Let's Talk About Layering: Money Laundering, Anti-Money Laundering, and Digital Surveillance

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Introduction

The objective of money laundering, or "cleaning" one's money of any connection with illicit or criminal activity, is to get illicit cash into the formal financial system. Initially, the United States attempted to prevent money laundering in order to address the proceeds of illegal drug trafficking.[1] During the 1980s, depositing cash at local bank branches was the most straightforward method for money laundering, a practice dually familiar to bank customers paid in cash or by check. As a result, the banking sector was the first part of the economy to enact anti-money laundering (AML) legislation; however, years later, banks remain the targets of government action against AML failures.[2] Prominent examples in the past ten to fifteen years include the HSBC subsidiary bank operating in Mexico. In this instance, the drug cartels were so confident of their deposits being accepted, they constructed cash boxes to fit the dimensions of the branch teller windows. This technique reflected the perception "that Mexico had less stringent anti-money laundering laws" making it easier for them to deposit their cash at the bank.[3] More recently, NatWest Bank in the United Kingdom made headlines for failing to prevent money laundering by a gold dealer, through their acceptance of cash-filled garbage bags at local bank branches for several years. Branch staff followed the bank's procedures for reporting the transactions, yet the bank failed to submit suspicious activity reports on those deposits to the

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government.[4] These headline stories, however, do not reflect the vast majority of effectively enforced AML actions. They do highlight the fact that it remains possible to place illicit cash directly into a bank when said bank fails to follow its own AML procedures. The overall effectiveness of AML enforcement means illicit cash seeking to enter the financial system cannot simply be deposited but must find another route.

Most scholars explain money laundering as a three-step process. First, the illicit cash must enter the financial system. Second, through a process known as layering, the money is passed through a series of transactions to make tracing its illicit origins nearly impossible. Finally, this "clean" money is made ready for use with the appearance that it came from a completely legitimate source—a process known as integration. Procedures at financial institutions first seek to prevent suspect individuals from opening an account, and thereafter to identify any transactions that do not fit the normal, nominal transaction pattern for that account holder.[5] These efforts overlook the importance of the layering step, the "wash cycle," in which cleaning takes place to conceal the illicit origins of the money. Notably, any economic transaction may serve as a layering step to help obscure the original illicit origins of money, as illustrated by the following examples.

One easy demonstration of the layering step is found in the frequently repeated origin story of the term money laundering in the United States: laundromats owned by organized crime in the 1920s and 1930s.[6] As a cash-intensive business, the laundromat provides unique advantages for those seeking to introduce illicit cash to the financial system. For investigators to determine the extent to which a business may be involved in money laundering, they would have to monitor and count the loads of laundry and compare the revenue generated with the cash deposited at the bank. The first annual report of the Financial Action Task Force (FATF) in 1990 offered a sense of the enduring practices involved in the money laundering cycle beyond the use of a cash-intensive business.[7] It discussed the use of banks, informal financial practices, non-bank formal financial institutions, bulk cash transfer across borders, and "corporate techniques," which include the use of shell companies and merchandise trade.[8] This report also included one of the early references to "smurfing," the practice of making multiple, small deposits in order to avoid making a large deposit that would trigger a suspicious transaction report ($10,000, £10,000, or €10,000).[9] Cash is anonymous, only becoming identifiable and linked to an individual or company once it has entered the financial system.

With the shift away from using cash and toward the use of debit and credit cards, this anonymity is lost. Electronic payments leave a digital trail identifying the item purchased, in addition to when and where. The assumption is that the registered owner of the card account is the one making the transactions. Similarly, other forms of electronic transactions leave a digital record, retrievable on demand if required. This digital trail makes the movement of money traceable, and access to it allows law enforcement to follow suspicious transactions and money back to the point of entry in the financial system. Simultaneously, the privacy of the individual is stripped away when anyone with access to this digital financial data might review the transactions made by any account. Government capability to require access, when in search of criminals and terrorists, transforms the network of financial institutions into a financial panopticon that observes and tracks everyone's business.[10] Financial privacy is now lost in the pursuit of security.[11] Recognizing the presence of these structures of financial surveillance, money launderers look for easier routes into the financial system, as seen with the earlier referenced HSBC case. Therefore, they look for avenues not yet under surveillance, which thereby increases the importance of the layering step for money laundering as explored in the next section.

