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Economic and social effects of money laundering: the UK case

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Abstract

Money laundering is one of the largest economic problems of the 21st century with huge social implications and effects. It enables the richest and most powerful in society to take advantage of globalisation and differences across countries. It is only for less well-off money laundering regulations in the UK are stringent and enforced. Money laundering is not a 'victimless crime'. The individual(s) or the country (and inhabitants) from which the money is stolen are, by definition, the victims/losers, whilst the money is used in the recipient country to support the criminal's lifestyle or other activities such as drug importation, child sexual exploitation, human trafficking and terrorism and so on, alternatively, invested in property until a profitable opportunity arises.

This paper examines the problem both generally and the UK in particular. It describes the main forms and types of money laundering and the devices used. This is followed by sections on its effects on an economy and contains an empirical study of this as it affects London property prices, the actions taken by UK regulators against money launderers, their advisers and agents. The final section discusses some recent initiates and recommendations as to what can and should be done.

Introduction

Money laundering is one of the largest economic problems of the 21st century with huge social implications and effects [1]. Not only does it add to inequality by assisting criminals to steal, assisted by lawyers and accountants who devise the schemes yet appear to have no ethical restraints, it enables the richest and most powerful in society to take advantage of globalisation and differences across countries. It is only for less well-off money laundering regulations in the UK are stringent and enforced.

Money laundering is not a 'victimless crime' [2]. In many instances, this is obvious. In the case of an international transaction, the individual(s) or the country (and inhabitants) from which the money is stolen are, by definition, the victims/losers, whilst the money is used in the recipient country to support the criminal's lifestyle or other activities such as drug importation, child sexual exploitation, human trafficking and terrorism and so on, alternatively, invested in property until a profitable opportunity arises.

The best international estimate of money laundered globally is £1.25 trillion (US$1.6 trillion) in 2009 which is equivalent to 2.7% of global GDP [3]. The US is the top origin of laundered money (second and third are Italy and Russia) and the top destination (second and third are the Cayman Islands and Russia) [4]. Unger (p. 191-2) claims that the total contribution of small countries to total money laundering is small. Her main finding is that large industrialised OECD economies are the main conduits notably in the US where the regulation of shell companies fell short of regulatory safeguards necessary to deter money laundering (US GAO 2006: 41-42). She also cited evidence (although old) that the City of London was a key centre for money laundering and terrorist financing. In contrast, Jersey and the Isle of Man are found to be models of good corporate regulation that would be useful in countering money laundering (US GAO 2006: 41-42).

In the UK, the National Crime Agency ('NCA') has estimated that the amount of money laundered in the UK is around £150bn each year. It has also been estimated that £4.4bn of UK property has been bought with suspicious wealth, with more than a fifth purchased by Russians. During the 18 months to March 2017, £56m of cash was blocked from being transferred to criminals.

It is also believed that overseas companies are used as vehicles to invest funds in UK property from criminal or illegitimate activities in the UK and overseas. The Department of Business, Energy & Industrial Strategy has estimated that over £135m of UK property owned by overseas companies is currently the subject of a criminal investigation but this, of course, represents a small proportion of the UK property owned by offshore companies. In the majority of cases, the use of an offshore entity to hold property may not have

any criminal motivation other than a desire for secrecy. Overseas companies have been used legitimately for decades as a tax as a tax avoidance device.

Whilst the freedom of movement of funds is a necessary condition for efficient resource allocation leading to economic efficiency and prosperity, it has pitfalls. One of these is the encouragement of money laundering effectively involving the transfer of money ('theft') from one country (the 'victim') to another with and many socially undesirable effects. Whilst at first glance the transfer of money to the receiving country provides it with economic benefits, it swamps it with unneeded funds leading to inflation and other socially undesirable effects. A good example of this is the flow of money from Russia to the UK and in particular London where much of this money is invested in property affecting the housing market in both London and its hinterland. Real estate prices in London increased 50% from 2007 to 2016. It is also well known that London house prices have increased over many years relative to elsewhere in the UK. It is often asserted that this is not just because of higher average earnings in London but because it has become a safe haven for corrupt capital stolen from around the world, facilitated by the laws which allow UK property to be owned by secret offshore companies [5].

It is the purpose of this paper to briefly examine these issues using publicly available information. The next section examines the problem both generally and the UK in particular. it is followed by a brief description of the forms and types of money laundering and the devices used. This is followed by sections on its effects on an economy, an empirical study of this as it affects London property prices, and actions taken by UK regulators against money launderers, their advisers and agents. The final section discusses some recent initiates and recommendations as to what can and should be done.

The Problem of Countering Money Laundering: The UK legislation and regulation.

Money laundering is a process whose objective is to disguise the existence, nature, source, control, beneficial ownership, location and disposition of property derived from criminal activity or fraudulent behaviour. There are many reasons why an individual may wish to launder money ranging from a divorcee hiding money from an ex-spouse through to tax evasion, the legitimisation of the proceeds of sale of drugs, the funding of terrorists, domestic flight and evading government monetary controls and regulations. The difference between tax avoidance and evasion is legality. Tax evasion is the illegal act of not paying taxes: for example, by not reporting income, falsifying expenses and tax returns or by devising schemes for not paying what is owed. Tax avoidance is simply arranging one's financial affairs in order to minimise tax payable. Whilst it may be unethical, it is not illegal. Moving money simply to avoid tax or conceal ownership is not unlawful and does not constitute money laundering. It only becomes unlawful if the funds are the proceeds of crime.

Laws against money laundering were created in the US to use against organized crime during Prohibition in the 1930s. In the 1980s, the war on drugs in the US and elsewhere led governments again to turn to money-laundering rules in an attempt to seize their proceeds of sale in order to catch and deter the organizers and individuals involved. The 9/11 attacks in the US in 2001 led to a new emphasis on money laundering laws to combat terrorism financing throughout the world: starting in 2002 with the Patriot Act in the US, the Proceeds of Crime Act 2002 ('PoCA') in the UK and similar legislation elsewhere.

PoCA facilitated the confiscation of money by law enforcement agencies without having to prove guilt. The individual is required to prove that the sources of funds are legitimate. PoCA created a single set of money laundering offences applicable to the proceeds of all crimes, i.e. it was obtained through unlawful conduct whether in the UK or elsewhere (Section 241). Money laundering offences assume that a criminal offence has occurred in order to generate the criminal property that is being laundered (a 'predicate offence'). However, it must be proved that, at the time of the offence, the defendant knew or suspected that the property was criminal property. Also, under Section 327, a person commits an offence if he/she conceals, disguises, converts, transfers or removes criminal property from the UK. Under Section 328 a person commits an offence if he/she enters into an arrangement which he/she knows or suspects facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person. PoCA treats all forms of 'acquisitive criminal behaviour' as proceeds of crime. So, a simple non-payment of tax, an organised bank robbery, or even share ramping would all be viewed in the same way: if the crime results in a benefit or permits the criminal to avoid paying something he/she is obliged to pay, this would be classed as the proceeds of crime.

