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Combating
Money-Laundering:
Arizona-Based Approach

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Combating Money Laundering: An Arizona-Based Approach

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PREFACE

This report is intended for use by law enforcement personnel who want to apply civil and criminal remedies focused on the financial aspects of ongoing criminal industries. Whether these actions are brought under specific money laundering statutes or under more general conspiracy, facilitation, or RICO legal theories, the report attempts to provide a framework for building a comprehensive strategy for a sustained state-level attack.

The report draws on the experience of law enforcement in a major money laundering region—the Southwest border of the U.S.—and on the study which was funded as part of a pilot project by BJA and administered by PERF. The report proposes a strategy for Arizona and perhaps the rest of the Southwest region. In the process of developing this strategy, the report describes methods of strategy development that may be appropriate for general use by other state agencies, and which, if implemented carefully, should dramatically increase asset forfeiture in money laundering cases.

Cameron Holmes

FOREWORD

In 1989, PERF provided funds from the BJA Asset Forfeiture Training and Technical Assistance Project to support a demonstration effort—development of a model state money laundering strategy—in the Arizona Attorney General's Office. The objective was to help Arizona investigators and prosecutors derive greater benefit from their arsenal of state money laundering, RICO, and forfeiture laws by understanding how the process of laundering helps criminals conceal their ill gotten assets. We believed that a frontal assault against money laundering would greatly enhance the state asset forfeiture program because more laundered assets would be uncovered and tied to the criminal activities that generated them--and then seized and forfeited.

The attractiveness of the strategy proposed by the Arizona Attorney General lay in the analysis of data on reported currency transactions in Arizona, and the forwarding of reports of suspicious transactions by financial institutions under a specific Arizona law. Lessons learned from this pilot effort were the systematic way that Arizona officials examined the interface between drug trafficking and money laundering, and the use of systematically collected data to identify parties to transactions that were worthy of further inquiry.

The reader is encouraged to treat this report not as an Arizona blueprint that can be replicated everywhere, but as a sound planning approach with many interlocking components that could form the basis of parallel strategies in other states. In a word, we are recommending consideration of the *process* that Arizona used to arrive at its strategy, rather than the adoption of specific elements of the *strategy* itself.

We hope that the Arizona strategy proves to be helpful to officials in other states, leading to greater use of state money laundering laws to combat narcotics trafficking.

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DRUG TRAFFICKING AND MONEY LAUNDERING IN PERSPECTIVE

The scope and nature of the illicit drug industry defy concise description. It is not difficult to comprehend, however, that the prospect of enormous profits constitutes the prime motivation of those who would be drug traffickers. Yet the promise of profitability is empty unless those illegal profits are endowed with an aura of respectability and legitimacy so they can be spent safely. Equally important, the ongoing operation of a drug enterprise is not possible unless money and other property can be given apparent legitimacy or effectively separated from the operator so they can be used effectively without arousing suspicion. Meeting these two related needs is the objective of the many methods used to launder money.

Illegal Drugs in Dollars and Tons

Estimates indicate that, worldwide, 25 to 30 million drug users and addicts spend as much as \$500 billion annually on illegal drugs. Of that amount, between \$80 and \$200 billion is spent in the United States each year. From \$40 to \$80 billion in drug proceeds are said to be laundered annually through financial institutions in the United States.¹

These figures reflect only the cost of drugs. They do not include drug-related outlays for prevention, treatment, and education. Nor do they encompass the economic loss resulting from drug-related accidents, absenteeism, and crime.² Credible estimates place the total cost to society of dealing with drug trafficking in the United States at the same level as the nation's expenditure for national defense.³

According to Congressional findings in Section 4702 of the U.S. Anti-Drug Abuse Act of 1988, worldwide annual production of controlled substances is as follows: opiates, 1,902 to 3,107 metric tons⁴; cocaine hydrochloride, 324 to 422 metric tons; and marijuana, 10,930 to 17,625 metric tons.

Note that as law enforcement agencies succeed in targeting drug traffickers in such areas as Florida and the Caribbean, the drug trade shifts its expansion to the Southwest United States, where the United States-Mexico border is a major national and international trafficking hub. That border is becoming a more and more popular route for smugglers from Latin American nations⁵ with regard to both cocaine and marijuana.⁶ These operations supply the illicit drug distribution network as far west as San Diego, as far north as Seattle, and as far east as New York City. In all likelihood, smugglers will continue to concentrate their expansion along the United States-Mexico border.⁷

At this writing, cocaine traffic in Arizona appears to be somewhat over 100 metric tons (100,000 kilograms) yearly.⁸ (Cocaine traffic across the United States-Mexico border is so prevalent that a 30-mile stretch is known in the drug industry as "cocaine alley."⁹) Marijuana tonnage flowing through Arizona from Mexico is far greater than cocaine tonnage. For example, a marijuana producer and distributor prosecuted by the Arizona Attorney General's Office was transporting as many as three semitrailer loads of marijuana daily (about 5 metric tons per load).

The amount of cocaine and marijuana routed through Arizona is suggested by seizure statistics.¹⁰ Federal agents seize approximately 50,000 pounds of marijuana in Arizona annually.¹¹ In 1987, federal agents seized about 9,000 pounds of cocaine, placing the state third in the nation for such seizures.¹²

Money Available for Laundering

The 100,000 kilograms of cocaine transported through Arizona each year generate about \$30 billion from street sales.¹³ At the wholesale level, sales of the cocaine amount to about \$1.5 billion yearly based on a conservative price of \$15,000 per kilogram. As of mid-1990, between \$1 and \$2 billion appears to be the best estimate for annual cocaine sales at the wholesale level in the state. The mid-1990 dollar estimate for marijuana sales at the wholesale level in Arizona is also between \$1 and \$2 billion annually.

Therefore, between \$2 and \$4 billion annually in wholesale cocaine and marijuana sales is available for money laundering operations in Arizona, in addition to the proceeds of sales occurring further down the distribution chain in the state. The \$2-to-\$4 billion figure is confirmed as conservative by an analysis of computer tapes of Arizona-related Currency Transaction Reports and Currency and Monetary Instrument Reports. The Arizona Attorney General's Office receives the information under the terms of an understanding with the U.S. Department of the Treasury. (This is discussed further in Chapter III.)

Money Laundering: Necessary and Vulnerable

If the money derived from illegal drug sales cannot be safely employed—either to enhance traffickers' lifestyles or to sustain the criminal enterprise—the risks and effort in obtaining such income would be better invested in other endeavors. As noted earlier, the objective of money laundering is to make illegally obtained money safe to use by making it appear to have been derived from legitimate sources or to be unrelated to the trafficker. To the extent that law enforcement agencies and prosecutors' offices can sufficiently disrupt drug-related money laundering activity, they will have struck at the motivational heart of dominant traffickers and will have deprived trafficking networks of an asset traffickers must possess to function effectively—an adequate supply of money that can be spent in relative safety.

Fortunately, money laundering is not only necessary, but vulnerable as well. The combination of necessity and vulnerability makes money laundering a prime target for enforcement personnel and prosecutors.

As a separate business or specialty of drug organizations, money laundering is vulnerable for a number of reasons. First, it is generally dominated by professional people—financial advisors, attorneys, bankers, accountants, and other white-collar workers—individuals who are responsive to deterrence. A street dealer is motivated generally by desire for drugs, money, and by other societal factors. He perceives little alternative to participation in drug dealing and is not terrified of criminal sanctions, much less of civil sanctions. An accountant, banker, or attorney, in contrast, is motivated by profit, has many apparent alternatives, and has great fear of sanctions.

Second, money launderers who become witnesses for the state are likely to be valuable and effective. On the witness stand, they tend to be a distinct contrast to the usual drug defendant or coconspirator. They are likely to be educated, articulate, and sophisticated. They generally have no criminal records, live stable personal lives, and have other indicia of credibility. Their testimony is likely to be corroborated by plentiful records and documents, such as financial records, phone toll records, calendars, and phone books.

Third, the same records that make money launderers solid witnesses make them and their clients vulnerable to investigation generally. Unlike the scarce, closely guarded, and heavily coded records of drug sellers, some records of money launderers must "surface" and interface with records of

legitimate business, thereby creating a paper trail that is vulnerable to investigation. The money launderer's specific knowledge of the most critical information about the trafficking network—how its money is spent—will lead law enforcement to the dominant participants and to the key physical assets not only of a target enterprise but also of each of the other enterprises with which an individual money launderer has dealt. One individual may have dealt with many separate drug networks. Money launderers, therefore, are a rich source of investigative leads.

Finally, a professional money launderer is a relatively scarce resource. Unlike the mid- to street-level dealer, for example, whose place is so easily and rapidly filled that his removal is not even noticed, the money launderer is hard to replace. Concentration on the removal of money launderers will, in effect, create a bottleneck in the flow of illicit funds.

The Balance of This Report

As used prior to 1985, the colloquial term "money laundering" focused on the act of converting the proceeds of crime into useful funds by cloaking those proceeds with apparent legitimacy. Beginning with Arizona's A.R.S. 13-2317 (effective August 1985), legislation using the term has prohibited not only the concealment of illegal income sources but also all uses of those proceeds. How such legislation might be enforced is a major objective of the balance of this report, which is based on Arizona's approach to combating money laundering.

The next chapter lays the investigative and enforcement groundwork by illustrating many basic methods used by money launderers. The final chapter focuses on strategies designed to disrupt money laundering operations. Appendices provide supplementary information, including legislation and a general discussion of drug trafficking networks.

II

TYPES OF MONEY LAUNDERING TRANSACTIONS

Money laundering may take many forms. Much significant enforcement focuses on money laundering that is made criminal because it facilitates the underlying crime, even though it is incidental and may not involve transactions. Incidental money laundering includes knowing possession of criminal proceeds, and transportation, receipt, or concealment of criminal proceeds. Active money laundering, in contrast, takes the form of a transaction. Simply speaking, these transactions are methods of raising apparently legitimate income in one or a series of transactions by creating an artificially low expenditure or an artificially high receipt. This is done by manipulating the apparent money "out," the apparent money "in," or the records of the transaction. Despite numerous variations, these transactions can be classified according to type, method used, and other characteristics. A system of classification is helpful for investigators. It can also be helpful in educating businessmen, juries, and the general public about basic money laundering schemes.

Exhibit 1 (page 6) is a transaction classification chart for use by investigators and prosecutors. It classifies money laundering transactions by money-flow type, secondary person involved, method used, circumstances under which the method is applied, and technique used to make the method more difficult to prevent, detect, or prove.

An investigator's initial approach to a case will often depend on whether the money involved in the transaction flows to or from the launderer—that is, whether the investigator is looking at the launderer from upstream or downstream. If the manipulated transaction occurs in connection with money flowing from the launderer, the transaction is classified as "cash out." If the deception occurs in connection with money flowing to the launderer, it is called "cash in."

In addition to the launderer, secondary persons or entities are involved in money laundering transactions. How the investigator proceeds depends on the degree to which the secondary person or entity is implicated and culpable. Involvement may be unwitting and blameless (a normal commercial relationship), or the transaction may involve some element of knowledge or willing falsification of records for tax or other purposes (a facilitator's role) or may constitute participation in the laundering itself as an alter ego, coconspirator, or agent of the launderer (the role of an accomplice). The investigator may approach the scheme quite differently depending on his assessment of the degree of culpability of the secondary people involved, so the approaches are classified accordingly.

Prosecution of money laundering also depends on the degree of culpability of secondary persons. The remedy in cases involving purely commercial secondary parties is directed at prevention, education, and structural changes that discourage repetition. The commercial parties may also have been fraudulently damaged by the transaction and be entitled to restitution. Civil forfeiture remedies or civil tax evasion remedies and peripheral criminal remedies for falsification of records, tax evasion, and similar behavior may be appropriate for facilitators. Criminal prosecution and civil RICO liability are reserved for accomplices.

