MONEY LAUNDERING AND INTERNATIONAL FINANCIAL CRIME IN SMALL STATES WITH SPECIAL REFERENCE TO MALTA*

Frank Caruana§ and George Farrugia¶

Abstract. The paper first gives an overview of money laundering highlighting the vulnerability of small states in this regard, and explains why money laundering should be combated. A brief description of the international efforts to curb money laundering follows, focusing mainly on the Financial Action Task Force (FATF) and the European Union. In the last part of the paper the focus is on Malta’s anti-money laundering effort which is reviewed through legislation, regulations and the guidance notes.

Introduction

The communications revolution has opened the gates of information and rendered small states ever more dependent and vulnerable to what is happening elsewhere. The United Nations Programme against Money Laundering identified the preciousness of small states with regard to money laundering activities, stating that “The economic power generated by outlaw activities provides criminal organisations with leverage on small economies”.¹ Threats come from all directions towards the financial viability and integrity of small state, arising from increased transnational crime, particularly drug trafficking, money laundering and terrorism. Money laundering is generally associated with criminal activity or corruption, with the intention of disguising the money’s origin of income so that the money generated can be used “legitimately”. As is

---

* This is a revised version of a presentation made by Frank Caruana at a Workshop on Banking and Finance in Small States at the Islands and small States Institute of Malta with the support of the Commonwealth Secretariat and the Ministry of Foreign Affairs, Malta, held on 2-13 December 2002.

§ Frank Caruana is the Director of the Financial Intelligence Analyst Unit, Malta.

¶ George Farrugia is an analyst with the Financial Intelligence Analysis Unit, Malta. He holds a Masters degree in Business Administration.

¹ http://www.imolin.org.gpml.htm
Money Laundering and International Financial Crime

commonplace around the globe, money laundering generally involves a series of multiple transactions used to disguise the source of financial assets. Money laundering methods can be classified into three distinct stages: placement, layering, and integration (Kehoe, 1996). These stages may be briefly explained as follows:

1. Placement. This is the process of placing, through deposits, SWIFT/wire transfers, or other means, unlawful proceeds into financial institutions;

2. Layering. This refers to the process of separating the proceeds of criminal activity from their origin through the use of layers of complex financial transactions; and,

3. Integration. This is the process of using an apparently legitimate transaction to disguise the illicit proceeds. Through this process the criminal tries to transform the monetary proceeds derived from illegal activities into funds with an apparently legal source.

The Need to Combat Money Laundering

Money laundering may have devastating social consequences and poses a threat to the security of any country, large or small. It provides the fuel for drug dealers, terrorists, illegal arms dealers, corrupt public officials and all types of criminals to operate and expand their criminal activities.

The globalisation process and the communications revolution have made crime increasingly international in scope, and the financial aspects of crime have become more complex. The spread of international banks all over the world has facilitated the transmission and disguising of the origin of funds. This has also been assisted by the “hijacking” of financial institutions by wealthy criminals who use their institutions to introduce their illicitly earned funds into the financial world.

Modern financial systems, in addition to facilitating legitimate commerce, permit criminals to order the transfer of millions of dollars instantly, using personal computers and state of the art communications systems. Money is laundered through currency exchange agencies, stockbrokers, jewellers, casinos, expensive car dealers, insurance companies, and trading companies. Private banking facilities, offshore banking havens, shell corporations, free trade zones, money transfer
systems (like SWIFT), and trade financing can all be used to cover-up illegal activities.

Unhindered money laundering can quickly erode the integrity of a small nation’s financial institutions creating unfair competition between legitimate and illegitimate business. International Monetary Fund studies suggest that smaller countries are more susceptible to large scale money laundering operations causing severe macroeconomic instability (Bartlett and Ballantine, 2002). Due to the extremely close relationships of capital markets, money laundering could also adversely affect currencies and interest rates as launderers reinvest funds where their schemes are less likely to be detected, rather than where rates of return are higher. Money launderers do not necessarily seek the best rate of return but the easiest way to clean their dirty money (Porteous, 2000).