In the UK, as in many other countries, the requirement of a financial institution to 'know your customer' together with Suspicious Activity Reports (SAR) or Suspicious Transaction Reports (STR) form the basis of the regulatory process in practice. A SAR or STR is required to be made by financial institutions and other professionals such as solicitors, accountants and estate agents about suspicious or potentially suspicious activity to the NCA's Financial Intelligence Unit (UKFIU). The criteria used to define suspicion vary from country to country, but generally it is that the transaction does not make sense to the financial institution, is unusual for the client, or it appears to be done to hide or obfuscate another transaction. The UKFIU analyses the reports and then sends them to the appropriate organisations for investigation.

One of the most powerful tools available to UK regulators is the 'skilled person' report. Under the Financial Services and Markets Act 2000, S166 as amended by the 2012 Finance Act, the FCA may obtain a view from a third party (the 'skilled person') about aspects of a regulated firm's activities. Either the regulated firm chooses the skilled person firm for FCA approval or, if not, the FCA decides. A similarly effective instrument in the US is Section 311 of the USA Patriot Act, 2001, which empowers the US Treasury Department to designate foreign financial institutions, jurisdictions, or entities as 'of primary money laundering concern'. Such a designation is intended to highlight to regulators suspicious patterns of activity without having to prove any single transaction is illegal. It also forces financial institutions to avoid the entity, effectively prohibiting the entity from being involved in global finance.

PoCA was amended by the Money Laundering Regulations 2007

following the EU's Third Money Laundering Directive, 2005. It was further amended by the Criminal Finances Act 2017 which introduced a new corporate criminal offence of failing to prevent tax evasion and provided additional tools to investigate suspected money laundering and terrorist financing. The 2017 Act also introduced 'Unexplained Wealth Orders', in which professionals such as estate agents are required to report to regulators investments made by individuals who did not appear to have legitimate means to afford them or could not explain the source of their money. Law enforcement are then able to seize the assets.

The 2007 regulations were revised by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 and now apply to banks, building societies and other firms undertaking certain financial activities including all gambling providers rather than simply holders of a casino operating licence required under the 2007 regulations [6]. The 2017 regulations require them to apply risk-based customer due diligence measures and take more stringent measures to prevent their services from being used for money laundering or terrorist financing. The 2017 regulations introduced a number of other significant changes, notably relating to politically exposed persons (PEP). The parts of the 2007 regulations which applied only to foreign PEPs now also apply to local PEPs. In practice, this means increasing due diligence requirements for a broader range of individuals who have been trusted with prominent public functions both in the UK and overseas.

The 2017 regulations empower the UK Government to target individuals accused of 'gross human rights violations and seize their UK assets in line with the US approach under the US Magnitsky Act. Finally, the 2017 regulations introduced a new criminal offence relating to any individual who recklessly makes a statement in the context of money laundering which is false or misleading. The most recent change is the passing of the Sanctions and Anti-Money Laundering Act, 2018 whose aim was to provide a legal framework to allow the UK to impose and implement its own sanctions regime when the UK leaves the EU and goes beyond the current EU sanctions regime.

The Forms and Types of Money Laundering and The Devices Used.

The money laundering process involves three stages:

(1) The placement of funds into the financial system unnoticed. This may take many forms ranging from a large single deposit to a series of smaller amounts. The process of depositing or withdrawing a larger sum by means of a number of smaller amounts is known as 'smurfing'. EC/UK money laundering legislation has concentrated its efforts on this first stage attempting to prevent the proceeds of criminal behaviour leaving the system.

'Structuring' or 'Smurfing' involves breaking up the receipt of a large amount of money into smaller transactions below the reporting threshold (10,000 euros or US dollars, the reporting threshold for banks) then used to purchase money orders or other instruments to avoid detection or suspicion. Often, these smaller sums can then be deposited in various banks by different people ('smurfs') effectively 'placing. However, it is possible to structure without the use of any smurfs at all.

(2) Layering which involves the creation of apparently legitimate transactions. This involves the transfer of funds across many bank accounts and jurisdictions in order to frustrate attempts at tracing the original funds

(3) Integration, involving bringing the money back into the financial system (again, through smurfing if necessary) with the appearance that it came from a legitimate source either the result of a legitimate transaction or that the assets already belonged to the beneficial owner. These transactions may be difficult to detect deter as they are designed to appear normal.

There are many ways by which money may be laundered. The following are some of the most popular designed to ensure that transactions are hidden:

1. 'Bulk cash', the smuggling by the money launderer him/herself or a courier. This involves literally smuggling cash into another country and depositing it there in a bank that provides client secrecy or converting it directly into cheques or money orders. As the courier has no apparent connection with the true owner of the funds, the criminal retains his anonymity.

2. 'Bank capture', the use of a bank that is owned by money launderers or criminals themselves, who are then able to move funds through the bank without fear of investigation. The classic example in the UK is the Bank of Credit and Commerce International ('BCCI'). BCCI was formed in 1972 and registered in Luxembourg with head offices in Karachi and London. At its peak, BCCI had over 400 branches in 78 countries and assets over US$20bn, making it the seventh largest private bank in the world. However, in the 1980s, due to regulators' suspicions it was investigated and found to be involved in massive money laundering and other financial crimes, and had illegally gained the controlling interest in a large US bank. In 1991 it was raised by bank regulators in seven countries and closed down. US and UK Investigators stated that BCCI had been 'set up deliberately to avoid centralized regulatory review …. to commit fraud on a massive scale, and to avoid detection'.

3. The use of a Money Services Business (MSB), an organisation that transfers money, cashes cheques or converts currencies. A corrupt MSB would arrange for money to be paid into UK bank accounts which it would then wire abroad, typically, to locations in the Far East or Middle East using falsified business records and forged documents to cover its tracks. See for example the case of Touma Foreign Exchange Ltd which was fined £7.8.

4. The use of prepaid cards, or stored value cards (SVC) (https://www.vantiv.com/vantage-point/smarter-payments/stored-value-cards).

5. The use of unregulated, hidden and informal banking facilities such as cybercurrency and other exchanges such as the black market Peso Exchange Hawala.

6. The use of a legitimate cash-based business, 'hiding In plain sight' Perhaps the simplest is filtering the laundered funds through an apparently legitimate business, preferably cash-based. Businesses that handle large amounts of cash sales have always been

popular for money laundering, such as bars, taxi firms, recycling firms, restaurants, and nightclubs. This may be done by recording the laundered money as business income and accompanying this with payments disguised by fictitious invoices purporting to be necessary business expenses. Invoices may also be altered to show a higher or lower amount in order to disguise the movement of money If the firm has no auditors, there are no checks to identify these receipts as business sales. For example, in the case of a restaurant this would involve the purchase of fictitious meals. Alternatively, rather than attempting to disguise money as normal business revenue, the funds may simply be deposited into the bank account of the business as a capital investment.