Money laundering, as noted in *Exhibit 1*, can be conducted under diverse circumstances; indeed, laundering can be achieved as part of virtually any transaction. Some circumstances lend themselves to money laundering more than others, however, in part because of economic factors and in part because of the lifestyles of the launderers and the nature of the criminal industries they serve. Those

Exhibit 1
TRANSACTION CLASSIFICATION CHART

Types of Transactions
Cash Out and Cash In

Secondary Persons
Commercial Entity, Facilitator, Accomplice

Methods

Property Acquisition	Dual Pricing
Cash Purchase	False Seller/Buyer
False Title	Cash Receipt
False Credit	Cash Buyer/Padding
False Loan	Fictitious Goods/Services
False Salary Amount	

Circumstances

Real Estate	Inheritance	Banks
Cash Business	Cash Horde	Casa de Cambios
Commodities	Cattle	Payroll
Retail Sales	Auto Dealerships	Import-Export
Manufacturing	Auto Sales	Savings & Loans

Evasion Techniques

Time	National Borders
Persons	False I.D.
Layering of Transactions	Distance

circumstances are subject to change as a result of changes in the general economy, in tax laws, and in law enforcement. They are also different in different regions. *Exhibit 1* lists a few of the circumstances investigators are likely to find in the Southwest in the early 1990's.

Various evasion techniques are used by launderers to make their transactions more difficult to prevent, detect, or prove. Complexity and multiplicity are sometimes pursued by launderers as ends in themselves. Deliberate employment of evasive or avoidance techniques is sometimes referred to as "layering." *Exhibit 1* lists some of the more general evasion techniques. Some or all of them may be added to any transaction or group of transactions. Long-term strategies to combat money laundering address each of these techniques with countermeasures designed to recognize the technique, prevent its success, and even turn it against its practitioner.

"Cash Out" Transactions

Money laundering can be achieved through cash out transactions, defined as any transaction in which the launderer parts with money in exchange for something else.

Property Acquisition

Even the lowest level trafficker engages in property acquisition transactions. They involve money flowing from the launderer in exchange for various kinds of property and may involve other participants, such as commercial, facilitator, or accomplice parties. The transactions may be simple cash payments in return for property, or they may involve false titles, false credit, or false loans in addition to cash (see *Exhibit A-1*, page 34, in Appendix A).

Cash payment is a simple way to avoid leaving a paper trail of the transaction. If the property (commonly vehicles, residences, and certain financial investments) inherently involves a title or other documentation, the property may be purchased under a false title—that is, in the name of a straw owner, someone other than the actual buyer (that is, the launderer).

The straw owner may be a real person, a facilitator, or a fictitious person or entity. The actual buyer pays cash to the seller, who conveys the title to the straw. The straw, if a real person, then "gives" or "lends" the property to the buyer, or may "sell" it to the actual buyer, generally without fair payment or expectation of payment.

False credit may be used to evade the common investigatory technique of interviewing commercial sellers to determine who was actually present at, and made decisions relating to, the purchase. The launderer hands the money to the straw facilitator or accomplice, who then does the actual purchasing, adding a thin layer of credibility to the straw's later claim of ownership. The false credit may be buttressed by documentation of the alleged "loan." The straw then makes the property available to the launderer.

Under a variation of false credit, the straw owner of the money and property may be the launderer himself operating under an alias. He opens a bank account, gets credit cards, and so forth, under an assumed identity. He can now have all of the conveniences of financial services without the risks and conspicuousness of cash expenditures. He can also take expensive vacations, own and enjoy property, and the like, without having to trust another person to serve as his straw.

"Asset protection" is another variation on false credit. The launderer transfers his own assets to, for example, a "family trust," but retains the power to deal with and enjoy the assets. The trust is prepared to claim ownership in the event of a suit or seizure aimed at the launderer. Its trustees may be in foreign "bank secrecy" countries and may have trust agreements designed to defeat pursuit.

As illustrated in *Exhibit A-1*, a false loan to the launderer by the straw may add another layer of credibility. Under this arrangement, the launderer gives his cash to the straw lender, an accomplice, who in turn "lends" it back to the launderer in a visible transfer, generally accompanied by apparently normal documentation. Now the launderer, when questioned, has some way of explaining his ability to pay for the item and holds it in his own name. The accomplice is prepared to support the "loan."

One of several illicit methods of using a casa de cambio (money exchange) (*Exhibit A-2*, page 35) involves false title and false credit. As the launderer makes drug money, he smuggles it, in cash, to the casa de cambio. The casa deposits it in a U.S. or foreign bank, in its own name, in the name of one of its courier employees, or in a fictitious name. The casa pools many customers' funds in one account and keeps its own records on what is owed to each customer. When a drug dealer wishes to make a purchase, he designates a straw owner and requests the casa de cambio to direct a check to the seller. The casa may buy a cashier's check through its bank (or may simply write a check on its bank) payable to the seller on behalf of the designated straw owner. The ownership is in the name of the straw owner, who allows the drug dealer to use the property, by loan or, less formally, by family access. The records, showing that the drug dealer is the original source of the funds, are

safely out of the United States and the audit trail ends at the casa account at the bank. The straw owner simply claims the casa funds to be his own casa deposit, and no available proof contradicts the claim.

The offshore account is the classic variation on the false loan transaction. It adds the evasion technique of offshore secrecy to the transaction, denying law enforcement the proof that money for the straw's "loan" came from the launderer. Offshore loans may be layered with added complexity. *Exhibit A-3 (page 36)* depicts an offshore scheme by which the launderer uses Bearer Share Company A, controlled through Fiduciary A, for the initial deposit, then transfers the funds to a second such company, Bearer Share Company B, through a cash withdrawal and deposit cutout and loans the funds to himself through the second offshore bearer share company, Company B. He controls Bearer Share Company B through a separate fiduciary, Fiduciary B. Both fiduciaries are controlled by the launderer through separate letters, which are kept at separate foreign locations.

The layering of transactions, the addition of multiple companies and multiple persons, and the use of geographical distance and haven countries are techniques designed to produce infinite complexity and prevent investigative penetration through the sheer time, numbers, and distances involved. *Exhibit A-3* illustrates some of the avoidance techniques listed earlier in the transaction classification chart. Each of the other transactions depicted in Appendix A are often layered with added complexity through the use of similar techniques.

Dual-Pricing

Dual-pricing, depicted in *Exhibit A-4 (page 37)*, is a method of raising apparent profits in one or a series of transactions by creating an artificially low purchase price through manipulation of the seller.

The launderer in the example approaches a seller of property that is worth \$3 million with an offer to pay \$2 million in a visible transaction and the balance, \$1 million, in unreported cash. The seller may be willing to make the transaction in order to take a tax loss, to loot corporate assets for personal benefit, or to use a slumping market as an excuse for the apparent low price and for extracting quick cash from a sale. The launderer takes title and sells the property for its fair market value of \$3 million. He has made an apparent "profit" of \$1 million, on which he dutifully pays his taxes (or, preferably, avoids taxes). This example uses huge value/price differences. The same method can be used in a series of transactions with very small value/price differences to the same effect.

An example of dual pricing in real estate development is illustrated in *Exhibit A-5 (page 38)*. The launderer acquires land at market price: \$1 million. (Of course, he could just as easily launder money by dual-pricing this purchase as well, as in *Exhibit A-4*.)

He then contracts for improvements worth \$4 million. Rather than receive only the \$4 million in improvements, he pays cash for an additional \$2 million worth of improvements. This can be done by direct agreement with the prime contractor or by upgrading subcontractors' work as it progresses. Basic work and materials in the bid are upgraded to luxury status and paid for in cash. The contractors are willing to forgo reporting the cash enhancements in order to avoid taxes.

The launderer has now invested \$7 million, \$5 million of it stated on his records, and \$2 million in unreported drug cash. (He spent \$1 million for the land and \$6 million total for improvements.) He sells the improved property for \$7 million to a buyer and makes an apparent \$2 million "profit." The inflated "profit" actually represents only his drug cash infusion. He pays tax on the \$2 million and appears to be a legitimate businessman.

Real estate development, for example, in urban areas or of historical sites, also offers numerous opportunities to avoid taxes. When the "profits" are assured, since they merely reflect drug money injected into the transaction, these tax considerations are particularly attractive to launderers. Tax evasion in such contexts has become a useful indicia of laundering activity.

Dual-pricing is a particularly attractive form of money laundering in connection with the looting of corporate assets by an accomplice insider. The launderer pays the insider a cash bonus, bribe, or hidden benefit to sell corporate property at less than market value. *Exhibit A-6 (page 39)* depicts this type of activity in the context of a financial institution victim. In the example, the financial institution has paid \$3 million for a piece of property in a commercial transaction. The launderer obtains the \$3 million property from the financial institution for only \$2 million. He accomplishes this by paying an additional \$1 million to an insider. Of course, he may also accomplish it by a smaller bribe, by bribing an appraiser, or by some other means. The launderer sells the \$3 million property for its actual value of \$3 million and pays (or avoids) taxes. The financial institution suffers the consequences of the loss and passes the loss to taxpayers if a government bailout or takeover becomes necessary. This possibility is a particularly insidious side effect of financial institution corruption by money launderers. The degree of involvement of drug money laundering in the massive losses of the savings and loan industry is yet to be determined.

False Seller

Unreported money may be used to set up an accomplice in a position to sell to the launderer at a favorable price, allowing the launderer, in turn, to make artificial profits by selling the property he got through a "good deal" at a market rate. *Exhibit A-7 (page 41)* is a generic example. The example could be applied to any property, for example, produce or manufactured goods. The launderer funds an accomplice with the launderer's unreported drug proceeds. The accomplice here is called "silently controlled entity" to emphasize that the launderer has no overt or apparent ties to the accomplice. This silent control could, of course, be exerted through a family member, friend, attorney, corrupt associate, or even a true bearer share company.

Once the launderer has funded the accomplice with, for example, \$2 million, the accomplice uses it to purchase on the commercial market one million pounds of produce or widgets at \$2 per pound. The accomplice then sells the same one million pounds to the launderer in a visible, documented sale for \$1 million, half the market value. The launderer sells the one million pounds to a commercial market buyer at the market price of \$2 million. The launderer's records show that he has made a "good deal" on his purchase (\$1 million in profits on a \$1 million investment), whereas he and his accomplice, considered together, have simply bought at \$2.00/lb. and sold at \$2.00/lb. The launderer completes the scheme by paying or otherwise dealing with his taxes on the \$1 million false profit.

This scheme is well suited for creating apparent legitimacy for many transactions in the course of a business, since the false profit on each item or deal can be inconspicuously small if the number of items or deals is large. It is also especially suited for import-export businesses because the records of the accomplice entity remain safely out of the country.

"Cash In" Transactions

Cash acquisition is the upstream complement of the downstream cash expenditure discussed above. Like cash out, cash in can take various forms.

Cash Receipt

Cash receipt can provide apparent legitimacy for criminal proceeds in a variety of ways. It encompasses low-technology methods used by low-dollar participants as well as methods that are adaptable to high sophistication and high volume. *Exhibit A-8 (page 42)* depicts several examples.

The classic and still most favored method of manipulating cash-in is padding (overstatement) of cash receipts from cash buyers in a series of commercial transactions. Bars, restaurants, pizza parlors, video rental outlets, theaters, service businesses, and similar operations offer endless opportunities for overstating income while padding it with drug dollars. The launderer sells, say, 2,000 glasses of beer per month for \$4,000, but reports selling 4,000 glasses for \$8,000; drug cash makes up the \$4,000 difference. Completely false cash receipts are a variation on this scheme. False inheritances, cash "savings," false gambling winnings, and false sales of nonexistent assets in a foreign country are all popular among drug dealers.

The logical extension of this method is to dispense with the underlying real transaction entirely and "sell" fictitious goods or services to an accomplice. The time honored "ghost employee" payment is of this variety. It allows an organized crime operative to have an apparently legitimate income from the payroll of a business for which he does no legitimate work. A launderer can accomplish much the same result by padding payments from his employer, creating a false salary amount. The launderer hands the employer cash, or otherwise enriches the employer in an unreported transaction, and in return receives added payment in reported compensation.

Dual-Pricing

A facilitator or accomplice can be added to the basic overstatement plan to create a false sale amount through dual-pricing, depicted in *Exhibit A-9 (page 43)*. The launderer buys property on the open market, locates a buyer, and gives cash to the buyer, who in turn pays it to the launderer in addition to the actual purchase price. The launderer has increased his "profit" on the transaction by the inflated amount, and the buyer has increased the apparent value of the property in preparation for its sale to some other commercial buyer. This form of artificial inflation of value has a particularly destructive effect on real estate markets, driving up the apparent value of property and making lenders at the new inflated values vulnerable to deflating swings. It is also a foundation for fraud in individual sales, since the apparent value is inflated above the actual value and a later buyer may be fooled into buying at a price that has been artificially created by the laundering activity.

