of financial activity making the entities more susceptible to criminals (Saperstein et al, 2015).For example, all the major banks in the UK and United States have abdicated wire transfers to Somalia to avoid the risk of the money ending up with terrorists. This has caused a humanitarian tragedy since most of the families in Somalia rely on money from abroad sent by their relatives. Consequently, Somali nationals living in the United States have opted to use third party agents who ferry the money in suitcases on flights to Somalia. The money flowing into Somalia has become unregulated, untraceable and expensive for the Somalis living from hand-to-mouth. The end result is a riskier channel for money laundering than if the banks had continued wiring the money. De-risking also referred to as de-banking is a practice where financial institutions exit relationships and close the accounts of clients perceived as “high risk” (Durner and Shetret, 2015). Financial institutions choose to end the relationship altogether rather than manage risky clients who are involved in money laundering. De-risking hence increases financial exclusion in the developing world; further, posing a challenge to the implementation of the AML regulations. Along the Mexican border, the closure of the Banamex subsidiary by Citigroup eliminated eleven branches in the Southwest. Due to the closure, long term accounts of cash intensive businesses like farming and ranching were affected. The result of the closure was the businesses moving into cash based transactions since they still had to continue paying their service providers. This has spread the risk of money laundering. This is an example of how the immense pressure on the banks placed by regulators produces unintended consequences. The moving of banks from high-risk regions forces entities to disguise cash holdings and leads to an increase in transactions. The resultant entities then transfer the funds through underground channels (Saperstein et al, 2015). Accordingly, the regulators have made it difficult to catch money launderers due to the increased avenues for money launderers and strengthening of criminal networks. When the banks spend a lot of money in compliance, the money is not available for the running of the banking system. Customers are burdened with the increase in banking fees and more onerous bank rates which in turn hamper the economic growth of a country. More importantly, the people affected are those in regions that are at high risk of money laundering. The regulators should have a valid reason for imposing high costs to the banks to avoid implementing laws that worsen the issue of money laundering.

5.4 Corruption

Corruption is another challenge the regulators face in the implementation of AML regulations. Corruption takes advantage of the implementation of AML measures in the countries and frustrates the trans-national cooperation to investigate money laundering in different countries. Corruption impedes the enforcement of AML measures and also creates confusion in the implementing agencies within a country. The wide range of AML regulations bring together treasury departments, financial intelligence units, Attorney Generals, Directors of Public prosecutions, Intelligence operatives, Ministry of Justice, intelligence operatives, Central Banks, and revenue authorities among others. When these institutions are corrupt, there is a hindrance in the implementation of AML regulations. Corrupt individuals can exploit the leadership of the anti-money laundering structures, thus incapacitating them. A survey on money laundering through intermediaries discloses the involvement of bureau de exchanges, banks, lawyers acting as nominees, investment advisers and estate agents in money laundering (Gordena and Madzima, 2009). The banks have played a significant role in transferring of funds from the accounts held in the country to offshore accounts. This has been attributed to the corrupt nature of these banks. Some banks have been accused of advising clients to evade taxes by creating offshore companies which declare no profit. According to Chaikin (2008), the risks brought about by commercial corruption are present in the placement stage of money laundering. Individuals in the private sector may be bribed to collude and engage in money laundering, non-reporting of suspicious activity or tip off clients who should be subject to government investigation. The concealment of business activities through financial intermediaries further affects the detection of this illicit activity. The employees in the financial institutions may be bribed to overlook the presence of any suspicious transaction, falsify documents, and overlook suspected documents (Gordena and Madzima, 2009). Bank officials may be paid to look the other way as illicit funds are siphoned from banks to offshore centers. Corruption activities committed by highly ranked politicians and senior government officials have facilitated the transfer of funds from the national treasury to private hands. With all this happening across the world, corruption therefore continues to be a threat to the implementation of AML initiatives.

CONCLUSIONS

Globally, money laundering continues to be the most common form of financial crime. Notably, the advancement in technology has further facilitated money laundering particularly with the availability of electronic transfers, online gaming, and virtual casinos. Money launderers find it safer to deposit ‘dirty money' in other countries to reduce the risk of them being caught. The availability of private financial institutions such as the offshore financial centers has also elevated the smuggling of cash (Ryder, 2008). In reaction, most countries have enacted anti-money laundering legislations that are widely used to curb money laundering. The major focus is on non-complying countries that ignore the FATF and the United Nations directive. The offshore centers are major elements undermining the fight against money laundering. This is because they play a critical role in the layering phase in the money laundering process.