7. The use of professionals, such as solicitors, accountants, and stock brokers, to launder the money. Through investments, trust accounts, fund transfers, and tax avoidance schemes, they may manipulate the financial, commercial, and legal systems to conceal the origin and ownership of assets. Another way to use an innocent professional is to engage him/her in a financial scheme, pay fees up-front, and then cancel the transaction and ask for the return of fees but in a different name of form. A variation of this is to invent a claim or enter into sham litigation. For example, a director appears to dismisses an employee, who then sues and the company agrees to settle out of court.

8. The use of educational institutions such as schools, colleges and universities where money is transferred by criminals to fund pupils' and students' living expenses and fees. The problem of fictitious college and university students and their courses in the UK has been well documented. However, these schemes also extend to schools which may not be expected to know which are legitimate bank accounts even though some of their pupils come from parts of the world with high levels of corruption.

9. Casino gambling which involves an individual going into a casino with the illegally obtained money. The individual purchases chips with the cash, plays for a while, then cashes out the chips, and claims the money as gambling winnings.

10. The use of gambling such as online gaming or horse racing Money launderers, say from the illegal sale of drugs, often use betting to help disguise their dealing. For example, the use of fixed odds betting terminals (FOBTs). Here, the launderer having received the proceeds of crime in cash may attempt to 'cleanse' it by betting through these machines or doing the same online. The 'winnings' will either be taken in cash or credited to the launderer's account. FOBTs pay out between 85% and 95% so a money launderer may employ 'smurfs' to gamble in this way. The proceeds from winning would then appear to be legitimate as receipts may be obtained if done online or if the customer has an account with the betting company it will appear on his/her statement of account. It is possible that this may be hidden from investigators if the identities of the smurfs is hidden.

A similar method would be to bet by what is known as 'arbitrage betting' (or 'arbing'). This involves betting on all the possible outcomes of a competition. For example, the outcome of a football or tennis match, a car race or even a horse race when there are relatively few runners. Again, a money launderer would probably employ smurfs to bet in this way. Although he/she may make a net loss, this would be an acceptable cost of legitimisation. (As betting companies dislike 'arbing', they may ban individuals from betting with them if they suspect a person is a smurf.)

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11. Cuckoo smurfing. This involves the payment of money into accounts of unsuspecting individuals. The term is derived from the way a cuckoo will lay its eggs in the nests of other species of birds. The process involves two or more concurrent transactions: a legitimate payment by an unwitting customer to a legitimate supplier (probably in a different country) and the need for a payment of a similar sum by a money launderer and a complicit bank. See Figure 1. Say the legitimate businesses are in the UK and USA where a UK buyer wants to pay a US supplier and the money launderers are in the same two countries and a (probably complicit) international bank has branches there. In which case, the UK buyer pays the money owed to the bank in the UK which transfers the money not to the US supplier (as the innocent supplier and buyer think) but to the UK money launderer. At the same time, the US money launderer pays an equivalent of money into the US bank which transfers that money to the US supplier. The effect is that the UK buyer has paid the US supplier but the money has not been transferred to the US; it has been used by the bank in the UK to pay the UK money launderer and the US supplier has received a similar sum from the US bank being the money paid to it by the US money launderer.

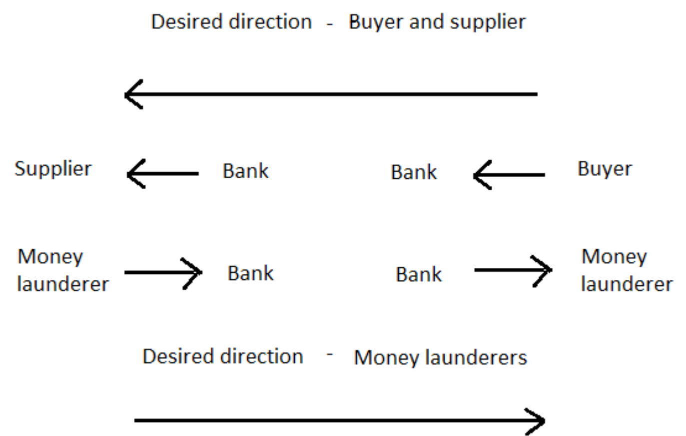

Figure 1: Cuckoo Smurfing

12. Real estate laundering, when someone purchases it with money obtained illegally or wishes to move money abroad through the purchase of property abroad but wants to evade paying tax in that country. In which case, the property will then be sold and the money deposited in bank accounts in that country or then used to buy property in another country. This will usually involve the use of shell companies and some of these schemes are explained below.

13. The use of shell companies (analogous to an empty shell), corporate entities that do not trade and have no significant assets. They are not necessarily illegal - one may be needed to set up a new legitimate business - but they are often used unlawfully to disguise or hide the ownership of money or other assets from regulators and/or the public. They are not limited to limited liability companies but may be for example limited liability partnerships, trusts or foundations.

Often the names of nominee individuals as shareholders and directors are used to hide the identities of the real owners. A nominee has no real power and merely signs forms and documents for a fee as instructed by the real owner. Shell companies may be registered in a tax haven, where the nominee will usually be a resident. These services are available from firms online. Often large numbers of shell companies are registered at the same address. For example, the indictment accusing Donald Trump's former campaign chairman Paul Manafort of a money laundering scheme traced shell companies involved to 2 Woodberry Grove N12 0DR, a small house in north London at which more than 25,802 companies had been registered by a company services agent.

Another recent UK example involves revelations concern the business practices and clients of the company service provider, Formations House. OCCRP have shown how Formations House set up 400,000 companies around the world since 2001, 'many for those with dubious pasts and assets to hide' including '929 UK shell companies used in 89 corruption and money laundering cases, amounting to around £137bn globally'.

Various law firms have been found to not only offer nominee services but also devise and arrange money laundering and tax evasion schemes involving regulatory and tax havens such as The British Virgin Isles (BVI) and Panama where it is almost impossible to know the identity of the real owners of the companies and properties. For example, in Spain, a Mallorca law firm, Buffet Feliu, set up corporate structures mainly in Panama to conceal their ownership and defraud the Spanish Government of taxes. The schemes involved the laundering millions of euros derived from drug trafficking, fraud and tax evasion and invested in Spanish property avoiding its taxes on the transfer of property and then transferred abroad. Buffet Feliu made the necessary arrangements and did the paperwork often involving nominees.