Dual-pricing is a method of siphoning off corporate or financial institution assets on the cash-in side as well as the cash-out side of the money launderer. For example, in *Exhibit A-10 (page 44)* the launderer acquires property at the market rate. He then bribes an insider (and/or an appraiser, perhaps) to induce a bank or a savings and loan to buy the property at an inflated price. Once again, the ultimate loser in such a scheme is the taxpayer. Note that while both the cash-out dual-pricing example (*Exhibit A-6*) and the cash-in dual-pricing example use outright purchases and sales for simplicity in illustrating the transaction, loans are the functional equivalent of sales for the money launderer and the financial institution. A loan based on an artificial value accomplishes the laundering purpose and is just as destructive to the victim institution.

False Buyer

Exhibit A-11 (page 46) depicts the steps in, or related to, the false buyer scheme (sometimes called false invoicing or double invoicing). The launderer acquires property from a seller, often an amorphous type of property such as an option, intellectual property, or a security. He gives cash equivalent to the

purchase price of the property to an accomplice false buyer, who "purchases" the property, and generates documentation of the "sale." The launderer's records now show his purchase and his false sale. He may repeat the false sale as many times as he wishes; the suspiciousness of multiple sales will be dependent on the type of property. For example, two recorded sales of the same vehicle would be very suspicious and therefore useless to the launderer. Successive sales of options to buy speculative real property, on the other hand, would appear to be legitimate if the launderer made sure one option had expired before the next sale of an option on the same property occurred. After the launderer has made all of the false sales of a particular property he intends to make, he sells the property in a regular commercial sale and pays or avoids taxes on all of his purported "profit."

Combination Transactions

Each of the methods described above can be used in combination with other methods. The combinations may be as simple or as convoluted as the launderer's experience, ability, and personal preferences dictate. *Exhibit A-12 (page 47)*, for example, depicts commodities speculation, the brain child of Michele Sindona, a self-proclaimed expert money launderer, as disclosed in *Power on Earth*, which he wrote with Nick Tosches.

The launderer begins by setting up an accomplice company with a stake, say \$2 million, which the company holds at a bank, called "Far East Bank" in the example. The launderer enters into option contracts for currency. He agrees to buy at price X through Far East, while his accomplice company agrees to sell at price X.

If the market value of the currency goes above price X, the launderer's contracts at X are more valuable and he makes a gain while the accomplice company shows a loss. The launderer accepts the gain, pays or otherwise deals with his taxes, and has completed the legitimization of some of his funds. He replenishes the losses of the accomplice company from his supply of dirty money.

If the market value of the currency goes below price X, the launderer shows a loss while his accomplice makes a gain. The loss, though flowing the wrong way for laundering purposes, is not all bad because it is a tax loss. The accomplice's gain is reinvested and the process repeated.

As the market for the currency ebbs and flows, so does the laundered money. The launderer pays only transaction costs and bears no real risk of loss because he has balanced his position (as a lay-off bookie would do for a bookmaker). This process is easily visualized as a game of roulette in which there are no "house" numbers. The launderer bets on red (up), and the accomplice on black (down). The launderer plays at no real risk because if a black number comes up, the accomplice gains the same amount the launderer loses. The launderer reports his winnings and the accomplice's role is masked by international anonymity.

The cash-out and cash-in attacks on a financial institution can be combined, as depicted in *Exhibit A-13 (page 48)*. In this example, the launderer and an insider have combined to form two silently controlled entities, A and B. Entities A and B are then used to engage in dual-pricing transactions with the financial institution. In the example, A sells (or gets loans on) property for more than its fair market value, described earlier as cash-in dual-pricing. B buys property for less than its fair market value, cash-out dual-pricing. The combined effect is that A and B buy low and sell high, which, of course, means that the victim company is buying high and selling low. Entities A and B realize their profits in purchases or sales on the open market. Any number of entities may be used in any number of countries. Although the example has A doing all the sales to the victim and B doing all the purchases from the victim, their roles may be mixed and the laundering transactions may be intermingled with legitimate transactions.

As long as the victim is strong and profitable, a great deal of money can be laundered through transactions with it. If economic circumstances, tax laws, the business environment, and/or the local real estate market change for the worse for the victim, however, such parasitic money laundering may destroy its host entirely. Empirical evidence of the extent of the role of drug money laundering in the savings and loan crisis probably will not be available for at least several more years.

Conclusion

Money laundering transactions may be downstream from the launderer (cash-out), upstream from the launderer (cash-in), or both. They may involve commercial bystanders, partially culpable facilitators, or outright accomplices. The examples in this chapter illustrate basic concepts but do not describe all types of transactions. An investigator may observe that different methods work better for launderers in different circumstances and may attempt to predict which method will be used. Or he may deduce the laundering method from the configuration of circumstances and business relationships the launderer presents as a cover. An investigator must also consider the evasion techniques he may encounter in his locale and in the types of cases he investigates, in order to make long-term plans to develop legal and investigative countermeasures.

III

GENERAL AND ARIZONA MONEY LAUNDERING STRATEGIES

Money laundering countermeasures, along with other drug enforcement strategies, can be developed more effectively once an investigator has an accurate view of the organizational structure of drug trafficking operations in a given locality. Organizationally, a drug trafficking operation is a network composed of several interacting, mutually dependent activities, or components, including money laundering. Diagramming and analyzing the network's components can help identify those that are vulnerable or those whose links with other components are vulnerable. Appendix B presents a general discussion of the structure and operation of drug trafficking networks.

Arizona's illegal drug activities are of the same types as those found throughout the West and the rest of the nation. They include wholesale importation, indigenous production, and lower level sales. Although Arizona's importation is enormously swollen because drugs imported through Arizona are destined for markets far greater than the state's own lower level sales, the difference is in degree more than in kind. All areas have some ties to wholesale importation activity. The methods of combating money laundering in Arizona are also applicable elsewhere, though the priorities by which they are applied may differ substantially.

Drug Money Sources and Implications for Money Laundering Strategy

Three significant sources of drug money in Arizona are northern Mexico drug importation cartels, indigenous production, and lower level sales. Each is discussed below, as are the overall implications for money-laundering countermeasures.

Northern Mexico Drug Importation Cartels

Arizona's two primary wholesale drug industries are cocaine and marijuana. Although virtually all the cocaine arrives in Mexico under the control of Colombian cartels and the bulk of the marijuana is grown by Mexican groups in Mexico, the two industries have the same handlers at the point where the drugs are imported into Arizona from Mexico. A group of Mexican cartels is responsible for the smuggling process. The cartels, for the most part, are composed of familial organizations. Many of them trace their experience to smuggling of marijuana and Mexican brown heroin during the 1960's and 1970's. They operate as a loose association of shifting alliances, dominated by a succession of young to middle-aged men who claw their way to positions of power in one enterprise or another and are eventually removed by competitors or, less frequently, by law enforcement. The primary Arizona activity, in terms of the cocaine and marijuana industries, is a specialized portion of their respective transportation components—"crossing" the drugs and transferring them from growing and storage facilities in northern Mexico to "stash houses" in Tucson, Phoenix, and Los Angeles for further distribution at the wholesale level.

An enormous amount of money is exchanged for the drugs at brokerage points. Seizures of hundreds of thousands of dollars in cocaine-related transactions are common, with occasional seizures of millions. One marijuana stash house, according to its own ledgers, transacted \$126 million in marijuana (valued at about \$1 million per ton) during an eight-month period. Twenty tons of marijuana were seized from this stash house in 1984. The leadership void created by the arrest

of the person responsible for that stash house was partially filled by another interrelated family enterprise, from which another 20 tons was seized in a single incident in 1989.

The importation cartels move money for three purposes. First, of course, they move money back into Mexico for payment to Colombian cocaine suppliers and Mexican marijuana producers. Second, they handle payments for necessary physical and personnel assets for the smuggling activity, such as load vehicles, stash houses, load drivers, and corrupt officials. Third, they spend money for the personal pleasure and benefit of the participants, who strive to make enough profit to support substantial living expenses. The most frequent expenditures for other than personal items (jewelry, clothing, weapons, etc.) are for commercial and residential real estate, luxury vehicles, and family businesses.

The links between the cartels' money laundering and transportation components are exposed to law enforcement in the movement of money back into transportation-related expenses—vehicles, stash houses, bribes, weapons and other equipment, and payments to load drivers and their coordinators.

Key participants in the cartels are enterprise leaders, financial advisors, money managers, coordinators of load drivers ("mules"), corrupt officials (especially at the border), and procurers of key physical assets (especially vehicles, planes, stash houses, and high technology special supplies and services). The key people in the money laundering component are handlers of money for the large transportation enterprises, procurers of necessary property, suppliers of that property, and corrupt facilitators. Corrupt facilitators include investment advisors, receivers of bribes and favors, business associates that operate front businesses or businesses obtained through drug proceeds, and contacts in financial institutions.

The overall enforcement strategy suggested by the foregoing is concentration on the money laundering component of the importation cartels. These cartels are the most significant drug-related law enforcement problem in Arizona.

Focusing on the money laundering activities of the cartels would be expected to lead to key enterprise leaders, disrupt mule coordination, and hamper the procurement of key assets. Foreseeable results of concentration on money laundering are generally positive. Pressure on Arizona's financial activity is particularly well timed now. The present political leadership in Mexico offers little comfort for cartel operatives who may be pushed to relocate financial activities out of Arizona and into Mexico, because financial enforcement in Mexico is also on the rise.

Indigenous Production

Arizona's secondary source of drug money in need of laundering is indigenous production, including methamphetamine laboratories and some marijuana growing. Accurate figures on the size of indigenous production are not available, but it is safe to estimate that gross yearly income is in the scores of millions of dollars.

The links between money laundering activity and production are especially promising targets in this sub-industry because local production requires numerous specialized suppliers. Precursor drugs, glassware, special supplies, and experienced cooks all must be paid for to support illegal laboratory operations. Marijuana production requires special hybrid seeds, watering systems, and cultivation experts.

The key participants in local production enterprises tend to be money launderers, because both the enterprise-related and personal benefit-related money movements are controlled by the production leaders themselves. They directly control the procurement and the profit distribution, so in this

subindustry the production and money laundering components overlap heavily, with some assistance from outside financial advisors, especially real estate advisors.

The foregoing suggests that emphasis on money laundering, in local production cases, would be useful because it would lead investigators to top-echelon participants in illegal drug enterprises.

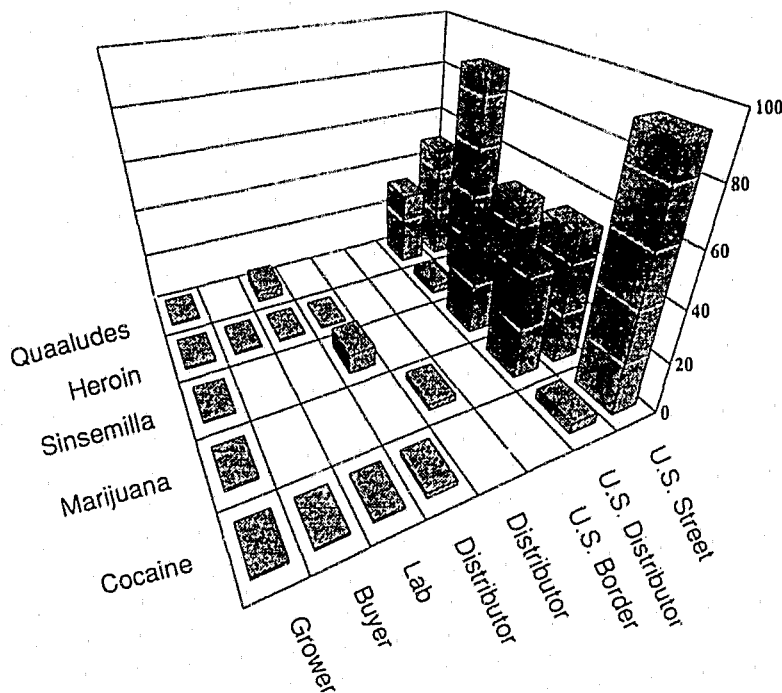
Money laundering strategies relating to local production are similar to those for smuggling. Significant distinctions, beyond the obvious lack of a border location and differences in the types of people and assets necessary, do exist, however. First, the key participants in indigenous production are, generally, better integrated into society than are smugglers, so their money laundering methods, as they relate to money flowing to participants, are less obvious. Second, they depend on U.S. production experts for both the cooking of methamphetamine and the cultivation of high potency marijuana. Payments to these experts provide fruitful investigative leads. Third, the location of the production component and the assets needed to operate it are in the United States, which makes indigenous producers especially vulnerable to civil forfeiture remedies once asset purchases are located.