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Illustrations of the Layering Step

One way to pursue international illegal drug trafficking, as seen with Operation Greenback in the early 1980s, is to establish the crime of money laundering itself.[12] By its very definition, the act of money laundering applies to any illicit origin for money that must be transformed to appear legitimate. Conversely, any money with a legitimate source that is intended to serve an illicit purpose must be disguised to shield the legitimate origin from being recognized and prosecuted. The memoir of musician Thomas Dolby provides a case study demonstrating the latter function. Dolby relates the story of events in the early 1980s in connection with his involvement in the production of the film *Howard the Duck* (1986). Given the job to write and direct an MTV video for the film's title song, he discovered that the record label expected to pay far more than the going rate for a set decorator. Dolby relates this action as "one of the many ways record companies laundered the money they needed to bribe radio programmers and buy radio play."[13] In essence, the set decorator was complicit in accepting the higher amount, from which he would keep his normal rate of pay, plus a handling fee. The rest of the money would be placed in brown envelopes for use by the record company, while their accounting records showed a legitimate business expense for the production of the music video. Dolby's experience is an example of the second wave of payola scandals during the 1980s in the U.S. music industry. These activities were treated by the government as anti-competitive practices to promote specific artists and their music over others.[14] The continuing efforts in the music industry to pay-for-play required techniques to conceal the payments and, in doing so, established them as a form of money laundering.[15]

The following illustrations come from different economic sectors and countries to demonstrate the variety and complexity possible within the layering step of money laundering. The first two reflect the experience of China and its political economy—with one domestic example and one cross-border example. In the first illustration, art was used to conceal bribery, reflecting the circumstances surrounding poorly policed art auctions in China some twenty years ago in which the works of art were used as bribes.[16] The target of the bribe would be given an antique or work of art, with the understanding that they could then put it up for sale at auction. Notwithstanding its actual market value, the briber or their surrogate would bid up and purchase the work at a previously agreed amount. To the outside observer, the "owner" was fortunate at getting such a high price for it. The practice of using art and antiques to launder the money behind bribes has a long history in China and is known as elegant bribery, with variations on the simple transaction described here.[17] With their emphasis on the privacy of buyers and sellers during transactions, other art markets, such as those in Brazil and the United States, also facilitate money laundering.[18] Increased recognition of this fact has led to greater regulatory oversight and the introduction of AML obligations on the industry in Europe and the United States.[19]

The second, being the cross-border illustration from China, reflects the maintenance of capital controls by the government. Many Chinese citizens have substantial domestic financial assets beyond the amount they may legally transfer abroad in a single year. As a result, legal money beyond the capital control limit escapes the country via underground operators through methods similar to those used by criminal organizations to evade AML laws. At scale, the goal may be to get one's accumulated wealth out of the country due to concerns over personal safety and wealth expropriation. These worries have increased among high net worth individuals and their families in China over the past few years.[20]

Alternately, it may simply be to fund one's gambling at a casino in Macau by purchasing a luxury item like a watch using a China-based debit card, and then immediately selling it back to the retailer for cash.[21] More recently, the desire of the wealthy seeking to take their money out is being matched by individuals with the proceeds of crime seeking to get this money into China. The process in these circumstances involves the arrangement of "mirror transactions," in which the money launderer provides U.S. dollars to a customer in the United States in exchange for renminbi received from the customer's account in China. This transaction, however, is paired with another transaction where the money launderer received U.S. dollars from a drug cartel in exchange for Mexican pesos provided to them in Mexico.[22] Mexican pesos, in turn, were received in exchange for goods shipped from China, which may include the precursor chemicals used in the production of fentanyl. The challenge for AML investigations is that while these transactions are cross-border, the money itself does not cross the border; the renminbi stays in China, the dollars in the United States, and the pesos in Mexico, all managed by the money launderer to keep their books balanced. The ability to identify the flows of illegal money through the international financial system is now eliminated.[23] As a result, China and the United States have agreed to increase cooperation to deal with this growing money laundering problem.[24]