The investigation known as 'Operation Lightning' ('Operacion Relampago') began in 2005 and finished in 2016 examined 816 companies involving €307m. Of these companies, 252 were non-resident and 161 were in offshore tax havens. It was also found that between 1997 and 2006 Buffet Feliu had channelled more than €482m to offshore tax and regulatory havens. Operation Lightning' resulted in the sentencing to jail of a partner in Buffet Feliu and a British businessman, Peter Brian Bradley, and the fining of individuals whose companies were found to be involved in money laundering schemes. 'Operation White Whale' ('Ballena Blanca') was Spain's largest money laundering investigation involving around 1,000 companies formed to invest over €250m derived from criminal activities of foreign mafia organisations involved in prostitution, drug trafficking, and luxury car theft, laundered through the purchase of Spanish property and then transferred to offshore bank accounts in Gibraltar and the Channel Islands. Again, a recognized law firm, Del Valle law firm in Marbella, executed the transactions.

Little is known about the details of the money laundering schemes and the identities of the clients involved. However, in two other famous cases the full scale of the law firms' operations, schemes and individuals are known due to the release of documents by whistleblowers. The first involved the leak of documents and correspondence (in total 11.5 million files and known as the "Panama Papers") in 2015 directly from a database at Mossack Fonseca, at that time, the world's fourth largest offshore law firm based in Panama. These documents have been examined by the International Consortium of Investigative Journalists (ICIJ) and the Organised Crime and Corruption Reporting Project (OCCRP). Their findings have provided details and insights into how the rich and powerful are able to exploit secret offshore tax regimes in a variety of ways and soon led to the closure of the firm because of the reputational impact.

The second case occurred in November 2017 is, what is known as, the 'Paradise Papers', 13.4 million confidential electronic documents relating to offshore investments that were leaked to and examined by ICIJ. The documents originate from the legal firm Appleby which had offices in offshore locations including Bermuda, the BVI, and the financial centres of Hong Kong and Shanghai, together with the corporate services providers Estera and Asiaciti Trust, and business registries in 19 tax jurisdictions. The incriminating documents contain the names of more than 120,000 people and companies including Prince Charles and Queen Elizabeth II, President of Colombia Juan Manuel Santos, and U.S. Secretary of Commerce Wilbur Ross.

In both cases, the information released resulted in scandal, litigation, and loss of position for some of the individuals named, (some of these are discussed later) as well as litigation against the media and journalists who published the papers. Also, more than $1.2 billion in back-taxes and penalties has been publicly collected by governments around the world after the 2016 investigation.

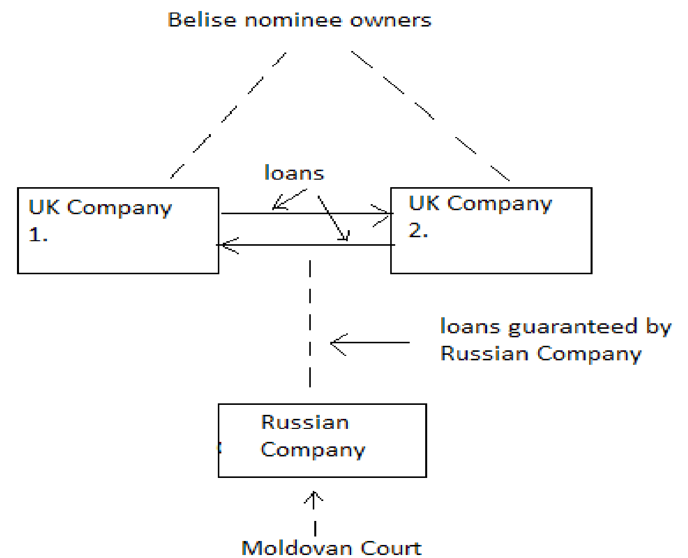

Figure 2: 'The Russian Laundromat'

Probably the most astonishing revelation was in 2014 of a scheme devised by organized criminals and corrupt politicians to move $20.8bn of dirty funds out of Russia. Between 2010 and 2014, at least $20.8bn was laundered out of Russia, channelled into banks in Moldova and Latvia, and spread from there into 96 countries across the world. The OCCRP has called it "the Russian Laundromat." (https://www.occrp.org/en/laundromat/the-russian-laundromat-exposed/). 21 shell companies with hidden owners were set

up in the UK, Cyprus and New Zealand. A company would then create a fake 'loan' to another company, and a Russian firm would guarantee the loan. The shell companies would then default on the 'loan' and a corrupt Moldovan judge would 'authenticate' it, ordering the Russian debtor to make the repayment into a Moldovan court bank account. The money would usually go first to Trasta Komercbanka in Latvia and then be transferred to various banks abroad ending up in accounts in large global banks including 17 British banks of the largest of which was HSBC which received $545 million. The FCA stated in early 2017 that it was investigating but as yet they are not completed.

The US experience provides an interesting insight into what should and can be done. Federal investigations continue to reveal corrupt politicians, drug traffickers and other criminals using shell companies to purchase luxury real estate with cash through shell companies. Whilst they do not by themselves indicate illegal or improper activity, these transactions mean buyers can hide their finances and identities and avoid legal scrutiny. They have become more common in recent years in luxury home sales across the United States, notably buildings owned by Donald Trump, where developers have no obligation to scrutinize their purchasers or their funding sources. Since the 1980s, more than 1,300 Trump condominiums (one fifth of his sales) were bought by unidentified shell companies instead of people and the deals were completed without a mortgage, records of Trump's property deals show. It is also argued that these property deals enable money launderers to bring cash into the US and the UK. For example, pay for a property in excess of its true worth, then receive a refund from the seller.

It is difficult not to conclude from this discussion of the use of shell companies, offshore tax and regulatory havens that the individuals are attempting to hide or obfuscate their transactions and ask what are they hiding? Layers of corporate structure make it hard for investigators, tax officials and others to find the source of the money in these transactions, whether taxes are being avoided or evaded, or who the individuals are. Why are nominees used? Truly legitimate, transparent companies would not need to act in this way. Nevertheless, the secrecy available to shell companies could easily be removed. As Szubin in the US says 'Congress could close this loophole by passing a simple, two-page law requiring the beneficial owner of a company to be identified whenever a U.S. company is formed' [7].

14. 'Mirror trading'. Here, an individual or company opens up a trading account with a bank and deposits funds to purchase shares on an exchange in that country. An account is also opened by a counterparty in the country to which the money launderer wishes to move the money. Say, the launderer wishes to transfer money from Country A to Country B. The launderer would deposit the funds with the bank in country A asking it to buy shares in a stock on the exchange in that country. At the same time, it would ask the bank in country B to sell the same number of shares at the same price. See Figure 3.

