Factsheet
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Money laundering and the reform of the Money Laundering Directive

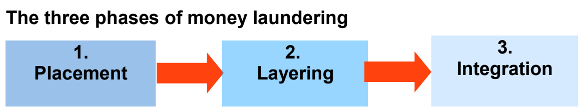
Money laundering – a global problem

Money laundering is the legalisation of illicit funds or assets through their introduction into the economic cycle. The illegal funds are often closely linked to organised crime and originate from illegal activities involving arms, drugs, human trafficking, extortion or corruption. Lately, the definition in many places also includes the crime of tax fraud. However, there is no internationally standardised definition of money laundering. One reason is that new ways of implementing money laundering methods can always be found in a globalised world, including Internet-based transfer systems which allow payments to be handled anonymously. These illegal activities carry the risk of undermining legal structures.

Although there are numerous studies on money laundering, its true scope can hardly be measured. According to calculations by the United Nations Office on Drugs and Crime (UNODC), the annual volume amounts to between 800 billion and two trillion $ U.S. (2-5% of the global GDP). According to estimates by the U.S. organisation Global Financial Integrity, this sum includes $ U.S. 723-844 billion in corrupt funds flowing from developing into industrialised countries. According to the Swiss money laundering expert Andreas Frank, of the total money laundered worldwide, less than 1% is confiscated.

How does money laundering work?

A general theory holds that in order to launder illegally acquired or untaxed funds, three steps are necessary:



(1) Placement of the funds in the legal economy: The goal of this phase is to convert cash into deposit currency (mainly bank account holdings). This often takes place in small instalments to avoid arousing suspicion. This cash can be paid directly into an account using so-called “financial agents”. In return for a commission, these agents make their private accounts available for money laundering activities. The Islamic payment system of “hawala”, which is commonly used by guest workers to transfer earnings to family members in their home country, can also be utilised here. Another method is to purchase quickly realizable assets such as real estate, luxury goods, etc. in order to subsequently resell them. Casinos and bureaux de change are also suitable for the placement of money.

(2) Layering the origin of money/assets: This usually takes place through complex financial transactions and the diversification of previously placed funds. This phase is designed to make tracing illicit money impossible. Here globalisation plays into the hands of the money launderers, as these types of transactions usually run through banks, sham companies and foreign financial institutions in tax havens.

(3) Integration of funds into the economic cycle: At the end of the process, the illegally obtained funds are invested in a legal asset (real estate, shares, etc.). Thus, they are permanently legalised and no longer traceable.

Situation in Germany

In Germany, the Organisation for Economic Cooperation and Development (OECD) estimates the amount of money laundered annually to be 43-57 billion euros. Paradoxically, despite its secure constitutional state with a relatively low level of corruption, Germany is a popular destination for money laundering activities. A liquid market with a high cash flow also makes Germany attractive while also complicating the monitoring of financial flows. Particularly for the Mafia, Germany is an ideal place for money laundering, as there is little public awareness of the presence of Mafia structures. Its central location between Eastern and Western Europe makes Germany an ideal trading centre.

Standards in the fight against money laundering

International standards to combat money laundering have been set out in 40 directives since 1990 by the FATF (Financial Action Task Force), a working group of the OECD. In the wake of September 11, 2001, these were supplemented by nine additional counter-terrorism directives. In 2012, the areas of corruption and tax avoidance were included in a further revision, though these are not legally binding recommendations.

The first EU directive for the implementation of the FATF standards was introduced in 1991 under the title “Prevention of the use of the financial system for the purpose of money laundering illegally acquired proceeds from crime in the drug trade”. In 2001, the directive was extended to include real estate brokers, notaries and casinos. The third revision of the EU directive, which is currently valid, was adopted in 2005 and includes more stringent due diligence requirements, the establishment of a national centre for suspicious transaction reports and new rules against terrorist financing. The directive is implemented in Germany through the Penal Code (Paragraph 261) and the Money Laundering Act, which has been in force since 1993.

All the standards share common due diligence obligations for specific professional groups, especially banks. The identification of the customer ("know your customer") is regarded as one of the key instruments in preventing anonymous transactions. Providers whose industry is at risk for money laundering activities must commit themselves to verifying the identity of their customers before doing business. It must also be determined whether another person is concealed behind the contractual partner, who ultimately holds the ownership or control (the "beneficial owner"). Another key concept is the "risk-based approach", whereby compulsory verification of customers must be carried out in simplified or enhanced form, depending on the specific foreseeable risk of money laundering. PEPs (politically exposed persons) undergo a particularly rigorous investigation, as well as those persons associated with them.

Credit institutions have a duty to monitor movements on their accounts and report suspicious transactions to the Financial Intelligence Unit (FIU) of their country. The FIU has the task of collecting, analysing, and communicating information on money laundering and terrorist financing operations. 131 countries have also joined an international association of FIUs called the Egmont Group.

If illegal money can be identified from corruption cases (e.g. by elites from developing countries), it is frozen at the request of the countries of origin and transferred back ("stolen asset recovery").

Implementation problems

The stringent prosecution of money laundering has failed internationally on many points. The FATF standards are a good foundation, but many countries, including Germany, do not fully implement the recommendations. The various standards to combat money laundering make stringent international tracking difficult. In some places, for example, the beneficial owner must not necessarily be ascertained for certain types of enterprises. A weak point in Germany is that self-laundering is not a crime. In this country, the offender can only be punished for a so-called "predicate offense", such as fraud, drug trafficking, etc. Furthermore, the fight against money laundering in the non-financial sector is decentrally regulated at the Federal State level by local authorities without a specialist staff. This makes it difficult to carry out investigations. At the same time, there are major shortcomings in the communication between the public authorities in various countries. Investigations often fail because there is insufficient transparency surrounding bank accounts and cash flows across national borders. These deficits are reflected in the 12,868 suspicious transaction reports which the German FIU received in 2011, 90% of which originate from banks and only 0.9% from numerically large professional groups, including lawyers, auditors, real estate brokers and others dealing with commercial products.

Necessary reforms

The European Commission delivered proposals in 2012 for the 4th revision of the Money Laundering Directive. This includes to require a company's management to have information about its own "beneficial owners". However, it does not reduce the threshold of 25% of company shares for the purpose of identifying the "beneficial owner". Tax fraud is to be considered a predicate offense for money laundering across Europe and sanctions for non-compliance with inspection requirements are to be tightened.

On many points, the Commission's ideas do not go far enough. With 25%, the threshold for beneficial ownership is still high. The index would not be made public and may not even be centralised. In addition, international cooperation must be strengthened to enable the uninhibited flow of information. Any filtering in the transmission of information should be eliminated and suspicious transaction reports from abroad should have the same priority as national reports. The prerequisite for this is not only harmonisation of powers at a national level but also a universally-accepted definition of money laundering.

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Links:

[FATF recommendations]

[EU Commission]

[German Money Laundering Act]

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