Similar to the art market, real estate has been recognized for some time as a sector with limited oversight for possible money laundering. In addition to purchasing property with illicit money, which becomes "clean" when the property is sold, the property temporarily functions as a store of wealth. This practice operates successfully in countries that do not require anyone to conduct due diligence on the buyer's source of money or report transactions they suspect may involve suspicious money. This had been the situation in the United States until 2016, when a special reporting requirement was introduced for high-value real estate transactions in Florida and New York.[25] The action taken by the U.S. government in 2016 was in response to a series of news articles published in the *New York Times*, investigating the purchase of luxury condos using shell companies. A number of these shell companies were linked to non-U.S. citizens, "at least 16 of whom have been the subject of government inquiries around the world, either personally or as heads of companies."[26] The scope of the government's "geographic targeting order," requiring reports on property transactions involving cash and shell companies, initially covered Manhattan (New York County) and Miami-Dade County.[27] It was subsequently expanded to include other luxury property markets in 12 metropolitan areas on cash (broadly defined to include checks, money orders, and wire transfers) purchases greater than $300,000.[28]

The obligation for AML reporting by the real estate industry throughout the United States was introduced with a proposed rule by the Treasury Department's Financial Crimes Enforcement Network (FinCEN) in February 2024. At the time of writing, implementation and enforcement of comprehensive AML obligations within the U.S. real estate sector had not begun, with the comment period for the proposed rule having closed on 16 April 2024. As seen with other industries in which AML reporting has been mandated, the real estate sector argued against it, asserting that "in no circumstance should real-estate agents or brokers be shouldered with the responsibility…[because it would put them] in a precarious and dangerous situation."[29] Few people in business, whether at a bank, real estate brokerage, or auction house, wish to confront their customer with bold questions on the origins of their money. To do so could imply that this customer may be a criminal, or at the very least have a suspicious reputation. These illustrations provide an idea of the difficulties involved in identifying layering transactions, along with the necessary expansion of the scope of AML surveillance and reporting to overcome them.

Why it Matters

One consequence of activities enlisted to conceal the illicit origins or purposes of money from bribery, capital flight, corruption, fraud, and illegal drug trafficking is the encouragement of ever-increasing regulation. New layering techniques are found and used as methods of laundering money become subjected to AML enforcement. In turn, additional regulations seek to prevent money laundering using that specific form of economic transaction to layer illicit money and transform it into apparently legitimate money. Yet, these regulations may not help investigators to "unlaunder" money, a term used by scholar and activist Ethan Nadelmann to describe the process of untangling the pattern of layering steps to expose the money's criminal origins.[30] Rather, they serve to displace the money laundering activity into forms that are yet more difficult to reveal, as seen with the above illustration of Chinese capital flight and its entanglement with the profits of international drug trafficking.