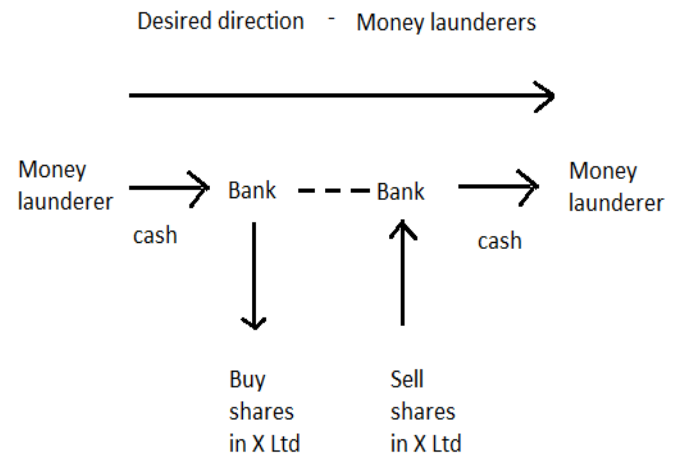

Figure 3: 'Mirror Trading'

Obviously, these transactions require a bank's complicity for them to be carried out. In January 2017, the New York State Department of Financial Services (DFS) announced it had found Deutsche Bank and some of its senior managers responsible for neglecting to detect, intercept and investigate a long-running mirror-trading scheme the bank had facilitated. This involved Deutsche Bank's Moscow, New York and London branches in which between 2011 and 2014 various wealthy Russians had been allowed to move $10bn out of Russia mainly into the UK. Each trade was between $2m and $3 million [8]. Companies that were clients of the Moscow branch requested its equity section to purchase certain Russian stocks. These would be paid for in roubles. Through Deutsche Bank's London branch, related counterparties would then sell the identical Russian stocks in US dollars. The counterparties involved were linked by common beneficial owners, management or agents to the Russian company. The trades were approved by Deutsche Bank.

The Effects of Money Laundering on An Economy

Unger, has surveyed the literature at the time and lists the effects as follows:

Short–term effects

1. Losses to the victims and gains to the perpetrators. Victims are likely to use the money differently to perpetrators. Victim's wealth and income are adversely affected, such as their disposable income and purchases of essentials, whilst the perpetrator's wealth and income will be increased affecting their ability to purchase luxury items and assets that enable them to conceal illicit money.

These affect the goods, services and financial markets. Not only are the consumption, output, supply and demand of goods and services affected but these are likely to lead to price increases and unfair competition. Other effects involve savings and investment, imports and exports, income and employment, revenues for the public sector (e.g. local and national taxation) exchange and interest rates. These, in turn, have secondary effects such as the volatility of interest and exchange rates, the availability of credit to nationals and increased capital flows.

Long-term effects on the countries involved

Not only may these have both positive and negative effects on countries' growth rates, other effects may include changes in foreign direct investment potentially undermining foreign policy goals, increased risks in their financial sectors notably liquidity and corporate profitability. Other secondary effects of illegal business include the undermining of political institutions, the contamination of legal business, the reputation of the financial sector which in turn will increase in the likelihood of corruption, bribery, other financial crimes and the likelihood of terrorism.

The next section examines these effects.

a. Russia

Money laundering had an impact on the rouble from 2011 onwards, and possibly earlier. A significant amount of it flowed to the UK, affecting the GB pound. See Figure 4 which shows the price of the rouble relative to the UK pound fell below 0.2 (i.e. it was worth 20 pence) in June 2012 and below 0.1 in July 2015, although it recovered to just over .01 in March 2016. It is currently around .013 (July 2019).

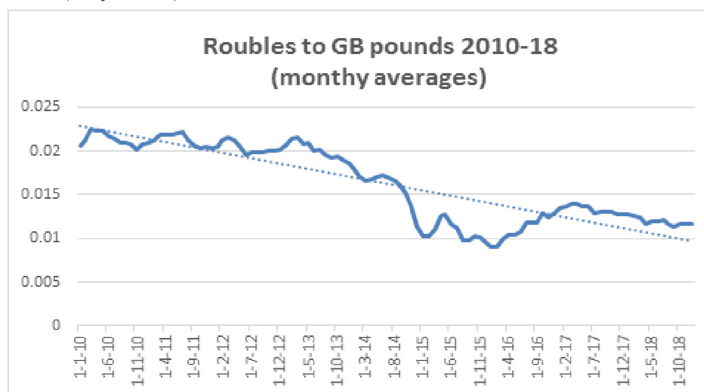

Figure 4: Source: https://www.exchangerates.org.uk/RUB-GBP-spot-exchange-rates-history-2018.html

In an attempt to keep Russian money at home and prevent it flowing abroad and protect the declining rouble exchange rate from further damaging the Russian economy, President Putin declared the illegality of 'offshorization'. The Federal Law No 376-FZ dated 24 November 2014 'Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation (Regarding the Taxation of the Profit of Controlled Foreign Companies and the Income of Foreign Organizations)' came into force in January 2015. The new Law introduced significant changes to the rules governing the reporting and taxation of interests of Russian tax residents resulting in the taxing of profits made by are known as 'controlled foreign companies' [9]. As a result, Russian billionaires attempted to hide their efforts [10,11].

The impact of the outflow of Russian money is illustrated by the rise and fall of Rublyovka, an area just outside Moscow. In the early 2000s it was by far the most prestigious place to live in Russia and one of the richest city suburbs in the world, providing the wealthiest Russians an appropriate address. Articles about Rublyovka around that time describe it as composed of magnificent buildings and residences and referred to as the Russian equivalent of Beverly Hills (http://www.home-designing.com/2011/06/rublevka-where-russias-super-elite-live).

(I actually visited it around 2005 and found it was splendidly sumptuous). In 2008 Forbes included one of its mansions in the top five most expensive homes in the world (https://www.myguidemoscow.com/regionalinfo/rublevka). However, at some point the wealthy inhabitants of Rublyovka decided to leave and/or move their money elsewhere, in many cases to London. Salomatin writes [12].

'Less than a decade ago, Rublyovka was one of the hottest suburbs in the world, with an influx of billionaire residents to live with the likes of Vladimir Putin and Roman Abramovich. Typical of the area was the ultra-high-end mall, Barvikha Luxury Village, opened in 2005. By 2011, however, the neighbourhood was emptying out, with one third of the houses either vacant or on the market and demand low. Many oligarchs were reportedly moving to the West, and it didn't help that Russia's economy was teetering from crisis to crisis. Now with money pouring out of the country at an astounding rate and oil prices painfully low, things are only getting worse.' (https://www.businessinsider.com/rublyovka-the-richest-neighborhood-in-moscow-2015-6?r=US&IR=T)

Salomatin also provides photographs in his article which show the deterioration in the neighbourhood, abandoned construction sites, random piles of rubbish and fences falling over.

b. London House Prices

It has been estimated that foreign buyers have bought £100bn of London property in the six years, between 2008 and 2014 (https://www.standard.co.uk/news/london/revealed-how-foreign-buyers-have-bought-100bn-of-london-property-in-six-years-a3095936.html). That is 27,989 purchases by companies usually registered in tax havens to hide the buyers' identities. According to Land Registry data obtained by Private Eye through freedom of information requests, two-thirds of the purchases were made by companies registered in four 'British' tax havens, Jersey, Guernsey, the Isle of Man and the BVI. The Metropolitan Police also stated in 2015 that British property purchases worth more than £180m were being investigated as the likely proceeds of crime, almost all bought through offshore companies.