At the final stage of the process, the laundered money flows into global financial systems where it could undermine national economies and currencies. Money laundering is thus not only a local law enforcement problem but poses a serious national and international threat to economic stability. The unfair competition created through money laundering would ultimately adversely affect tax revenues, increase the undue weight on honest tax-payers, and disrupt economic development. These consequences would be proportionately larger for small countries.

Unfortunately the continued abuse of some offshore financial centres and the increase of on-line Internet banking and Internet gambling have further enhanced the need to scrutinize new technologies to combat money laundering schemes. Every new product of the financial services industry, whether electronic or face-to-face, has to be scrutinised, secured and armed with the right anti-money laundering mechanisms so as to avoid assisting criminals to legitimise their “dirty” money.

Nowadays there is widespread awareness that every country must firmly and effectively deal with money launderers who are well-organised, financially and technologically, and ready to use every imaginable and available means to short-circuit the financial systems which are the base of legitimate commerce. Undoubtedly, fighting money launderers not only reduces financial crime; it also deprives criminals and terrorists of the means to commit other crimes.
The Financial Action Task Force

In response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognising the threat posed to the banking system and to financial institutions, the G-7 Heads of State or Government and the President of the European Commission convened the Task Force from the G-7 member States, the European Commission, and eight other countries.

The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, the FATF issued a report containing a set of forty recommendations, which provide a comprehensive blueprint of the action needed to fight against money laundering.

The main international anti-money laundering policies are still reflected in the 40 recommendations issued by FATF, which is an OECD intergovernmental body. These recommendations are a basic framework for anti-money laundering measures and are intended for universal application. They cover the criminal justice system and law enforcement, the financial system and its regulation and international co-operation. The recommendations were revised in 1996 to take into account of changes in money laundering trends and to anticipate potential future threats. The FATF has also developed various interpretative notes which are designed to clarify the application of specific recommendations and to provide additional guidance.

The FATF is also engaged in a major initiative to identify non-cooperative countries and territories (NCCT) in the fight against money laundering. Specifically, this has meant the development of a process to seek out critical weaknesses in anti-money laundering systems which serve as obstacles to international co-operation in this area. The goal of this process is to reduce the vulnerability of the financial system to money laundering by ensuring that all financial centres adopt and implement measures for the prevention, detection and punishment of money laundering according to internationally recognised standards. Following the
11th September attacks on New York, the FATF has issued eight Special Recommendations and guidance for detecting the financing of terrorism.

The FATF has recently published a revised version of the 40 recommendations, incorporating the 8 special recommendations and the NCCT evaluations. Amongst other important initiatives there are the EU directives on money laundering, the Basle Committee papers on customer due diligence and sharing of financial records in connection with terrorist financing and the Council of Europe’s Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime.

The Select Committee of Experts of the Council of Europe

The Council of Europe’s Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (now renamed MONEYVAL) was born in response to the FATF’s active promotion of regional bodies, based on the FATF model. This occurred when the FATF considered that it could not continue to allow its membership to expand but had to limit new members to those states which FATF considered to be of particularly strategic importance to the achievement of its objectives.

MONEYVAL has achieved significant progress since its creation in 1997. The Committee adopted a method of mutual evaluation whereby a member State was evaluated by a team of evaluators selected from other member States. The evaluation was based on an Examiner’s Guide compiled to incorporate in a handy volume a step by step account of the evaluation process, a checklist of issues to be covered during the evaluation, a procedure for the amendment of reports during plenary discussions and rules on the confidentiality of reports. The volume also included the essential reference documents which were to constitute the basis of the evaluation. Malta was a founder member of MONEYVAL and in fact Malta currently holds the presidency of this Committee. The second round of evaluations is in the process of being concluded.