Moreover, increased regulation means increased costs for market actors now obligated to follow and enforce them. Failure to adequately meet these AML obligations leads to more than just headlines exposing the failure of a bank to prevent money laundering.[31] It additionally results in fines and penalties imposed by the regulatory agencies, which in turn may lead to additional headlines in the press.[32] Compliance operations within the multinational financial corporation come at great costs to meet legal obligations and maintain the firm's reputation, without directly contributing to the firm's profits. To reduce the risk of unintentionally facilitating money laundering, the bank can stop working with the jurisdiction, business sector, or individual that is assessed to be risky. In addition to the politically exposed persons discussed below, an individual also may be considered risky because of their source of income or intermittent transactions to their account. The phenomenon to reduce a bank's risk is known as "derisking" and was identified as the possible cause for international banks to close their correspondent banking relationships with Caribbean banks and, in some cases, to close their subsidiaries and branches in specific Caribbean jurisdictions, including the Bahamas and Jamaica.[33] On the surface, derisking represents a rational actor response to the cost of compliance and potential reputational impact from what may be a small contributor to the firm's bottom line.[34] Nonetheless, in 2014 the FATF found it necessary to issue a statement emphasizing the other potential factors behind derisking, including "concerns about profitability, prudential requirements, anxiety after the global financial crisis, and reputational risk."[35]

Beyond derisking entire jurisdictions because of the perceived risks they might present to an international bank, as seen in the case of the Caribbean, banks also look to reduce risky customers within their domestic retail banking business. In 2012, the FATF Recommendation (#12) covering politically exposed persons (PEPs) was expanded to include domestic PEPs, in addition to the foreign PEPs previously identified for enhanced customer due diligence.[36] This Recommendation seeks to prevent money laundering connected to bribery and corruption by individuals with prominent public positions, including those via family members or close associates. The revision of this Recommendation forced countries to recognize and address potential bribery in their domestic economies rather than treating it as a foreign problem. In the United Kingdom, a controversy surrounding the closure of a politician's bank account led to the resignation of the bank's president and the CEO of its parent bank group. The resignations followed the CEO's inaccurate claims that the account was closed purely for business reasons.[37] The PEP in question was Nigel Farage, elected a Member of Parliament in 2024 and formerly a Member of the European Parliament (1999–2020). He had also campaigned for Brexit, the act of the U.K. exiting the European Union, as a founding member of the U.K. Independence Party.[38] The decision to close his account, however, was determined by the bank's Wealth Reputational Risk Committee, and the information considered by the committee included more references to his views on Brexit and Russia than to any risk of bribery, corruption, or money laundering. It led the committee to a conclusion "that Farage's views 'do not align with our values.'"[39] Banks are considering the reputational risks of PEPs in addition to their money laundering risks, and other British PEPs revealed at the time to having similar experiences with opening and maintaining a bank account. The guidance for customer due diligence on PEPs is clear, however, that they are preventive and not intended to stigmatize individuals.[40] The experience of British politicians suggests that some banks may be employing their AML obligations as justification for risk-based decisions beyond the expectations of the FATF.

The fact that PEPs are specified by the FATF for additional AML oversight does not mean that the rest of us are not subject to close surveillance for possible money laundering. There are recognized concerns that anyone could be a "money mule" by allowing their bank account to be used to accept a money transfer and then transfer the money onward in exchange for a handling fee.[41] In the United Kingdom, university students have been targeted for recruitment as money mules. One reported instance involved an international student that did a favor for a new friend, unaware that this friend's father was a criminal and the money they transferred had been stolen.[42] In response to similar events, information sessions have been added to the pre-semester orientation week, letting students know this "money-making opportunity" would involve them in illegal conduct by helping others to launder money.[43] Banks are looking for these potential money laundering transactions using the aggregation of data available to them.[44] It is not just the banks searching this data to identify possible illegal transactions, as government agencies are also directly searching financial big data for possible illegal activity.[45]

Digital Transactions, Digital Data, and the Erasure of Privacy

Businesses are turning to automated processes to identify potentially risky customers and transactions. The goal is to identify these risks, report them to the relevant authorities, and help to make society safe from any illicit money exposed by the reports.[46] Simultaneously, people attempt to circumvent these verification checks, for example by using a shell company to establish an account or to conduct a transaction. A shell company is one without a physical or material presence, yet as a corporate entity it may own property or open a financial account.[47] To counter the practice of using a shell company in this fashion, governments are requiring the beneficial owner, the natural person behind the company, to be identified and recorded; in some countries this information is already publicly accessible.[48] As found in the real estate example of layering outlined above, this approach would reveal foreign property owners, including any that may be named on a sanctions list. However, if the beneficial ownership data is publicly available, it inherently eliminates privacy. Even before the introduction of a beneficial ownership registry in the United Kingdom, the data leaked by the Panama Papers exposé revealed actress Emma Watson's ownership of a £2.8 million home in London through a British Virgin Islands-registered company named Falling Leaves Ltd.[49] Consequently, the desire to retain some privacy from fans and paparazzi was undone by the data leak.