It is the purpose of this section to examine the effects in the context of the laundering of large amounts of foreign money, particularly from Russia, into the UK and in particular London where it is believed a large amount of this money was invested in property.

Table 1 shows London average house prices, disposable income and the number of properties purchased by offshore companies over the period. It will be seen that for London as a whole whilst house prices have doubled, gross disposable income ('GDI') has risen only by around 50% and that in certain prosperous areas house prices have increased considerably more than that which coincides with the large number of offshore companies.

House prices				Disposable income			Offshore companies		
	2006 £000	2015 £000	Growth %	2006 £000	2015 £000	Growth %	2006 £000	2015 £000	Growth %
London	318.5	627.5	97.0	11,989	18,034	44.7	1,674	3,017	80.2
Inner London - West	523.5	1,235.4	99.5	13,234	39,386	55.7	1,034	1,552	50.6
Inner London - East	282.9	546.4	93.1	24,339	19,624	42.6	276	650	135.5
Outer London - East and North East	227.3	357.7	57.3	6,295	8,867	35.5	87	212	143.7
Outer London - South	266.4	432.0	62.1	7,638	9,839	23.9	64	212	231.2
Outer London - West and North West	312.2	555.2	77.8	8,030	11,614	39.1	213	391	83.6
Kensington, Chelsea, Hammersmith & Fulham	663.7	1,565.1	135.8	13,165	20,050	46.5	329	500	52.0
Westminster	597.3	1,601.9	168.2	32,735	53,061	55.9	509	670	31.6
City of London & Camden	435.5	1,044.1	139.76	45,305	75,384	60.1	118	254	115.2

Figure 5 shows that whilst the P:GDI ratio is fairly constant over the period for London as a whole, it has risen sharply in those districts in which offshore companies are the most common, in particular Kensington, Chelsea, Hammersmith & Fulham. Because the data are aggregated for these districts, it is not possible to disaggregate them into their component parts. This also explains the extremely high average house prices to gross disposable income ratio (rising from 50 to almost 80) reflects this disparity of income across the population of these districts.

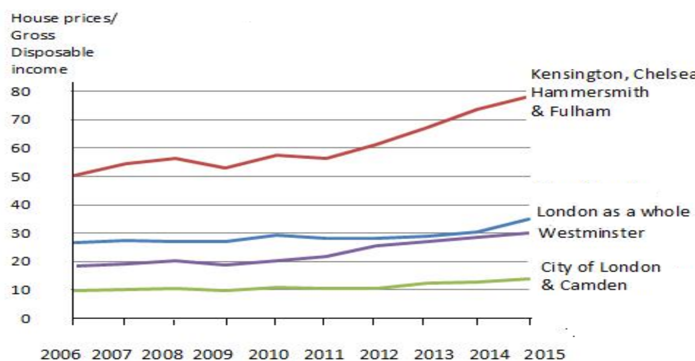

Figure 5: The Ratio of Average House to Gross Disposable Income for London As A Whole and Other District with Large Numbers of Offshore Companies For 2006-15.

The usual guide to expectations regarding house prices is the price to earnings ratio. House prices are determined by the ability of buyers to pay, i.e. their disposable income. Whist at times house prices increase relative to earnings, this is usually temporary and the price to earnings ratio (or price to GDI here, 'P:GDI ratio') eventually reverts to its historical mean.

So, by how much would prices have risen had the P:GDI ratio as at 2006 remained constant for the rest of the period? See Table 3 which shows that, whilst London house prices would have only increased by 50.42% as a result of increased GDI (mentioned earlier) house price rises in the more prosperous areas listed would have been significantly less. This conclusion is, of course, based on a number of major assumptions: that the variables remain constant, notably that gross disposable income in these areas is unaffected. This may be an unrealistic assumption given the inflow of non-nationals into these areas and the impact of house price rises on wage demands.

Table 2: Estimated House Prices If the Areas' Price to Gross Disposable Income Ratio Had Remained Constant as At Their 2006 values.

	House prices 2015 (£000)		Growth of house prices 2006-15 (%)	
	Actual	Forecast	Actual	Forecast
London as a whole	627,460	479,080	97.01	50.42
Kensington, Chelsea, Hammersmith & Fulham	1,565,149	1,010,832	135.81	52.30
City of London & Camden	1,044,130	724,609	139.76	66.39
Westminster	1,601,893	968,134	168.20	62.09

How does the large number of offshore companies buying properties in some districts affect these results? It is hypothesised that in those districts where there is a large number of offshore companies, house prices will be higher. This may be measured by estimating a regression model of the growth of house prices over the 2006-15 period (the independent variable) as a function of (1) the growth of gross disposable income over the same period and (2) the number of properties purchased by offshore companies (the independent variables). If the hypothesis is supported the coefficients of both independent variables will be positive. See Table 3 in which both independent variables are statistically significant, the coefficients are positive and the model's fit with the data, indicated by the R-Squared statistic, is good (Wessa, 2017).

Table 3: Regression Equation of The Growth of House Prices Over the Period 2006-15 As the Dependent Variable and The Growth of Gross Disposable Income Over the Same Period and The Number of New Offshore Companies as The Independent Variables.

Variable	Average, (Standard deviation)	Multiple regression			
		Coefficient	Standard Error.	t-stat	1-tail p-value
Growth in house prices	85.17 (31.02)				
Growth in disposable Income	39.56 (11.58)	1.0228	0.3333	3.0683	0.00331
New offshore companies each year	mn1,479 (2,226)	0.008878	0.0017	5.1255	0.00003
Intercept		31.563	12.643	2.4965	0.01124
R-Squared	0.784211				
F-test	32.707				
Observations	21				

How have the use of London property as a haven for corrupt capital and the use of secret offshore companies affected property prices in the city? Secret offshore companies may be used for purposes not associated with the laundering of corruptly obtained funds. They may be used to avoid or evade tax and hide ownership by UK nationals, for example. It is not possible, therefore, to ascertain their purpose from publicly available data limited to their number and the property location. It follows that it is not possible to ascertain the real amount of laundered money ending up in London property. Nevertheless, it is clear from these data that London house prices have risen disproportionately during the period and that the use of secret offshore companies has contributed to this, both in the areas directly concerned and elsewhere where people have been forced to purchase properties in other districts and this has cascaded down the property ladder. The result is that all areas have been affected although the cascading effect is less as it moves down the property ladder.