At the plenary meeting of the MONEYVAL held in January 2001, it was agreed that the FATF’s 25 criteria to identify non-cooperative countries and territories would be considered in assessing members’ anti-money laundering regimes during the MONEYVAL second round of mutual evaluations.
The Egmont Group Membership

The fight against money laundering has been an essential part of the overall struggle to combat illegal narcotics trafficking and the activities of organised crime. The measures governments have developed to counter money laundering can also help stem corruption, terrorist financing, and other serious crime. Banks and other financial institutions are an important source for information about money laundering and other financial crimes, as can be expected.

In the 1990s, governments around the world started to work together to mitigate the corrosive dangers that unchecked financial crimes posed to their economic and political systems (Woods, 1998:10-19; McDonell, 1998:9-14). To address this threat, many governments created specialised agencies to deal with the problem of money laundering. In the beginning, there was no unifying concept of what functions these agencies should perform, and it was almost by accident that they had in common the function of receiving and processing financial disclosures.

At about this time, the heads of these organisations started to become visible on national delegations at various international meetings and conferences. Through these informal contacts, they shared common experiences. These first contacts led to a meeting on June 1995 at the Egmont-Arenberg Palace in Brussels, Belgium to discuss financial intelligence units or FIUs. Chaired jointly by FinCEN and the Cellule de Traitement des Informations Financieres (CTIF) of Belgium, the meeting in Brussels enabled participants to become acquainted with the already existing FIUs (14 nations) and to open communication channels. Now known as the Egmont Group, these FIUs meet yearly to find ways to cooperate, especially in the areas of information exchange, training, and the sharing of expertise.

The Egmont Group as a whole meets once a year and working groups (Legal, Training/Communications, and Outreach) meet three times a year to discuss issues related to money laundering. The Legal Working Group has focused its efforts on issues related to information exchange between FIUs. The Training/Communications Working Group looks at ways to communicate more effectively, identifies training opportunities for FIU personnel and examines new software applications that might
facilitate the analytical work of these personnel. Other significant programs developed by this working group are the FIU personnel exchange programs and the topical/regional workshops hosted by various FIUs. Exchanges and workshops between FIUs have occurred all over the globe with good results. The Outreach Working Group works to create a global network of FIUs to facilitate international cooperation. The Outreach Working Group identifies countries that the Egmont Group should approach to offer to assist in the development of FIUs.

Although different FIUs operate differently, they exchange information with each other under certain specific conditions. This information could relate to suspicious or unusual transaction reports from the financial sector as well as government administrative data and public record information. Many FIUs can be of assistance in providing financial intelligence rapidly to other FIUs. One of the most significant accomplishments of the group’s efforts has been the creation of a secure Internet website. Egmont’s International Secure Web System (ESW)-developed primarily by FinCEN permits members of the group to communicate with one another via secure e-mail, posting and assessing information regarding trends, analytical tools, and technological developments. In other words, this system provides the ability to facilitate practical, rapid exchanges of information that could enhance the efforts of the fight against money laundering. FinCEN, on behalf of the Egmont Group, maintains the Egmont Secure Web. The ongoing development and establishment of FIUs exemplify how countries around the world continue to intensify their efforts to focus on research, analysis and information exchange in order to combat money laundering and other financial crimes.

The European Union

Directive 91/308/EEC of June 1991 introduced measures for the prevention of the use of the financial system for the purpose of money laundering. Although the directive in its preamble made reference to proceeds from other criminal activities (such as organised crime and terrorism) it defined criminal activity as a crime specified in Article 3 (1) (a) of the Vienna Convention and any other criminal activity designated by each Member State. Therefore, the Directive was primarily targeting proceeds
Money Laundering and International Financial Crime

 deriving from drug related crimes. Most Member States however introduced also other forms of criminal activity in their relative legislation.

