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PROXIMAL CONSULTING WHITE PAPER 17 MONEY LAUNDERING THROUGH STOCK EXCHANGES

It was Al Capone who observed that he was surprised that so many people turned to crime when there are so many legal ways to be dishonest. Mr Capone would have been familiar with both the theory and practice of money laundering as the term - and the process of money laundering - originated in the United States in the 1920's. Criminal gangs then were trying to do much the same as today: disassociate the proceeds of their criminal endeavours from the activities that generated them. To do this they took over businesses with high cash turnovers - such as laundrettes and car washes. The criminals then proceeded to mingle the cash from nefarious activities with legitimate income, thus creating a logical commercial reason for the existence of large sums of cash.

The financial world has moved on substantially in the intervening years - however it is open to question whether the response to (or understanding of) money laundering has developed at the same pace. The London Stock Exchange is, just like any other international financial forum, a magnet for money laundering: which is conservatively estimated to be worth £1.5 trillion per year. The very simple reason for this is because it is an effective vehicle to wash funds. Examples are:

- Criminal funds transferred into alternative financial instruments, ownership of shares and bonds
- Brokerage firms taking washed or partially washed funds that are then used to buy shares or other financial instruments

Research has shown that 80% of all money laundering transactions involve an international component: certainly criminals have fully embraced the new global marketplace. This creates additional problems as criminal money arriving to be invested in the Stock Exchange is more likely to come from another reputable financial centre than a country with discernible links to organized criminal activity. The increased globalization of financial marketplaces also throws up other difficulties: such as criminals establishing a trading account in the office of a financial institution in one country and then having it transferred to London.

Another more extreme method to utilize the Stock Exchange as a money laundering vehicle is through listed companies being nothing more than a laundering operation themselves. The now infamous YBM Magnex International Inc was delisted by the Toronto Stock Exchange in December 1998. A US class action suit claimed that YBM's "only successful business is the laundering of criminal proceeds". Red flags have already been raised about the money laundering possibilities inherent in the listing of dotcom companies with no track record and unsustainable market valuations.

The current regulatory regime that highlights identification procedures, record keeping, internal reporting systems and staff training can effectively combat money laundering only if it is applied on a coherent basis in a serious and

effective way with a true understanding by those in the market of what they are trying to fight and why. Critical to the success of the UK anti-money laundering regime is the disclosure of suspicious transactions (and clients) to NCIS (National Criminal Intelligence Service).

In 1999 of 271 member firms of the London Stock Exchange 18 made disclosures – 6.6% of the total. This compares unfavourably with almost 77% of Building Societies that made disclosures in the same period but favourably with the 0.1% of Accountants in the United Kingdom that made a disclosure.

But disclosure of suspicious transactions and/or clients can only be successful if relevant staff are trained to identify “red flags” of money laundering activity. Whilst it is not possible to list all of these within the confines of this article, here are a few more obvious ones:

- “Know Your Customer” (KYC) procedures are vital: but nothing should be taken at face value, as identification documents are very easily purchased on the black market or forged. Effective due diligence at this stage can avoid many problems – including loss of reputation – later
- It is doubtful whether any organization can rely on the due diligence/KYC checks carried out by another firm: this is particularly relevant when clients are referred from one party to another. In the end, it is your organization that has responsibility (and culpability) for such checks
- The use of shell companies (such as International Business Companies registered offshore) is now a very common money laundering tool. Moreover it is one that is being targeted by both regulatory and law enforcement authorities. Variations on this theme include transfers of funds from offshore banks; loans to and from offshore banks; a high level of transactions with offshore entities or companies in geographical high risk areas
- And finally two old favourites: believe it or not, potential clients still do turn up with suitcases full of cash and if a client appears with a set of financial instruments from Nigeria, be very sceptical

August 2002