Table 4: Money laundering Fines by the FCA, 2002 -19

2002 – Royal Bank of Scotland Plc – £750,000	Weaknesses in controls such as having insufficient evidence to verify clients' identities,
2003 – Abbey National Plc – £2,320,000	Lax procedures against money laundering
2003 – Northern Bank – £1,250,000	'Inadequate' safeguards that its customers, particularly business customers, really were who they claimed to be.
2004 – Bank of Ireland – £375,000	Failing to detect a series of "suspicious" cash transactions totalling nearly £2m.
2004 – Bank of Scotland – £1,250,000	Failing to keep proper records of customer identification
2004 – Carr Sheppards Crosthwaite (stockbrokers) – £500,000	Failure to have adequate AML systems and controls.
2005 – Investment Services UK Ltd (an emerging market bond broker) – £175,000 and Managing Director – Ram Melwani – £30,000	Failure to control its business effectively in relation to its AML systems.
2008 – Sindicatum Holdings Ltd £49,000 and MLRO Michael Wheelhouse – £17,500	Failure to have adequate AML systems and controls in place for verifying and recording clients' identities
2010 – Alpari (UK) Ltd – £140,000 and Sudipto Chattopadhyay (MLRO) – £14,000	Failing to have adequate anti-money laundering systems and controls.
2012 – Habib Bank AG Zurich (Habib) – £525,000 and MLRO Syed Itrat Hussain – £17,500	Failure to take reasonable care to establish and maintain adequate AML systems and controls. Approximately 45% of Habib Bank's customers were based outside the UK and about half of its deposits came from jurisdictions which, were perceived to have higher levels of corruption than the UK.
2012 - Turkish Bank (UK) Ltd - £294,000	Failure to establish and maintain appropriate and risk-sensitive AML policies and procedures, carry out adequate due diligence and monitoring of its customers and maintain adequate records.
2012 – Coutts – £8.75m	Inadequately dealing with clients who were 'politically exposed persons'
2013 – EFG Private Bank Ltd (a global private banking group, based in Switzerland) – £4,200,000	Failing to take reasonable care to establish and maintain effective AML controls for high risk customers
2013 – Guaranty Trust Bank (UK) Ltd (a subsidiary of Nigerian Guaranty Trust Bank PLC) – £525,000	Failings in its AML controls for high risk customers based in countries associated with a higher risk of money laundering, bribery or corruption, including accounts held by PEPs.
2014 – Standard Bank PLC – £7,640,400	Failings relating to its AML policies and procedures over corporate customers connected to PEPs.
2015 – Bank of Beirut (UK) Ltd. – £2.1m, Anthony Wills (former compliance officer), and Michael Allin (internal auditor), £19,600 and £9,900, respectively	Repeatedly providing the regulator with misleading information after it was required to address concerns regarding its financial crime systems and controls.
2015 – Barclays Bank– £72m	The failings relate to a £1.88bn transaction arranged for a number of ultra-high net worth clients who were PEPs
2017 - Deutsche Bank AG (Deutsche Bank) £163,076,224	Failing to maintain an adequate AML control framework. See text.
2018 - Canara Bank £896,100	Failing to maintain adequate AML systems and failing to take sufficient steps to remedy identified weaknesses.
2019 - Standard Chartered Bank £102.2m	Failings relating to its AML policies and procedures over corporate customers connected to PEPs.

Source: http://www.fca.org.uk/firms/being-regulated/enforcement/fines

Regulation

The 2007 Regulations require all businesses to be supervised by an appropriate Anti-Money-Laundering (AML) supervisory authority. Table 4 lists the fines imposed by the FCA on financial intermediaries. Others involved in the movement of 'liquid assets' such as, lawyers, jewellers, casinos, accountants and tax advisers, estate agents and other property transaction professionals are not but instead by their own regulatory authorities.

The UK Gambling Commission handles the regulation of AML obligations of bookmakers, casinos and online gambling organisations. In November 2018 the Commission announced it had fined various online betting firms a total of £14m for failing to prevent money laundering and effectively protect problem gamblers. In May 2019 it announced it had fined four more. These are listed in Table 5. It also announced that various other operators had been issued with Advice to Conduct letters and there were others under investigation. Also, since the investigation began, five companies, including CZ Holdings, have surrendered their UK betting licences.

Table 5: Money laundering Fines by the UK Gambling Commission, 2015-2019

2018 - CZ Holdings Ltd	Breached conditions of its licence relating to AML and failed to comply with social responsibility codes of practice, subsequently surrendered its licence
2018 - William Hill, bookmaker	Fined £6.2m for breaching AML and social responsibility regulations. William Hill gained £1.2m by failing to prevent 10 customers from depositing large sums linked to criminal offences.
2018 - Daub Alderney, an online gambling company	Fined £7.1m for failing to follow Gambling Commission rules aimed at preventing money laundering and protecting vulnerable consumer.
2018 - Casumo, an online gambling company	Fined £5.85m for shortfalls in its social responsibility and AML procedures.
2018 - Videoslots, an online gambling company	Fined £1m regulatory settlement
20018 - 32Red, an online gambling company	Fined £2m for failing to protect a consumer and for money laundering failures. This involved a customer being allowed to deposit £758,000 on the site without money laundering or social responsibility checks.
2019 - InTouch Games, an online gambling company	Fined £2.2m for failing to prevent money laundering and keep consumers safe from harm.
2019 - Betit Operations Limited	Fined £1.4m for failing to prevent money laundering and keep consumers safe from harm.
2019 - MT Secure Trade	Fined £700,000 for failing to prevent money laundering and keep consumers safe from harm.
2019 - BestBet	Fined £230,972 for failing to prevent money laundering and keep consumers safe from harm.
2019 – Platinum Gaming Ltd	Fined £1.6m for failing to identify gambling harm and prevent money laundering
2019 – Gamesys Ltd	Fined £1.2m for failing to prevent gambling harm and breaching money laundering regulations
2019 – Ladbroke Coral Group	Fined £5.9m for failing to put in place effective safeguards to prevent consumers suffering gambling harm and against money laundering

Table 6: Solicitors fined by the Solicitors Disciplinary Tribunal for money laundering offences

2017 - Stephen Grimes and Frederick Broadbridge	Fined £35,000 for multiple accounts rule breaches
2017 - Clyde & Co	Fined £50,000 and three of its partners fined £10,000 following a Solicitors Disciplinary Tribunal ruling that they breached money laundering and accountancy rule
2019 - Khalid Mohammed Sharif, a partner at Child & Child	Fined £45,000 for failing to conduct anti-money laundering checks for wealthy clients believed to be linked to the Panama Papers scandal.
2018 - Amit Kumar Manibhai Patel a partner at Manis	Fined £12,500 by SDT for recklessly exposed his firm to the risk of money laundering.

The Solicitors Disciplinary Tribunal handles complaints of misconduct by solicitors including investigating money laundering offences. Recently published cases are listed in Table 6. The Consultative Committee of Accountancy Bodies ('CCAB') handles the regulation of AML obligations of the provision of auditing, accountancy, tax advisory, insolvency and related services. N. Bevan Ltd is the only one reported (https://www.rossmartin.co.uk/sme-tax-news/2358-hmrc-fine-for-anti-money-laundering-failures). It is ironic that small accountancy firm has been fined for probably a minor AML offence when the large firms are allegedly involved in advisory work.