In an effort to curb money laundering activities, the EU included, in its amending directive, what are called “gatekeepers.” As a result, a broader range of professionals have to abide by anti-money laundering rules professionals assist in the planning or execution of certain transactions or act on behalf of their clients in the conduct of certain financial or commercial activities. This amending Directive was endorsed by the European Parliament on 4th December 2001 and the 15 member states. The 10 candidate countries were required to bring their domestic laws in conformity with the new provisions of the new Directive by 15 June 2003.

The new Directive extends the scope of the original Directive on money laundering. In particular, it obliges Member States to combat laundering of the proceeds of all serious crime (including fraud against the EU budget). The amendment also extends the coverage of the current Directive (limited to the financial sector) to a series of non-financial activities and professions that are vulnerable to misuse by money launderers. Requirements relating to client identification, record keeping and reporting of suspicious transactions are therefore extended to external accountants and auditors, real estate agents, notaries, lawyers, dealers in high value goods, such as precious stones and metals or works of art, auctioneers, transporters of funds and casinos. Malta, being an EU acceding country had to abide with these directives, resulting in the updating of the Prevention of Money Laundering Act together with the establishment of the Maltese Financial Intelligence Analysis Unit.

Malta’s Current Anti-Money Laundering Measures

In deciding to establish and promote Malta as a prudent and efficient international financial centre, the Maltese authorities recognised the need for a major change in the framework of the financial legislation in Malta. This change prompted the development of a comprehensive set of laws for the financial services sector ranging from the enactment of totally new laws to the enhancement, amendment and/or consolidation of existing legislation. Focusing on the four principles of professionalism, confidentiality, efficiency and integrity, the necessary legislation was enacted and put in force during 1994.
The Maltese authorities have further recognised that as an international financial centre, Malta could be targeted by money launderers. The authorities have therefore seen the need to protect the financial and operational integrity of the domestic and international markets. Consequently considerable emphasis has been made on statutory and regulatory requirements for the prevention of money laundering activities.

The introduction of a general obligation of professional secrecy in the Professional Secrecy Act of 1994, has consolidated the various provisions in Maltese law on confidentiality and professional secrecy thus providing the necessary reassurance to both domestic and foreign investors without obstructing, unnecessarily, the supervision of fiscal and regulatory compliance. However, the introduction of the Prevention of Money Laundering Act (1994) and the statutory provisions or gateways in the respective financial legislation for banks or credit and financial institutions, investment services and the insurance business for the strict lifting of confidentiality for disclosure of information in cases of suspicious transactions, have consolidated the integrity of the legislative framework itself and the credibility of Malta as a financial centre.

The Maltese Prevention of Money Laundering legislation, modelled on international standards, is based on three tiers legislative namely the Prevention of Money Laundering Act, the Prevention of Money Laundering Regulations and the Prevention of Money Laundering Guidance Notes issued by the regulatory authorities.

**The Prevention of Money Laundering Act, 1994**

The Act was enacted in 1994 to provide for the prevention of money laundering in Malta. In its definition of criminal activity, the Act goes beyond the requirements the first EU Directive in that it defines criminal activity as any crime specified in the Vienna Convention (i.e. those crimes related to drugs) and any one of the crimes listed in the Second Schedule to the Act.

Money laundering is defined as:

(i) the acquisition, conversion, transfer or retention without reasonable excuse, the concealment or disguise of the true nature, source,
location, disposition, movement, rights with respect of, ownership of property knowing that such property is derived directly or indirectly from criminal activity or of participation in criminal activity;
(ii) attempting any of the matters or activities described above;
(iii) acting as an accomplice in respect of any of the matters or activities defined above.

The Act then defines property for the purposes of money laundering. The definition practically includes every kind, nature and description of any movable or immovable, tangible or intangible property and includes cash or monetary instruments of any kind, land and any interest therein.