The OFCs also facilitate the transfer of funds from one country to another. The secrecy of these financial institutions facilitates this process, making it difficult to note any suspicious activity. Moreover, the transactions cannot be traced, thus making them a favorite spot for money launderers. There has been a lot of pressure on the offshore financial centers as most of them are non-compliant. Particularly, the advisories issued by Britain and United States against Barbuda and Antigua have resulted in the amendment of the Antiguan anti-money smuggling laws. The private sector has also been encouraged to extend their due diligence in curbing the vice (Ryder, 2008).

The collaborative efforts of the FATF, OECD, UN, the World Bank and IMF have encouraged the fight against incidences of money laundering by encouraging nations to set policies aimed at combating money laundering, some of the nations with AML deficiencies that have pledged their commitment include Yemen, Vanuatu, Uganda among others (FATF, 2016). FATF has intensified close monitoring to ensure that nations with strategic deficiencies comply countries such as Guyana are no longer subject to FATF's on-going global AML/CFT compliance process since they have established a legal and regulatory framework to meet FATF requirements (FATF, 2016).However, the high costs associated with the implementation of the AML policies have made it difficult for countries to realize achievements. The high costs have increased plus the cost of financial products for the customer, which has resulted in financial exclusion of most of the disadvantaged groups in the society, especially the poor. The high numbers of financially-excluded individuals has resulted in increased use of cash-based transactions further facilitating the increase of money laundering despite the presence of AML policies. The increased costs associated with compliance to the AML regulations have additionally caused de-risking of banks where they cease conducting business in high risk areas like terror torn zones. Consequently, individuals have embraced the smuggling of cash between borders via illicit ways. This practice has simply created a channel through which money is laundered. Besides, the rapid growth of technology has been a challenge during the implementation of AML policies. Hence, the emergence of new ways of laundering money calls for the evaluation of the policies to provide diverse mechanisms concerning money laundering. Each country should as well lay out concrete plans to curb the smuggling of money. More transparency will also facilitate the financial systems to deal with the vice.

Cooperation between countries is important for the effective implementation of the AML network. Particularly, it's essential because different countries have different AML priorities. Furthermore, the challenges highlighted mean that the AML framework needs modification to curb money laundering. With respect to compliance, the AML systems faces some challenges as some countries fail to ratify the policies while others have weak surveillance systems. The UN alongside other international bodies thus needs to formulate more stringent policies to enhance compliance by all countries.

RECOMMENDATIONS

In regards to corruption, the concerned countries should formulate anti-corruption strategic plans to curb corruption. The strategic plans should take cognizance of the broad themes of prevention, enforcement and public education. Creating public awareness on the effects of corruption provides necessary information to the public and facilitates reporting of corruption incidences from the public.

Regulators should revise the AML framework due to technological developments that have opened new avenues of money laundering. To this effect, they should conduct empirical studies to determine the effectiveness of the AML regime and to also assist them in devising new ways to counter money laundering. Empirical studies will assist regulators obtain both qualitative and quantitative information. The statistics will assist them determine if the AML framework is working appropriately. In addition to that, each country has different external and internal money laundering threats. Major financial centers in the US or UK face a wide range of threats that include complex fraud. Conversely, in developing countries, corruption and drug trade increase their vulnerability. In ensuring that the FATF and AML measures are effective, FATF should take into account these variations between nations. As such, FATF should work towards creating a tailor-made risk- based approach and encourage countries to perform a risk-assessment to assist them in formulating a more effective AML network. Tailor-made policies coupled with country by country evaluation will increase the compatibility of the AML network.

All countries should also aim towards financial inclusion to eliminate the challenge it poses in the implementation of the AML measures. What's more, achieving an optimal regulatory regime requires the concerned authorities to conduct a cost-benefit analysis of the purported benefits of the regulations against the alternative options. The analysis will assist in eliminating the unsuitable and cumbersome legislations. Through conducting a qualitative and quantitative assessment of the cost and benefits of the AML legislations, the regulators can objectively view the impact of regulations and verify if the laws hurt the public or worsen the issue of money laundering. Ideally, a regulation should not be undertaken if the potential benefits outweigh the potential costs to the society. The regulators should cut down the compliance costs to avoid burdening the customer and to ensure that low-income countries can afford the implementation process. Further, financial institutions need to create awareness on the importance of using banks. This includes properly laying out the products that are offered in banks. The banks should also reduce the costs associated with banking to ensure that they include everyone, even the low-income earners.

Lastly, there is need to understand that money laundering is not only a problem to the government but also to the public. Public awareness on the effects of money laundering should be done through the media and public events. The education system (especially in aspects such as banking, law, criminology, and public governance) should inculcate awareness of money laundering together with its consequences. Moreover, there is need for proper exchange of information to facilitate the elimination of money laundering. Each country needs to be vigilant and strengthen the judicial system to ensure it appropriately deals with financial crimes such as money laundering. Synchronization of money laundering laws between countries is equally important in limiting the vice.

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