Lower Level Sales

Payments to participants in the lower level drug sales component account for the bulk of the drug industry's gross receipts on a national basis. Calculations based on Drug Enforcement Administration (DEA) estimates of prices paid for various drugs at the different stages of their journey from production/growing, to processing, through ultimate consumption demonstrate that more than 80 percent of the ultimate consumer's dollar is obtained by lower level and street dealers. *Exhibits 2*

Exhibit 2

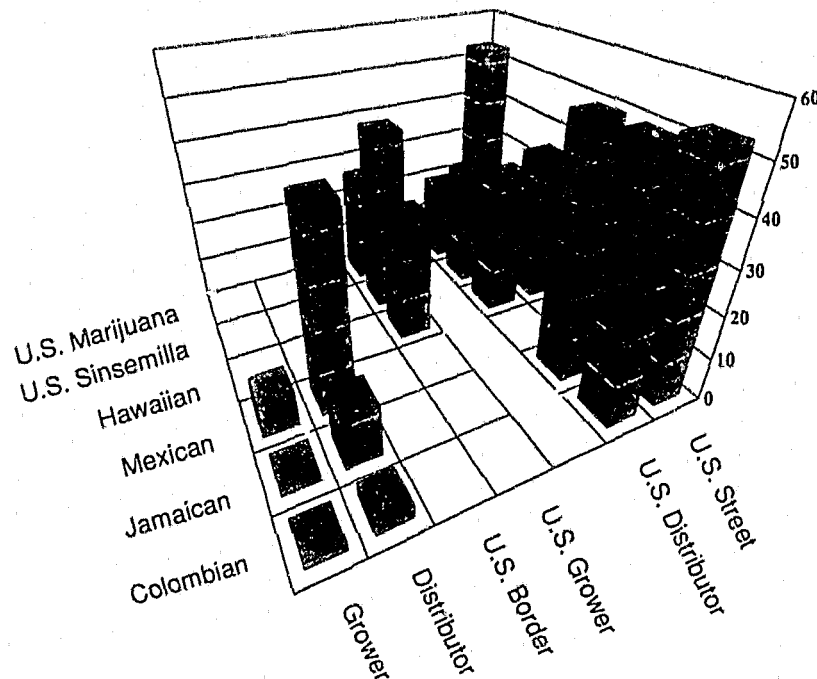
Percent of Street Price Received by Participants in Assorted Drug Sales



Source: Arizona Attorney General, Financial Remedies Unit

Exhibit 3

Percent of Street Price Received by Participants in Sales of Marijuana



Source: Arizona Attorney General, Financial Remedies Unit

and 3 (pages 15 and 16) are graphs showing the percentage of the ultimate retail dollar earned by each participant in the distribution chain for assorted key drugs and for marijuana alone, respectively. The exhibits illustrate that money laundering is a local street problem as well as an international problem. The street dealers, however, have proportionately little need for laundering skills beyond mere spending.

They appear to spend most of their income on the goods they sell, drugs for their own consumption, or living expenses. The particularly successful and financially astute small dealers who are not heavy drug users themselves are the ones who produce significant excess funds.

The links between the lower level participants in the drug network's sales component and the network's money laundering activity are primarily payments for goods sold (drugs) and transfer of profits to obtain personal benefits. Payments for drugs are generally in cash and therefore hard to trace or prove. The personal benefits are generally those that appeal to risk takers, people of low morals, and people with little inclination to defer personal gratification, such as "wine, women, and song," "toys," and flashy cars, in addition to clothes, houses, and consumer goods. These expenditures provide useful investigative leads.

The key participants in the lower level of the sales component almost completely overlap with the money launderers, since most drug dealers at this level handle their own money, with some outside facilitation and advice. As with leaders of local production enterprises, concentration on money laundering activities in cases involving lower level drug dealers is an alternative approach to targeting core participants.

Money laundering strategies relating to the lower level sales component include only a portion of the strategies applicable to smuggling enterprises. They focus on detection of consumption at an unexplainable level by the dealers themselves, similar to the detection of personal wealth of smuggling participants and facilitators. Detection is generally through traditional criminal investigation and less often through financial surveillance. Detection is often followed by criminal prosecution and civil forfeiture of the proceeds.

Developing a Money Laundering Enforcement Strategy

As indicated above, development of a money laundering strategy involves inquiry into (1) the vulnerabilities of a drug network's money laundering component, (2) the links between the money laundering component and the other components with which it must operate, and (3) the key physical and personnel assets associated with money laundering. Each of these three areas is addressed below.

Focusing on the Money Laundering Component

The investigation and prosecution of the money laundering component itself is, of course, a prime enforcement strategy, including reactive and proactive investigations and criminal, civil, and administrative remedies.

Arizona has sophisticated racketeering, forfeiture, and drug statutes and has used its legislative tools aggressively to prosecute money laundering civilly and criminally. Money laundering is a "predicate offense" under Arizona's Racketeering Act. Therefore, substantial criminal and civil remedies are available for money laundering, including a personal civil judgment for an amount equal to the illegal gain, forfeiture of the proceeds of money laundering and of the underlying criminal acts, and forfeiture of the defendant's interest in any enterprise used for or conducted through money laundering (A.R.S. 13-2301(D)(4), 13-2314).

Arizona has turned increasingly to financially oriented investigations. One useful illustration of this focus is a conscious concentration on finances when debriefing and directing witnesses and sources of information. *Exhibit 4 (pages 18-19)* is a checklist of topics of inquiry used by the Arizona Attorney General's Office.

Money laundering prevention, at its lower level, is aimed at drug smugglers, producers, and dealers who launder money to conduct their illegal enterprises and to legitimize their own personal profit from their operations. Tactics used against low-level money laundering include general investigation as well as such special tactics as identification of conspicuous consumption and development of financial intelligence. Financial training for investigators and recruitment of financial analysts are essential to money laundering prosecutions.

Higher level money laundering is carried out by specialists, including casa de cambio (money exchange) operators, financial advisors, attorneys, accountants, real property brokers, bankers, and business insiders who create and participate in money laundering schemes for the benefit of themselves and others. Again, the most effective investigative tactics are drawn from general law enforcement, although often through a somewhat different approach than standard drug enforcement. Specialized tactics include using physical surveillance, electronic surveillance, and undercover officers posing as drug dealers or smugglers, and tracing the paths of the various money laundering transactions as described in Chapter II.

When specialists, such as casa de cambio operators, become sources of information for the government, they are particularly disruptive to the illegal drug industry because the fear of being identified by a casa operator tends to drive dealers and smugglers away from all casas. This is as

Exhibit 4

Information Sources—Types of Information Needed

- I. *Enterprise/Conspiracy*—an overview of the enterprise or conspiracy's structure over time.
 - A. **Members:** Identity of all members and facilitators, including each person's functional role with the enterprise or conspiracy; e.g., a low-level street distributor is normally not as important as a mid-level wholesaler, a close friend or girlfriend of a main member, or an interstate courier. The personal identification of all individuals' roles in the organization will provide an initial gauge of the complexity of the operation and can establish a possible income and/or profit base of the organization and its main participants. Focus on key personnel that the organization needs to keep operating including support/facilitation people.
 - B. **Structure:** What functional roles are performed or controlled by the enterprise within its industry, e.g., sales, money laundering, transportation?
 - C. **Assets:** Type and as specific a description as possible of assets the organization needs to keep operating.
- II. *Finances of the Enterprise*—where does the operating money come from and where does it go?
 - A. **Enterprise Income:** Sources and amounts of income to the enterprise and method(s) of making income appear legitimate. Concentrate on quantity, quality, and price of drugs manufactured, imported, or distributed by the enterprise. This will provide a base of income received by a dealer, the main participants, or the total organization.
 - B. **Enterprise Expenses:** Reasons for all expenses needed to keep the enterprise going, focusing on the particular source(s) of funds, accounts, safe deposit boxes, etc., where the funds came from and the method(s) used to make the funds/expenses appear legitimate.
- III. *Finances of Participants*—how and how much does each one benefit and what is done with it?
 - A. **Income:** Methods and sources of each participant's receipt of income and the path it takes to the participant. Where does he bank, have a safe deposit box, get any cash, or get loans, especially loans from associates, family, or foreign sources? What's his employment history, name and address of employers, level of pay, and type of job/skill/profession?
 - B. **Expenditures:** Does the participant use a banker, stockbroker, financial advisor, investment firm, or accountant? Accountants in particular may have tax and financial records. Where does the participant buy jewelry, clothing, etc., or make large payments (mortgage, car, etc.) or cash payments? Does he go to a casino (records and information are kept on patrons) or gamble elsewhere?
 - C. **Property/Assets:** Real—residence, apartment, business or rental property that is owned, leased, rented, or frequently used by the participant or members of his family or organization. These properties can be in the name of the participant or in the names of associates, relatives, friends, paramours, attorneys, or children. Personal—valuable assets such as vehicles, jewelry, a cash horde, and any location where they may be found, such as a safe deposit box, private storage locker, safe, etc.
 - D. **Methods of concealing property ownership:** Focus on statements made by the violator himself or by close associates about the violator's assets and the sources and methods of payment for them. How does he legitimize his income or lifestyle?

Exhibit 4 (continued)

IV. *Evidence*—exactly how is the information going to be corroborated or independently proven, piece by piece?

For all records, has the source seen them; when, where, who was present, etc.? If involved in a legitimate business, what records are kept and what other businesses or suppliers does the company do business with? (Example restaurant or bar: who is its liquor distributor; from whom does it purchase food and supplies; who was the contractor for remodeling or renovations, if any; who owns the vending machines; who is the bookkeeper for the firm; and who is the business manager?) Explore the location of all records from the time of creation (e.g., who makes them?), through storage (e.g., can we get a search warrant to include them?), and disposal (e.g., how is trash disposed of?).

V. *Enterprise-related Records*—focus on the records that are generated as the enterprise does its business.

- A. **Travel:** Hotels, airlines, rental car firms, and travel agencies. Inquire as to name, location, and date. With regard to date, try to obtain at least the month and year. It will be of great assistance especially when reviewing hotel or restaurant records.
- B. **Communication:** Telephone calls to or from hotels, motels, or other businesses that keep phone records. Do any relevant phone systems keep long distance records internally? Identify individuals or businesses contacted by the participant.

Toll call analysis: Identify long distance calls placed to individuals, residences, businesses, etc., owned, operated, or utilized by the participant. Does he use a long distance service/card, a beeper, car phone, etc.?

Has the source ever contacted the participant? If so, from what number, from where, when, etc.?

Mail: Did the source ever mail anything to the participant. Does the source know where participant receives personal and/or business mail? Post office box? What express mail service does the participant use?

Personal telephone books: Identify all close associates and individuals whom the participant needs to contact in conducting personal and business activities.

- C. **General:** Go over each of the areas in Finances of the Enterprise and ask about records or other evidence available on each point.

VI. *Participants' Personal Records*—focus on the records that each participant generates, especially in connection with the enterprise.

Pose the above questions to the source in relation to each of the participant. Go over each of the areas in Finances of Participants and ask about records or other evidence that may be available on each point.

effective as a massive subpoena or search warrant project directed at casas. (Money laundering specialists are specifically treated under Arizona's money laundering statute. A.R.S. 13-2317(B) enhances the degree of the money laundering offense if a person "knowingly initiates, organizes, plans, finances, directs, manages, supervises, or is in the business of money-laundering.")