The Act lays down the heaviest penalties in the Maltese statute books. In fact any person found guilty of committing an act of money laundering shall, on conviction, be liable to a maximum fine of one million Maltese liri, or to imprisonment for a maximum period of fourteen years, or to both such fine and imprisonment. It also lays down a penalty of a fine of up to twenty thousand liri or of imprisonment not exceeding 24 months, or to both such fine and imprisonment for disclosing that an investigation is being undertaken or for making any other disclosures likely to prejudice the investigation or for contravening a Court order.

The Act gives additional powers of investigation whereby, upon information received, the Attorney General may apply to the Criminal Court for an investigation order so that any person, whether natural or legal, named in the order, appears to be in possession of information which is likely to be of substantial value (whether by itself or together with other material) to the investigation of, or in connection with, the suspect, shall produce or grant access to such material.

Together with, or separately from an investigation order, the Attorney General can also apply to the Criminal Court for an attachment order, whereby property mentioned in the order is attached into the hands of persons in possession of the property. At a later stage when a person is charged in Court, the property may be frozen and, on conviction, it is confiscated.

The Act also allows the investigation and the freezing of property of an accused person as well as the enforcement of confiscation orders follow-
ing conviction in connection with offences recognised by the Maltese courts outside Malta. The Act also permits the Minister to make rules or regulations generally for the better carrying out of the provisions of this Act and in particular, such rules or regulations to provide for the regulation and control of banks, credit and other financial institutions to provide \textit{inter alia} for procedures and systems for training, identification, record-keeping, internal reporting and reporting to supervisory authorities for the prevention of money laundering.

The second part of the principle law provides for the establishment of a government agency to be known as the Financial Intelligence Analysis Unit (FIAU) which has a distinct legal personality and capable of entering into contracts, concluding memoranda of understanding or other agreements with any foreign body, authority or agency having functions equivalent or analogous to its own.

The Unit is responsible for the collection, collation, processing, analysis and dissemination of information with a view to combating money laundering and has the following functions:

(i) To receive reports on financial transactions suspected to involve money laundering made by persons subject to regulations which we describe further;

(ii) To request additional information for the purpose of drawing up analytical reports based on the information collected;

(iii) To send any analytical reports to the law enforcement authorities for further investigation, possible prosecution and eventual conviction;

(iv) To monitor compliance with the regulations by subject persons and to co-operate and liaise with supervisory authorities to ensure such compliance;

(v) To promote training, instruct, assist and advise subject persons to take appropriate steps to combat money laundering; and

(vi) To compile statistics and gather information on the financial and commercial activities in the country for analytical purposes.

The Unit is composed of a Board of Governors, a director, analysts and support staff. The selection process of the Board is designed in such a way as to ensure a mix of expertise whilst ensuring the Board acts as independently as possible. The Office of the Attorney General, the Malta Financial Services Authority, the Central Bank of Malta and the Malta
Police each submit three nominations to Government who selects a person from each authority. However, the selected candidates shall discharge their duties in their own individual capacity and are not subject to the direction of any other authority.

The Unit which has become fully operational in 2002, has in 2003 become a full member of the Egmont Group.

**The Regulations**

The Prevention of Money Laundering Regulations issued in 1994 are addressed to persons, whether natural or legal who carry out relevant financial business to introduce systems to prevent money laundering. Currently, persons engaged in banking, investment services, life assurance business, stock broking, bureau de change, collective investment schemes, other financial institutions and casinos are subject to the regulations. The list of subject persons is expected to be amended to include the persons and professions caught by the new EU Directive.

Subject persons are obliged by the regulations to maintain systems for identification, record-keeping, internal reporting and training either to prevent the institution from being used for money laundering activities or to report to the competent authorities any suspicious transactions that could involve money laundering.

Identification procedures apply whenever a business relationship is established or a one-off transaction is carried out and subject persons verify such identification against valid supporting evidence. The regulations laid down what constitutes adequate minimum standards for different situations including face-to-face, payment by post, on behalf of others, through corporate bodies as well as a list of four exemptions, when identification would not be required. Records of identification and related transactions must be kept for a minimum of five years and the regulations explain how and when the record-keeping period commences.