The end of financial secrecy has been an objective of the AML regime from the very start. The original legislation in the United States is known as The Bank Secrecy Act, but not with the intention of promoting and enforcing bank secrecy for customers. Rather, its purpose is to force banks to report suspicious transactions.[50] The initial report of the FATF noted that none of the original member countries allowed anonymous accounts, yet access to account information in other countries might require "judicial proceedings… to overcome bank secrecy rules."[51] Consequently, the initial version of Recommendation 2 was framed as: "Financial institution secrecy laws should be conceived so as to not to inhibit implementation of the recommendations of this group."[52] The conflation of secrecy with privacy is a normative judgment that serves to erase the human right to privacy. In essence, the balance between individual human rights and societal security from criminality has been imbalanced toward the pursuit of criminals with little regard to the rights of citizens.

As noted at the beginning, a cash transaction is anonymous and thus privately known only to the parties involved in the transaction. All non-cash transactions moving through the global financial system, on the other hand, are traceable because they leave a digital record.

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The capabilities of government surveillance over financial transactions were a topic of analysis even before the events of 2001, which served to increase the attention placed on the financial system in order to identify and counter any transactions involved in terrorist financing.[53] With the evolution of technology and the development of financial apps, the information connected to your transactions may be accessible to more than just the government and law enforcement.

In his analysis of the application of big data for financial surveillance, professor of criminology Anthony Amicelle found that the complexities of introducing AML requirements into existing software systems not designed for them might not achieve the goals of the regulatory authorities. It led him to conclude that the result fell somewhere in the middle, creating an "automated and everyday mass surveillance" mechanism in banking that did not fully achieve its objectives.[54] At the same time, this mechanism also failed to reach the level of "dystopian visions of big data and algorithmic drama" held by some critics.[55] On its own, this conclusion might be reassuring to those of us concerned by the continuing construction of a financial panopticon.[56] Amicelle offers a perspective in opposition to other scholars similarly concerned by the increasing role and danger from the use of big data in society. Shoshona Zuboff, professor emeritus of social psychology, for example, provides an extended critique of what she named "surveillance capitalism" and the danger it poses to democratic society with its accumulation and aggregation of data from people's digital presence and activities.[57] Beyond the financial data generated and analyzed as part of the AML regime is the larger operation of big data and its use by Apple, Amazon, Facebook, Google, and a multitude of smaller businesses with access to the digital data marketplace for targeted advertising. This commercial big data is increasingly accessed by U.S. law enforcement and integrated with AML-generated financial data to create a larger digital panopticon surveilling the country in search of criminality.[58]

The immediate concern may be to prevent the use of layering techniques that facilitate money laundering, however, at the same time, financial privacy concerns remain an important consequence to address. The collection of digital data on citizens for this purpose reduces their privacy as does the collection of data by tech companies as part of their business model. Certainly, the AML campaign requires a wide remit for data collection as demonstrated by the examples of layering presented here. The use of works of art and real estate in the layering step highlights the continued efforts made to avoid AML surveillance. Yet, it is also important to keep in mind that these examples only represent practices that have been identified—other methods may remain to be exposed. Finding new ways to layer transactions and disguise their origins remains a goal for anyone looking to cleanse their illicit money for later use in the legal economy. The goal, then, for AML enforcement must be to protect citizens' privacy as much as it is to protect them from criminality and dirty money.

Notes

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