Observers of racket activity recognize that the core participants in the criminal activity of the racket rely heavily on the self-interested assistance of less directly involved facilitators, those who knowingly assist criminal conduct but do not themselves share the goals or the direct benefits of the conspiracy or criminal enterprise. Over the past 20 years, law enforcement has recognized the critical importance of deterring racket facilitators. Investigators and prosecutors have developed some familiarity with civil and administrative remedies partly because those noncriminal remedies can be applied to facilitators. The strategy is to drive up the financial risk of facilitation to offset the financial advantages of cozy involvement with racketeers. Upon weighing the risk of loss against the possibility of extra gain, facilitators may decide to disengage from the racket, leaving the core participants unassisted and unable to conduct rackets that are efficient and secure from investigation.

In addition to tactics useful in investigations of core participants, less drastic measures can often deter facilitators. Educational initiatives designed to pierce willful blindness by laying out the money laundering methods employed and the social harms that result from facilitating money laundering may be effective. For example, willful failure by car dealerships to file IRS Form 8300 (reports on cash sales over \$10,000) may be regarded as innocent avoidance of paperwork until the requirements and their underlying utility are made clear to car dealers. Real estate professionals, bankers, financial advisors, and other similarly situated potential facilitators may respond to appeals by their own professional associations or by community leaders. Those groups may also be relied on to spread knowledge of enforcement action taken against one of their members, multiplying the deterrent impact of isolated enforcement.

Arizona can benefit from each of these strategies, particularly appeals to unwitting or willfully blind facilitators. The great majority of businessmen and women who facilitate money laundering are unaware of the full consequences. They may not know their conduct is connected to money laundering, or they may not understand the crucial nature of the service they provide. They, therefore, see neither the extent of the harm nor the importance of their opportunity to contribute to the social rejection of the underlying criminal conduct. On a statewide basis, real estate brokers and the suppliers of vehicles, planes, communications services, and financial services are key to Arizona's drug importation cartels. Specialized supplies are needed for drug production. Certain consumer items are good leads to local drug dealers. All are supplied by Arizona businesses. Law enforcement must concentrate its efforts on those groups through education, persuasion, and, ultimately, judicial civil remedies and even criminal sanctions when necessary.

Arizona and other border states also carry a special responsibility for preventing facilitation that occurs at the border itself. Facilitation of smuggling is particularly destructive to the nation because of its far-reaching consequences. It also presents an especially promising opportunity for intervention because there are just a few towns on the Southwest border and many are so small that the financial elite there tend to know of important financial developments in the community. They are in a position to know who is making transactions inconsistent with legitimate needs or purposes or through irregular means, who is purchasing or controlling assets useful in smuggling activities, and who is living beyond his legitimate means. Each resident of a border town has a disproportionate ability to do something about the nation's drug problem. If those few citizens acted, with law

enforcement leadership and support, to reject smuggling in their communities, they could force smugglers out.

The effect of denying smuggling operations a base of operations on the Mexican border would be devastating. Those operations tend to depend on intimate knowledge of law enforcement methods, personnel, work schedules, and technical capabilities. These close ties require actual presence in towns on the border. Storage, staging, infiltration, and corruption all require a border base. An interior Mexican base would be far less efficient. Also, success as a smuggler generally leads to investment of profits in the United States and to benefits related to smugglers' proximity to the United States, such as schools, hospitals, and U.S. births for alien children. Denial of these benefits would be an additional disincentive for involvement in smuggling.

The critical importance of the financial communities in border areas is illustrated by the Arizona-related CTR (Currency Transaction Report) and CMIR (Currency and Monetary Instrument Report) data provided to the Arizona Attorney General's Office by the U.S. Department of the Treasury. Treasury's concern about ensuring the continuing usefulness of the data prevents precise disclosure, but a general discussion can be enlightening. In 1987-1989, a staggering amount of money was reported on CMIR's as imported into Arizona from foreign countries in cash or cash equivalents in amounts over \$10,000. The importation amount represents a significant figure when compared with all deposits made into all Arizona banks. CTR's filed in Arizona relating to deposits only (that is, excluding withdrawals) totaled about half the inbound CMIR total. Of this amount, CTR's on nearly one-fifth of the total were filed in three border counties, Yuma, Santa Cruz, and Cochise (but not Pima, which, although it includes some of the border, has no border town).

Those three counties account for 19 percent of the deposit CTR's in the state but contain only 6 percent of the state's population. Tiny Santa Cruz County accounted for 10 percent of the total deposit CTR's but contains less than 1 percent of the state's population. The ratio of CTR-required deposits (over \$10,000 in cash) to all bank deposits in the county of Santa Cruz is almost four times higher than in the state as a whole. The reason is not that Santa Cruz is a particularly prosperous trade center. It has below average wages, above average unemployment, and well below average per capita income, as do the border counties as a group. In Santa Cruz County, a county in which unemployment is 14.7 percent and per capita income is under \$12,000 per year, 43 cash transactions of over \$10,000 for every person in the county were reported in 1989. The amount deposited and withdrawn in CTR-required transactions in Santa Cruz County is a significant portion of the aggregate personal income for the county; the amount deposited and withdrawn in CTR transactions statewide, expressed as a percentage of statewide personal income, was less than one-sixteenth as large.

Investigating Links Between Money Laundering and Other Network Components

Money laundering provides money for individual consumption and enterprise sustenance. Laundered money for individual consumption flows to individuals in all other industry components, so blocking its flow should be an enforcement strategy regardless of the component targeted. Similarly, laundered money destined for expenditure on illegal activities will also flow to the various drug network components. In the drug importation component, for example, the largest share of cash is spent for "cost of goods sold"—that is, for drugs. A large share is also spent for smuggling services. Some of the money shipments are large and vulnerable. That has been particularly true since 1985 because compliance with the Bank Secrecy Act has driven drug cash out of financial institutions and into the open. Physical interdiction of drug money is, therefore, a useful strategy.

Interdiction of money destined for suppliers is possible throughout the supply network, from the coca, poppy, or marijuana farmer or drug producer to the street user. Concentration on airports, bus and train depots, and highway couriers has proven effective. Large drug organizations have developed specialized money transport systems using money collection houses, secondary counting houses, and freight-handling mechanisms to gather the cash and move it to Colombia, Mexico, or Panama. Physical and electronic surveillance, use of informants, and undercover penetration of those money transportation mechanisms have all proven useful.

Interdiction of large movements of money is especially warranted at the national borders. Shipments of money for drug supplies, for smuggling participants, and for support of smuggling activities are concentrated at the border. The money for these three uses may flow quite separately. For example, establishments that collect cash for wiring to Colombia do not pay drug dealers in the United States and do not pay smugglers. The three flows may overlap significantly, however, as is often the case in Mexican marijuana enterprises that engage in growing, smuggling, and brokering.

Arizona-related CMIR's indicate that large quantities of unreported money are exported to Mexico. Inbound CMIR cash totals many times the reported outbound cash. For each \$1 reported leaving the state to a foreign country in 1988, more than \$50 was reported coming in. At one port of entry in 1988, for each \$1 reported leaving, almost \$2,000 was reported entering. One explanation of this difference is that cash importers face the possibility of a search and the forfeiture of the funds if they are not reported. Exporters who do not report the cash also face forfeiture, but they are rarely searched and, therefore, do not report. If true exports even approach reported imports (not to mention actual imports), the government is foregoing hundreds of millions of dollars per year in forfeitures in Arizona alone by failing to enforce, through exit searches, the CMIR statutes as they relate to cash exports.

In addition to being linked to production, transportation, and sales, the money laundering component must be closely linked to other network components by communication systems. Despite efforts to keep communications secure, they must operate over great distances and must achieve high speed and accuracy, often despite poor public communications facilities in some countries. They become vulnerable to electronic surveillance and to penetration by informants.

Identifying Key Physical and Personnel Assets

Money laundering offers significant exposure of assets to civil remedies, such as forfeiture. In addition to the vehicles, planes, houses, and other property used to transport money, money laundering gives rise to forfeiture of businesses used to launder money or used as laundering devices by laundering money into the business. Money laundering also may give rise to personal liability for the gross amount of the money laundered. See, for example, A.R.S. 13-2317, 13-2314(D)(5).

The money laundering component itself is personnel intensive. The key personnel assets within the component are the more experienced and technically proficient money laundering specialists, followed by the major drug smugglers, producers, and dealers who have money laundering expertise. Removal or neutralization of those key people can be accomplished through criminal and civil prosecution, through administrative remedies such as license requirement and revocation, and through court orders or legal coercion to testify against accomplices.

The linkage between money laundering and other components also presents important asset and personnel targets. Asset targets include money, transportation, and communications. Personnel targets include the dealers and smugglers who are successful enough to need money laundered.

A money launderer's testimony, information, assistance, and records can provide a wealth of information about key people and assets on which law enforcement strategy can focus.

Measures to Counter Evasion Techniques

As noted in Chapter II, evasion techniques increase the difficulty for investigators and prosecutors to prevent, detect, or prove money laundering transactions. Some evasion techniques might be weakened through changes in state statutes or changes that are within the power of the law enforcement or commercial communities to effect. Each evasion technique should be examined and possible countermeasures evaluated.

The essential objective of each of the various evasion techniques is to scatter or disperse law enforcement knowledge, understanding, and resources that otherwise might contribute to prevention, discovery, and proof of money laundering. The essential objective of each countertechnique, then, is to unite, synthesize, and coordinate investigative and prosecutive efforts. Countermeasures include legislation, cooperation among law enforcement agencies, support from the financial community, development of information sources, and establishment of international-boundary cooperation.

Legislation

The executive branch's authority and resources, and therefore its ability to coordinate duties and resources, rest on legislative mandates. The legal remedies available are the tools with which executive officials work. Many of the evasion techniques play on factors that may be effectively addressed by legislation. An effective and continuous legislative agenda is essential to combating money laundering. The agenda should include criminal remedies, broader civil remedies that enforce financial responsibility for facilitators as well as accomplices, and regulatory provisions that create structural barriers to money laundering. Appendix C suggests several legislative initiatives.

Law Enforcement Cooperation

Law enforcement fragmentation is nowhere more apparent than in the money laundering area. As federal agencies scramble for jurisdiction over portions of federal statutes relating to money laundering enforcement, responsibility for overall strategy becomes more fragmented. Four developments may mitigate this unfortunate situation.

First, the Department of the Treasury, parent of the U.S. Customs Service, the Internal Revenue Service, and the Secret Service, has created the Financial Crime Enforcement Network (FinCEN), designed to serve as a clearinghouse for data and services related to money laundering. The network has enormous potential as a coordinating body. States should contribute to the overall effectiveness of FinCEN by coordinating the collection of state agency data that would be useful, such as vehicle, real estate, corporate, licensure, and regulatory information, and by contributing legally appropriate databases containing such data to FinCEN.

Second, state-federal task forces tend to break down institutional barriers and pool resources constructively at the operational level. Task force operations take many forms. Most of the specialized money laundering enforcement in Arizona is now done through multiagency units, particularly those involving the U.S. Customs Service. Federal and state funding in the money laundering and racketeering fields, including drug crimes, should encourage or require joint participation by federal and state agents.

Third, state and local attention to money laundering as a preventive, investigative, and prosecutive tool promises to bring an additional dimension to money laundering enforcement. State agencies are more closely tied to state banking and financial regulation than are federal agencies involved in drug enforcement. In addition, they are staffed by people who are not subject to out-of-state transfer and who, therefore, identify with the long-range health of the state's economy.

Resources needed to unearth facts about money laundering within a state should be drawn from all available police, agency, and regulatory sources. Countermeasures should be selected from the entire range of criminal, civil, and regulatory remedies, including any combination thereof. The statewide prosecutive or enforcement agency, whether it is the Attorney General or another agency, should assume responsibility for acting as a clearinghouse for information on money laundering cases, techniques, and countermeasures. Nonfederal drug enforcement efforts at the statewide level should concentrate heavily on the financial aspects of the drug industry and on providing a vehicle by which to bring state regulatory agencies and the state's financial community into the enforcement effort.

Fourth, the U.S. Department of Justice has created a Money Laundering Section. It has an excellent opportunity to provide leadership and federal-state coordination and is moving to perform that role.