The regulations provide for subject persons to appoint an internal officer, called the Money Laundering Reporting Officer, to whom internal re-
ports are made. This person has the obligation to consider such reports in the light of all other relevant information to determine whether the report does give rise to a suspicion that a person might be engaged in money laundering. The regulations allow reasonable access for the MLRO to any information held by that subject person which might be of assistance for the purpose of considering the internal report.

Once it has been determined that there are reasonable grounds to suspect that a person has or may have been engaged in money laundering, that subject person must report those suspicions to the Financial Intelligence Analysis Unit. It is the usual practice that the Money Laundering Reporting Officer (MLRO) is the contact between the subject person and the FIAU. In making such disclosures, subject persons are exonerated from the duty of professional secrecy knowing that any information disclosed under these regulations shall be used only in connection with investigations of money laundering activities. Thus these regulations based on international standards give assurance to all law abiding persons that the financial industry has the necessary tools of professionalism, confidentiality, efficiency and integrity, whilst at the same time there are in place systems to protect the industry from illicit financial criminal activity.

The Guidance Notes

The Guidance Notes issued by the supervisory authorities of the financial sector are the third legislation layer for anti money laundering in Malta. On their own, they do not have the force of law but are the measuring stick which the Courts use in determining whether a subject person has complied with any of the requirements of the regulations.

The purpose of these Guidance Notes is to evaluate the obligations of the financial sector pursuant to the Regulations and to establish standard procedures of communication between subject persons, the competent authorities, the FIAU and the Enforcement Authority.

It must be emphasised, however, that these Guidance Notes are complementary to the Prevention of Money Laundering Act, the Regulations and relative provisions in other laws with reference to money laundering.
They are not intended to provide a complete summary of the legislation and should not be construed as a substitute to the relative legislation. The responsibility for observing the law rests entirely with the subject persons and their employees.

The Guidance Notes give an overview of the money laundering process and describe the domestic legislative and regulatory structure before going into great detail on what operators in the financial sector should introduce into their respective internal procedures to ensure compliance with the requirements of the regulations. For example they describe in detail what due diligence is expected in account opening identification procedures and propose a tiered due diligence structure which is also cost effective. They state in detail what constitutes an identification or transaction record.

The notes also guide the user in the recognition and reporting process of suspicious transactions. They introduce a standard format for reporting disclosures and give examples of possible suspicious transactions. This list is not intended to be exhaustive and should only be considered as a reference and to provide examples of the most basic ways through which money could be laundered. The possible identification of any of the types of listed examples should prompt further investigation and be a catalyst towards making at least initial enquiries about the source of funds.

Conclusion

By way of conclusion, it is opportune to indicate some of the future directions which anti-money laundering activities are expected to undertake. Inevitably, given the resolve of criminals and terrorists alike, one cannot rest or remain complacent but one should endeavour to develop new techniques and systems to combat money laundering and the financing of terrorism as well as further develop international co-operation. Among the priorities for future action for anti-money laundering activities in Malta, there are:

i. enacting amendments to current legislation to bring it in line with international developments;

ii. entering into mutual memoranda of understanding with foreign FIUs to facilitate the exchange of information;
iii. implementing more efficient analytical tools;
iv. revising the current Guidance Notes to reflect the recent domestic and international changes, namely the change to a single regulatory body, the establishment of the FIAU and the new EU directive.

It is difficult to specifically distinguish between the legislation requirements of large or small states in respect of anti-money laundering activities. However the dangers facing small states are greater due to their limited financed and human resources. Nevertheless a small country should exercise due diligence as the base of anti-money laundering vigilance. Additionally, co-operation with the already established countries or groups promoting prevention of money laundering is essential. Furthermore, co-operation between small states should also help to give more weight and credibility to their efforts in this field.

References

FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING (2003) Basic Facts about Money Laundering, OECD.