Table 7: Companies Fined for Money Laundering Offences Under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on The Payer) Regulations 2017 During the Period 2018-19*

Jewellers	3
Accountancy and taxation services	4
Financial intermediary	1
Estate agents	3
Business support	2
Second-hand car sales	1
Investment company	1
Total number	15
Total fines	£293,330
Average fine	£19,555

* Source: http://www.gov.uk/government/publications/businesses-not-complying-with-money-laundering-regulations-in-2018-to-2019/current-list-of-businesses-that-have-not-complied-with-the-2017-money-laundering-regulation

Under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 details are published of businesses that do not comply with AML regulations. These are summarised in Table 7. The average size of fines has increased considerably over recent years (£1,310 in 2016/17, £3,450 in 2017/18).

Estate agents are particularly susceptible to money laundering. The sector is predominantly unregulated and therefore vulnerable to criminal activity. Criminals look to launder money through properties not just high-end London properties but also university towns where foreign investment companies may hide their money. A number of estate agents have been fined under the 2017 regulations for failing to do anti-money-laundering checks on both the buyers and sellers of properties. Countrywide was fined 215,000, Tepilo Ltd £68,595, Settled Ltd £3,245, Sheridans Ltd £3,553 and Vail Williams LLP £3,461.

Recent Initiatives and What Could and Should Be Done

The main response in the UK to the problem that the real owners of companies registered in the UK are not known or disguised has been the revision and extension of information required to be provided to the Companies Registration Office (usually referred to as Companies House) and the Land Registry (LR). All UK companies must now maintain a public register listing 'persons with significant control' (PCS) ion line with the EU's 4th Anti-Money Laundering Directive to set up registers of the ultimate beneficial owners (UBOs) of legal entities.

The contents of a company's Annual Return have been revised and the document has been renamed a Confirmation Statement and includes what is referred to as the PCS section. There are other significant promised developments, largely as a result of the 2016 Anti-Corruption Summit. The Register of Beneficial Ownership of Property at the LR is to be publicly available in 2021. This will require overseas companies that own or purchase UK property (or bids on government procurement contracts) to enter details of ben-

eficial ownership of UK property on the register. Public registers showing the beneficial ownership of companies registered in some Crown Dependencies are to be available from 2023 for Jersey, Guernsey and the Isle of Man. Pressure has been applied to other dependencies to also publish registers such as Bermuda.

Whilst these developments were praised and seen as a breakthrough, elsewhere they have been seen with scepticism and, certainly, the momentum and political push at the time of the Anti-Corruption Summit have gone. Nevertheless, there are a number of areas in which AMR need to be improved. The first relates to the use of limited companies, or to be more precise, shell companies. It is often said by commentators that the secrecy available to shell companies could easily be removed Whilst the filing of company data at Companies House is a mandatory requirement, it acts merely as a depository. Data are not checked for factual accuracy. In fact, there are no checks on data at all other than Companies House's duty of care and its power to impose fines and instigate criminal proceedings for providing incorrect data.

This situation is made worse by the loss of the protection provided by audit and significantly undermines the reliability of financial and related information submitted to Companies House and provides huge scope for fraudsters. Until 2006 all limited companies' accounts were required to be audited. Auditors are required to check and verify data and report on unlawful acts by the company and its officers. They also have an obligation to report suspected money laundering. However, under the Companies Act 2006, Section 479, small companies (and therefore shell companies) are no longer required to be audited. The AML legislation imposes a duty to report money laundering in respect of all criminal property. Not only are the owners of a shell company able to avoid these checks, they are free to misrepresent and manipulate reported transactions that auditors are very likely to discover, e.g. fictitious receipts and payments mentioned in 3(6) above.

In my view, Section 479 should be repealed in respect of shell companies. Parliament should also require Companies House to raise the standards concerning the accuracy and reliability of the register. Companies incorporated in the UK are allowed to play an important role in money laundering and tax evasion because their owners are free to lie in the documents they are required to submit and avoid scrutiny. It is ironic that while banking regulations require in-depth documentation and identification for individuals, it is much easier for companies (with the help of their lawyers) to hide their transactions and the identity of their owners, simply being required to report their business location, company and tax numbers.

The second area in which AMR may be improved concerns the ability of off-shore companies to purchase UK properties without disclosing their UBOs. The Land Registration Act of 2002 should be changed to deter purchases of UK residential property by UK and off-shore shell companies. It should require all transaction prices to be recorded in the LR. The LR should also be required to receive and maintain records of all properties held by UK and off-shore companies and the evidence of the price paid for these properties. PoCA should be changed to facilitate confiscation of all properties registered in UK and off-shore shell companies if their owners (UBOs) are shown to have been engaged in money laundering or tax evasion. Further, businesses and intermediaries without HMRC registration for real estate operations should be prohibited from acting on behalf of customers, facilitating or assisting in their property deals. Parliament should require the UK National Crime Agency to conduct a review of all off- shore shell companies that were established in tax havens and now own UK properties. Further, the owners of these entities should be investigated for money laundering and tax evasion where appropriate.

Thirdly, there needs to be a radical overhaul of the UK's AML supervisory regime. The current arrangement, held together by a patchwork of 25 different oversight bodies with varying powers and responsibilities, is simply not working. There should be fewer supervisory bodies overseeing firms' compliance with the rules, with sufficient resourcing to carry out their duties, free from conflicts of interest, and a more targeted approach to how they work. For instance, in the area of company formation and maintenance services, there are 19 bodies responsible for ensuring compliance (e.g. ICAEW) many of whom are also the lobbyists for their regulated community. The Office for Professional Body Anti-Money Laundering Supervisors (OPBAS) has made the point that some of these self-regulatory bodies have expressed concerns that issuing robust fines would 'damage their ability to attract or retain members'.

To sum up, money laundering, together with the associated use of shell companies for tax avoidance and evasion, must be one of the most regressive economic phenomena whereby the rich and corrupt are able to avoid financial regulations and tax whilst the less wealthy and honest are not. It is little more than simple theft and this goes unchecked. It has been shown
here that whilst this is recognised by politicians and regulators, UK legislation has merely responded but only to the extent of requiring more information to be reported. As yet, no large-scale investigations have been launched, even though London has become a favourite city for money launderers. It has also been shown here that the economic and social effects on the UK as the receiver of laundered money and Russia as the provider are considerable: causing property prices in London to escalate in comparison to people's earnings and in Moscow an exodus of the rich and corrupt. This situation contrasts with elsewhere in Europe, where in certain instances a more radical approach has been adopted. It has been shown how in Spain, criminal investigations and prosecutions were launched at enormous expense but could be justified by the additional taxes and fines they generated - plus, of course, the preventative effects. At the time of writing, the involvement in Deutsche Bank in money laundering is still being investigated and the outcome of investigations at HSBC are not reported UK regulators should be required by Parliament to enforce AML laws and regulations and, where necessary, impose heavier fines and jail terms for violators [13-16].

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