Financial-Community Support and Information-Source Development

A third major strategy to counter evasion techniques of money launderers is development of financial-community support and information sources, particularly by building and relying on the goodwill of the legitimate commercial community. The financial community is in a unique and indispensable position to defeat the evasion techniques of money launderers. Its business often involves gathering, collating, and transmitting the kind of information that provides the links among people (including fictitious or falsely identified people), transactions, and countries that expose money laundering as well as fraud. Discussed below in this regard are Currency Transaction Reports (CTR's), Currency and Monetary Instrument Reports (CMIR's), computer generated data, and state Money Laundering Reports, among other topics.

Currency Transaction Reports. Under federal law, any transaction involving more than \$10,000 in currency requires the financial institution receiving the currency or completing the transaction to file a Currency Transaction Report (CTR, IRS Form 4789) with the Internal Revenue Service within 15 days of the transaction.¹⁴

CTR's constitute a massive database of currency movements in the country. The size of the database is increasing dramatically each year.¹⁵ All individuals conducting currency transactions with financial institutions in excess of \$10,000 must provide the information necessary to complete a CTR unless exempted by the financial institution.¹⁶

The statutes require CTR's from a range of businesses, in addition to banks, because the Treasury recognizes that as it puts pressure on more traditional financial institutions, money laundering shifts to other types of businesses.

Currency and Monetary Instrument Reports. The Currency and Monetary Instrument Report (CMIR, U.S. Customs Service Form 4790) must be completed by any person transporting over \$10,000 in currency or monetary instruments into or out of the United States. The reports are entered into the Treasury Enforcement Computer System (TECS) together with CTR data. The requirement of filing CMIR's provides very useful sanctions against the smuggling of currency into or out of the country to facilitate money laundering.

Computerizing Arizona-related CTR/CMIR data. The Arizona Attorney General's Office has obtained computer hardware and software for storing and manipulating data received from the U.S. Department of the Treasury. The data tapes, obtained under a Memorandum of Understanding (MOU) with the Treasury Department's Office of Financial Enforcement, contain all Arizona-related CTR and CMIR information from January 1987 to the present.

The Arizona Attorney General's Office is working to develop a computer system capable of manipulating the massive database and producing useful analyses. The office intends to distribute the hardware and software specifications of the system, along with its own software enhancements, to other states interested in putting the CTR/CMIR database to work. Each state that obtains data relevant to it from the Department of the Treasury will then be in a position to use Arizona's development products and move immediately to a working system.

The concept of computerized state CTR/CMIR analysis includes four capabilities. First, the data should be readily retrievable in response to specific queries about, for example, a name (including similar names), a social security number, or an address.

Second, the data search should be enhanced, so that a name inquiry, for example, would trigger responses including CTR's or CMIR's that did not contain the specified name but did contain some link to the name. The nature of the link would be defined by "expert rules," criteria that mimic the analysis an expert would do of the entire database.

For example, the computer could respond to a name query by providing CTR/CMIR data related to an address the subject used, even though the CTR/CMIR did not contain the subject's name. It could also link aliases, switched names, or "sound alikes." It could identify networks of names, addresses, social security numbers, and other identifiers and describe the activity of the group. The group's activity may be significant in ways beyond that of a single member, such as the activity of a group of "smurfs" or "mules."

Third, the computer would be fed expert rules for identifying potential money laundering suspects. Criteria can be established so that the computer can generate lists in response to the criteria. Experimentation with such criteria has advanced for a number of years in the Department of the Treasury, most recently under FinCEN. The Arizona Attorney General proposes to build on that foundation and adjust those nationwide expert rules to the needs of Arizona agencies in cooperation with FinCEN.

Fourth, general statistical questions would be posed to the computer for the purpose of generating strategic guidance. The database could then be useful as an empirical check on other trend analyses, intelligence, and economic observations.

The first goal, responding to inquiries, is straightforward and achieving it required only the technical work of defining, transferring, and digesting the data. That has been accomplished, and the data are on line for queries under the MOU. Computer responses have proven useful in numerous cases and promise to become ever more valuable as agencies become more familiar with the usefulness of CTR and CMIR data.

The system for recognizing related information in the database is currently being designed. The analytical capacity needed to perform the component tasks pushes the computer system to the limits of present technology. The first task after an inquiry results in a "hit" is to locate database records associated with the "hit." This is done by checking selected portions of the "hit" record against all other records in the system. The selected portions include address, social security number, organization name, organization address, and account numbers. The result of secondary "hits" is a web or network that is a subset of the total database, containing records that have common identifiers. For

example, the network may begin with a CMIR on a "mule," connect it with a relative who used the same address as the mule when depositing funds on which a CTR was filed, a business of a relative, and a series of other mules that used the same business name when reporting other cash importations. By identification of known associates in the initial inquiry, a more detailed picture of an enterprise may emerge.

The goal of developing a system that is within the financial reach of state law enforcement requires a compromise: limiting processing speed and system resources to keep costs at a realistic level. We are now in the process of improving software to enhance the efficiency of available hardware.

The development of an expert system capable of assisting strategic decisions is proceeding on two levels.

First, at a broad strategy level, CTR/CMIR and other data are being compared over time, across geographic location, and with external social and economic data. These comparisons will attempt to identify anomalies, data errors, and data collection deficiencies. As part of the anomaly identification process, results are being tested and explored for validity and significance. For example, a comparison of CTR totals by county, expressed as a percentage of total personal income by county, revealed consistently higher percentages in the border counties. The Arizona Attorney General's Office will be working with U.S. Customs Service agents and others experienced in drug finance investigations to develop useful results.

The broad analysis will be useful in allocating resources and identifying the systemic vulnerabilities of the money laundering component of the drug industry. For example, the amount of inbound cash reported on CMIR's and the relative amount of outbound cash so reported—about one-fiftieth of the inbound amount—indicates that spot searches of outbound traffic at border crossings would probably yield large amounts of unreported cash, especially at certain ports. Greater experience with the database, together with deeper understanding of the figures that go into it and their social and economic context, will allow development of formulas and comparisons that disclose which cash is drug cash and will provide insight into how and where it flows.

The second level of analysis will be aimed at identifying individual targets. It will build on the other two processes—network identification and broad analysis. As with the development of broad expert rules, the targeting of individuals and groups will require isolation of each of a multitude of variables and inquiry into their workings and their effects on the analysis. This process depends only partly on deductive reasoning and statistical review. It will turn primarily on interviews with people who have experience with the variable under study. These interviews will concentrate on law enforcement experts, bankers, economists, and demographers.

The process of developing expert rules will build on the experience of the Treasury Department by focusing on Arizona's data and tailoring nationwide conclusions to fit Arizona's particular circumstances. Important advantages of focusing on one small part of the national picture should be (1) greater attention given to local anomalies and (2) an enhanced ability to modify expert rules more accurately in response to changing circumstances.

Statistical analysis has proven possible on only a limited basis. The size of the database overwhelmed minicomputer technology. Only a mainframe computer, because of its memory capacity, could perform the full range of statistical analyses. Limited minicomputer memory, however, has not precluded some analyses of strategic importance, some of which have startled even experienced Arizona drug investigators.

Concern for investigative integrity, as expressed in the MOU with the Treasury Department, prevents widespread disclosure of computer-generated results. These results will be made available on a need-to-know, right-to-know basis as they are refined.

State Money Laundering Reports. In a recent report on money laundering by the American Bankers Association, "Toward a New National Drug Policy—The Banking Industry Strategy" (American Bankers Association Money Laundering Task Force, April 27, 1989), the financial industry adopted a philosophy regarding law enforcement, the financial industry, and money-laundering. The introduction to that report reads:

It is as imperative for the banking industry as it is for the law enforcement community to deter drug dealers from using our nation's financial institutions to launder monies derived from illegal activity. To be successful, however, there must be a partnership in this effort

Our members strongly believe that the government and the banking industry need to work together as a team, not as adversaries, in pursuing the goal of a drug-free America.

The Arizona Attorney General's Office has enjoyed a mutually beneficial relationship with Arizona's financial community for many years.

In 1985, when the state enacted its money laundering statute, which contains criminal and civil enforcement mechanisms, the Arizona Attorney General's Office met with financial leaders to discuss the effects of the new legislation. One result of those discussions was development of a voluntary, informal reporting system relating to possible money laundering through the use of bank services. The Money Laundering Report (MLR) was born of a mutual desire to prevent Arizona's financial institutions from being used for money laundering. MLR's were simple, one-sheet forms on which financial institution personnel provided information about suspected money launderers or suspicious transactions.

The information requested by MLR's included customer name, social security number or employer identification number, occupation, business name, description of transaction, transaction date, transaction time, bank identification code, and a characteristic code. The characteristic code was a letter that corresponded to a list of money launderer characteristics noted on the back of the form.

The forms that financial institutions are required to submit should be short and simple. Bank personnel are more likely to complete and submit a short, simple form than a lengthy form, such as the federal Criminal Referral Form. When federal regulations imposed a six-page report on bank personnel, for example, we noticed a significant decrease in the number of money laundering reports filed by banks.

Trying to keep the form as simple and brief as possible, the Attorney General's Office left a half-page blank for comments. The comment section proved very useful in detecting criminal activity. In contrast to the federal reports, which require only objective information, MLR's gave personnel filling them out an opportunity to state subjective impressions and observations. Bank personnel will include in the comment section information that they omitted from the federal Criminal Referral Forms and CTR's. Since the comment portion was narrative, it was relatively difficult to enter into a computer. We found, however, that the comments were worth the added effort.

Arizona accumulated about 6,000 MLR's over a three-year period. Approximately 150 new MLR's were submitted each month.

Sorting database records by subject name produced a list of persons about whom banks had submitted repeated MLR's over a two-year period. Multiple filings indicated an increased probability that the person was engaged in suspicious activities relating to money laundering.

Sorting the records by size of transaction resulted in a list of persons engaging in suspiciously large transactions. Sorting by transaction size will also reveal multiple transactions by the same person as a grand total instead of separate transactions.

From those two sorts, the Attorney General's Office compiled a list of persons who were associated with multiple MLR filings and for whom the largest 200 transactions were reported. Each person on the list was then assigned a score based on characteristics indicative of money laundering. Individuals received five points for appearing on the multiple filing list, five points for appearing on the large transaction list, and two points for each characteristic of money launderers.

The Attorney General's Office investigated the top ten scorers on the list. Without exception, each person who scored high on our computer list exhibited, upon further investigation, classic characteristics of financial criminals. Most of the high scorers were already subjects of investigations by the Attorney General's Office or by other state and federal agencies. Our results demonstrate that computerizing and analyzing a database of MLR's is a very reliable method of detecting and identifying money launderers and other white collar criminals.¹⁷

A state MLR system is a useful supplement to the federal reporting system. The federal system of reports relating to money laundering is comprehensive and a proven deterrent. State statutes should either designate as a state crime the failure to comply with, or the avoidance of, federal requirements or should mirror federal requirements. Arizona has enacted such a statute, set out in *Exhibit C-3*. Implementation was greatly enhanced through a working group composed of representatives of the banking, money-transmitting, and check-cashing industries; the state banking department; and state and federal law enforcement, which drafted a new MLR (called a Suspicious Transaction Report) for state use.

Other sources. Financial information might also be obtained through implementation of a money laundering hotline, along the general model of a "silent witness" program. The concept would center on a publicly announced and advertised telephone number, with the phone(s) staffed by volunteers, possibly retirees who have had experience in financial law enforcement. The activities would be publicized and overseen by a blue-ribbon board of directors composed of leaders in business and law enforcement. The program would solicit financial support and offer rewards for information, which would be held in strictest confidence.

The financial community is critical to money laundering prevention beyond its role as a source of information. Without support services from the financial community, money laundering could not flourish. Therefore, education of key financial personnel is essential as a prevention measure. Law enforcement must assume primary responsibility for educating financial service providers and instilling in them a will to resist money laundering. In areas where substantial money laundering is occurring, law enforcement should reach out to the financial community. Among the associations and planning groups from which it seeks cooperation and assistance (such as help in drafting legislative proposals), law enforcement must include representatives from the financial community and must consider and respect the financial community's points of view and agendas.

In the context of money laundering, law enforcement should recognize the special significance of border towns generally, particularly of the financial and business communities there. Even a few reliable sources of financial information in a border town provide a foothold for the community's effort to reject drug trafficking and the shadowy money it generates and operates on. The highest strategic priority of law enforcement in border states should be denial of financial facilitation to smuggling groups on the border. Methods of implementing this strategy include designing or encouraging professional and business education projects, fostering strong cooperation between law

enforcement and commercial interests, concentrating prosecution efforts on the more overt facilitators of money laundering, and developing reliable sources within the financial community, particularly in the areas of real estate, vehicle sales, and specialized services such as mobile phones, modified vehicles, and special electronics gear.

Law enforcement should also concentrate on border businesses that provide special opportunities for laundering money. Import-export firms, casa de cambios, traders in products (for example, produce, cattle, and manufactured goods), and investment concerns are all tempting targets for illicit control by money launderers.

Financial community awareness of money laundering is essential to an attack on all drug subindustries, including local production and lower level sales. Programs emphasizing knowledge of the customer, inquiries designed to pierce false identification and locate foreign connections, and similar methods of spotting potential launderers should be reinforced by legislation providing immunity from civil liability for divulging customer information to law enforcement, and perhaps also by legislation requiring reports of suspicious activities, such as Arizona's recent legislation.

International-Boundary Countermeasures

International legal and diplomatic developments related to money laundering enforcement over the past few years are truly revolutionary. They promise to reduce greatly the effectiveness of multicountry schemes, thanks to excellent work by federal officials to dissolve international barriers to investigation and prosecution of money laundering.

Much international cooperation can also be fostered at the state level. For example, the Conference of Border States Attorneys General is an excellent vehicle for direct cooperation on matters of mutual concern along the Mexican border. This conference has met twice yearly for many years and reflects the growing concern over drugs and money laundering in recent years on both sides of the border. It provides a forum for issue resolution that is more flexible and practical than federal treaties. This organization also provides an opportunity to design and implement training by and for officers and prosecutors on each side of the border in the financial investigation laws and techniques applicable on the other side of the border. More smoothly coordinated financial investigations are necessary to support the advancement of free trade. Money laundering investigations can benefit enormously from this general trend.

Various trade-related commissions and boards provide similar opportunities. Also, local law enforcement has long cooperated informally across the border on a wide range of topics, from stolen vehicles to missing persons. The list of topics has been recently expanded to include money laundering, a matter of vital concern to Mexican and U.S. officials. Direct contacts with Mexican prosecutors, investigators, and regulators are a key part of the strategy to combat money laundering in the Southwest.

Conclusion

Over the past 20 years, law enforcement has increasingly recognized the importance of the finances of crime. Combating money laundering is a process of discovering, selecting, developing, and perfecting techniques to reduce and remedy crime by focusing on its finances. This report proposes a general framework for identifying goals for financial enforcement and builds a strategy to address Arizona's three main sources of drug money, a strategy that is relevant to all states. Application of the strategy in Arizona will test it, guide it, and refine it as time goes on.

NOTES

¹ *Drugs, Law Enforcement and Foreign Policy: Panama. Hearings Before the Subcommittee on Terrorism, Narcotics and International Communications.* Committee on Foreign Relations, United States Senate, 100th Cong., 2nd Sess., pt. 2, p. 20 (1988).

Senator Kerry: It has been alleged not only by people who will testify here but others that the laundering of money is one of the principal reasons that it [drug trafficking] has grown so rapidly.

Do you have any sense of the level of drug money currently being laundered by New York financial institutions?

Mr. Morganthau: I do not. I know that the estimates go from \$40 to \$80 billion per year.

I think it would be fair to say that New York has probably 10 or 15 percent of that minimum. So, I think you are talking about anywhere from \$5 to \$10 billion being laundered through New York banks and other financial institutions.

² *Ibid.*, p. 5. ("Mr. Morganthau: The . . . point is that our jails and prisons throughout the country are not being overloaded with drug traffickers. What they are being overloaded with is people who are using drugs that commit robberies and burglaries and murders. That is where the problem is.")

³ *Ibid.*, at 28. (Statement of Gen. Paul Gorman, U.S. Army, Retired, former Commander, U.S. Southern Command.)

I have seen credible estimates, Mr. Chairman, that the aggregate annual financial impact of the Nation's drug habit, taking into account that lost productivity, taking into account clinical costs, taking into account public information campaigns to cut consumption, taking into account the expenditures within our legal systems, as well as all of the efforts of the United States overseas to interdict smugglers or to eradicate the plants where grown, taking into account all of that, you are looking at a sum of money which approximates what we spend for national defense—an enormous outlay.

⁴ A metric ton is 1,000 kilograms; each kilogram weighs 2.2 pounds. The approximate U.S. equivalent of a metric ton is 2,200 pounds, equal to 1.1 U.S. tons.

⁵ *Alliance for a Drug-Free Arizona*, Office of the Governor of the State of Arizona, 1987 Report, p. 256.

⁶ *Money Laundering Control Act of 1986 and the Regulations Implementing the Bank Secrecy Act: Hearings Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance.* Committee on Banking, Finance and Urban Affairs, United States House of Representatives, 100th Cong., 1st Sess., p. 32 (1987) (Statement of Francis A. Keating II, Assistant Secretary for Enforcement and Operations, Department of the Treasury).

⁷ See generally *Drugs, Law Enforcement and Foreign Policy: Panama. Hearings Before the Subcommittee on Terrorism, Narcotics and International Communications.* Committee on Foreign Relations, United States Senate, 100th Cong., 1st Sess., pt. 1, p. 17 (1987).

Senator McConnell: . . . If we were to shut the Bahamas down, in your judgment where would the smugglers go?

Mr. Garcia: I think if I were a regular smuggler, if I were a smuggler now . . . I would go to Mexico.

United States Department of State, *International Narcotics Control Strategy Report 107* (1989). ("Mexico's 2,000 mile border with the United States makes the country a natural point of origin and transshipment for drugs.")

8 These figures are based on calculations that synthesize data from world production estimates, seizures by U.S. and Mexican authorities, radar surveillance data, informant and witness accounts, and actual prosecutions of smuggling groups.

9 *Alliance for a Drug-Free Arizona*, p. 3.

10 Federal and state law enforcement officials in Arizona agree that the vast majority of the cocaine and marijuana is distributed from Arizona to other states. A significant amount of the interstate distribution of cocaine from Arizona appears to go directly to California for brokerage. Marijuana distributors operating primarily out of Arizona appear to be sending substantial quantities to all states in the region, and particularly to California, Texas, New Mexico, Colorado, New England, and the Midwest.

11 *Alliance for a Drug-Free Arizona*, p. 4 (Figure No. 2).

12 *Ibid.*, p. 3.

13 The street price of cocaine at the time of the figure was about \$100 per gram. At that price, the 28,130 kilograms of cocaine transported through Arizona would yield \$2,813,000. However, the cocaine hydrochloride transported through Arizona is approximately 90 percent pure. Ultimately, street dealers will "step on" the cocaine (i.e., cut the purity of the cocaine) three to one (or even five to one) before it reaches the street user. As a result, the amount of cocaine that is transported through Arizona each year is equivalent to 84,390 kilograms at the street level. The price is rising rapidly as this is written. Higher profitability in crack cocaine is not even accounted for in these figures.

14 31 U.S.C. Section 5313; 31 C.F.R. Section 103.22.

15 *Money Laundering Control Act of 1986 and the Regulations Implementing the Bank Secrecy Act: Hearings Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance*. Committee on Banking, Finance and Urban Affairs, United States House of Representatives. 100th Cong., 1st Sess., pp. 10-16 (1987) (Statement of Francis A. Keating II, Assistant Secretary for Enforcement and Operations, Department of the Treasury).

I am pleased to report that the IRS Detroit Data Center is current in the processing of Currency Transaction Reports. This is a noteworthy accomplishment in view of the ever increasing CTR filings. This year we estimate that over 5 million CTR's will be filed, up from 3.7 million in 1986. This is in contrast to the 1.8 million filed in 1985 and 700,000 filed in 1984.

Ibid., p. 13.

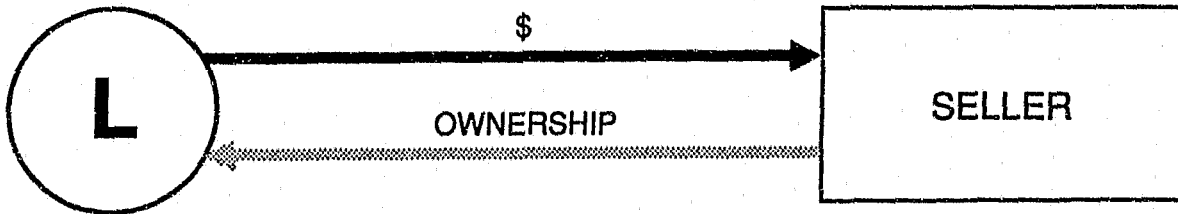
16 See 31 C.F.R. Section 103.22(b)(2)(i). See generally U.S. Department of the Treasury, *Currency and Foreign Transactions Reporting Act—Exemption Handbook*, Internal Revenue Service Publication 1387, U.S.G.P.O. #202-014/94503 (1988).

17 Research on this use of MLR's was conducted by James Preston and David Baize of the Arizona Attorney General's Office, as first published in Statement and Memorandum concerning International and Domestic Money Laundering, before the Committee on Banking, Finance and Urban Affairs, United States House of Representatives, Nov. 7, 1989 (Statement of James E. Preston).

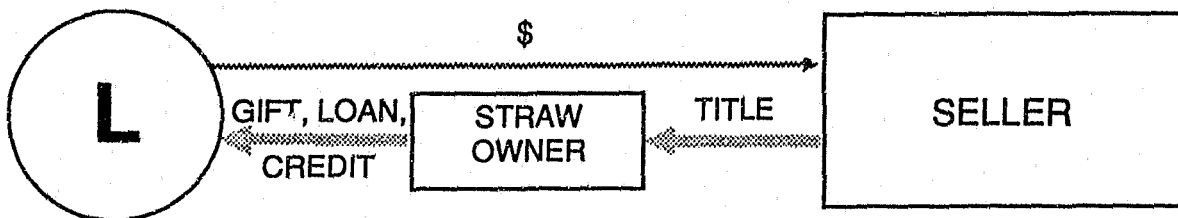
APPENDIX A
ILLUSTRATIVE MONEY LAUNDERING TRANSACTIONS
(see Chapter II for related text)

CASH OUT, PROPERTY ACQUISITION*

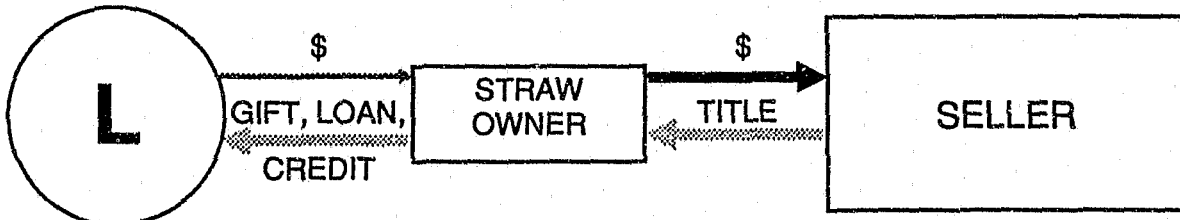
CASH PURCHASE



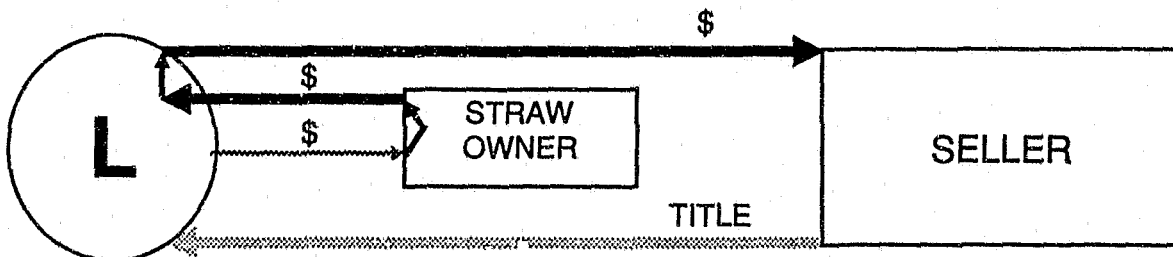
FALSE TITLE



FALSE CREDIT



FALSE LOAN

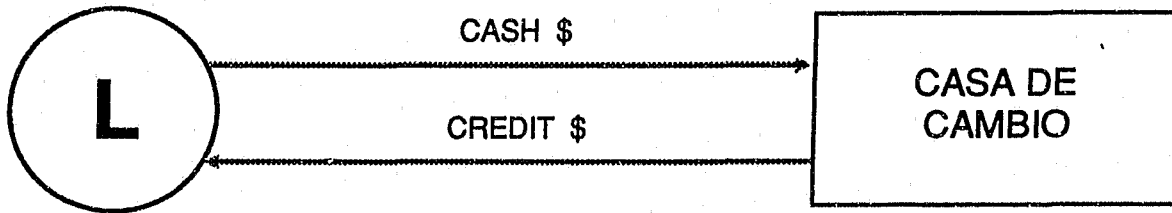


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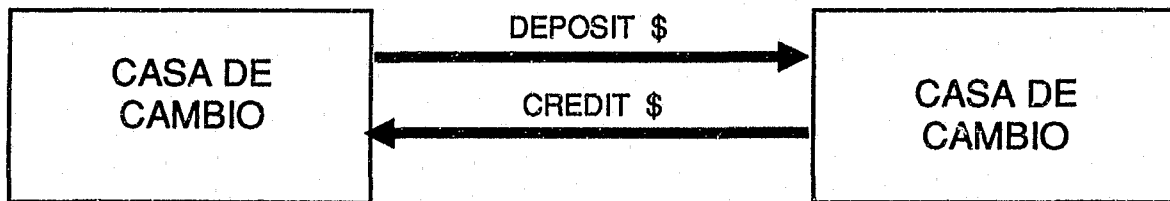
- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH OUT, FALSE CREDIT WITH PAPER TRAIL DISRUPTION BY CASE DE CAMBIO*

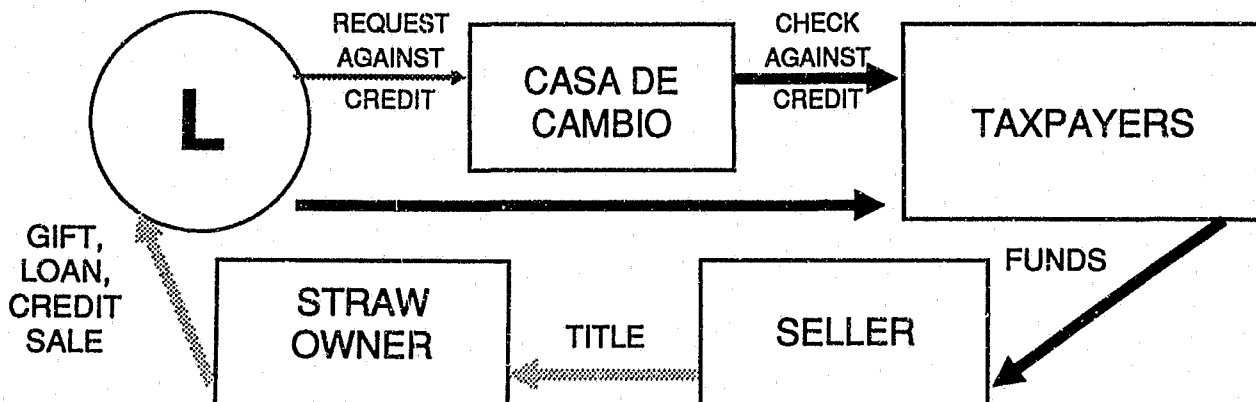
STEP 1



STEP 2



STEP 3

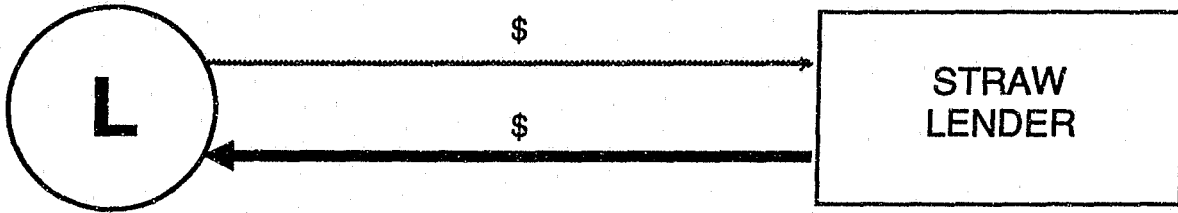


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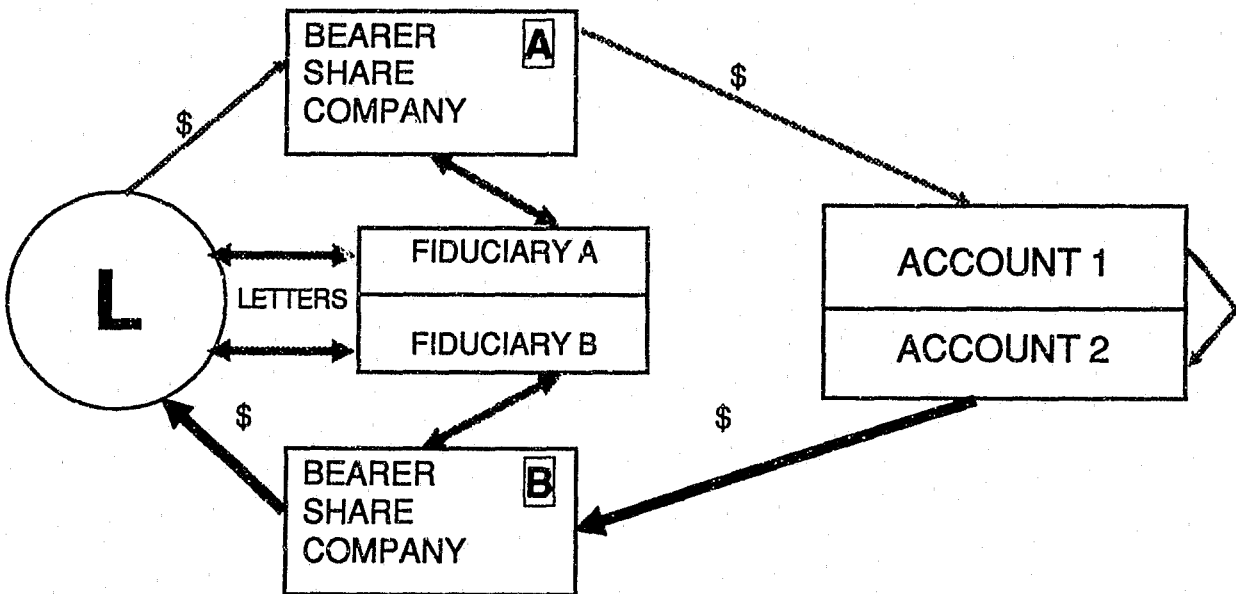
- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH OUT, FALSE LOAN BY DEPOSIT TO SECRECY ACCOUNT*

1.) PRINCIPLE



2.) COMPLEX APPLICATION

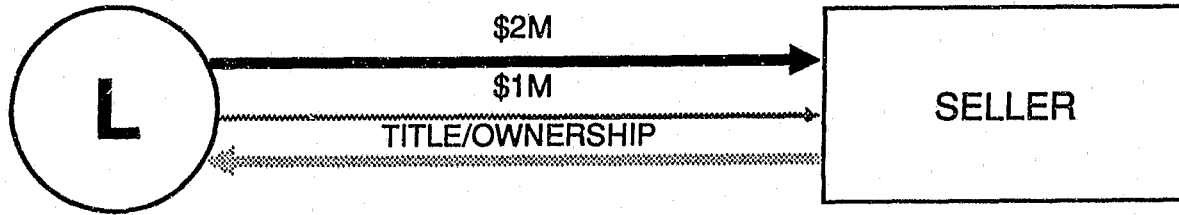


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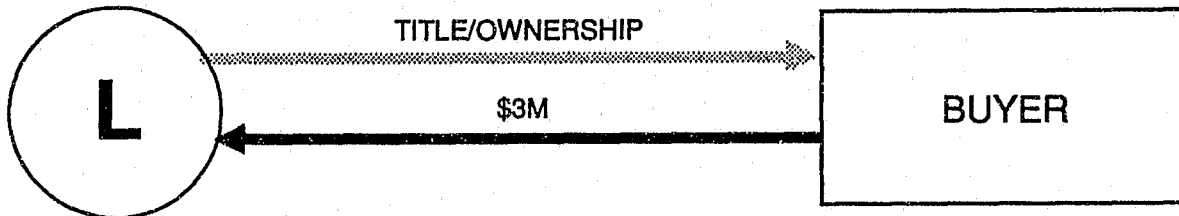
- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP
- CONTROL

CASH OUT, DUAL PRICING*

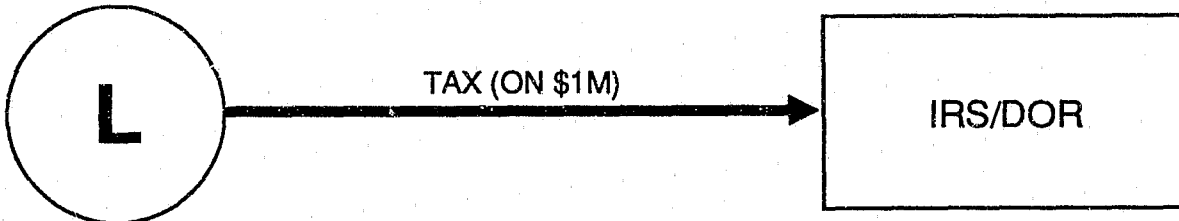
STEP 1



STEP 2



STEP 3

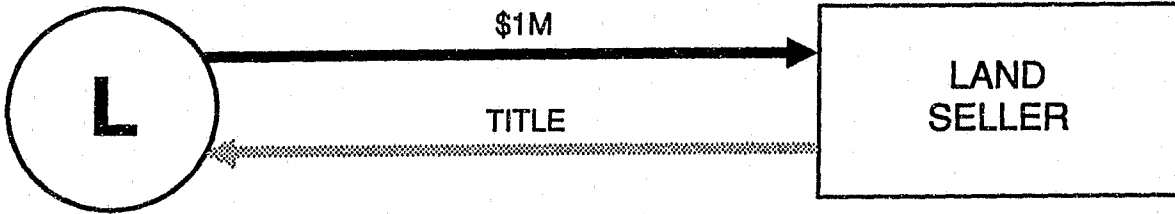


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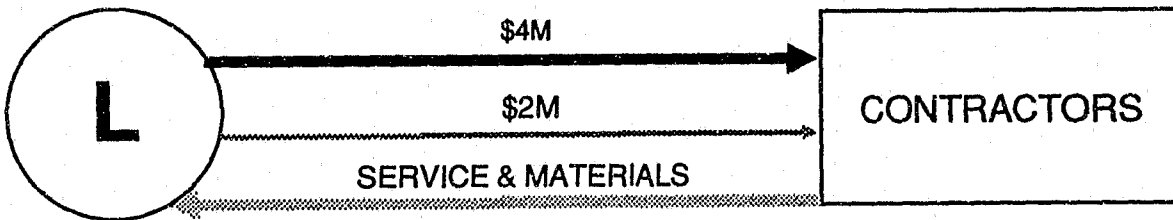
- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH OUT, DUAL-PRICING REAL ESTATE DEVELOPMENT*

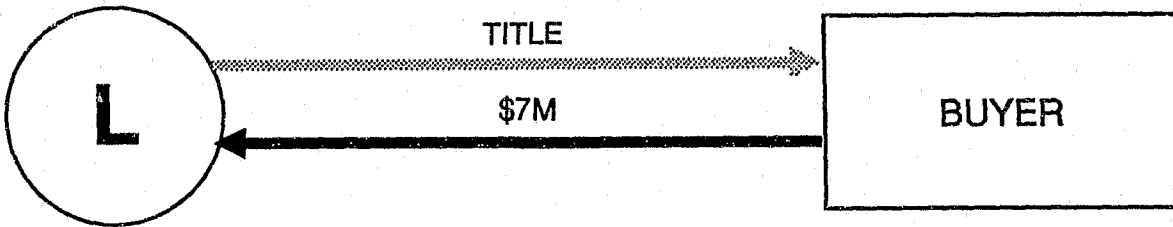
STEP 1



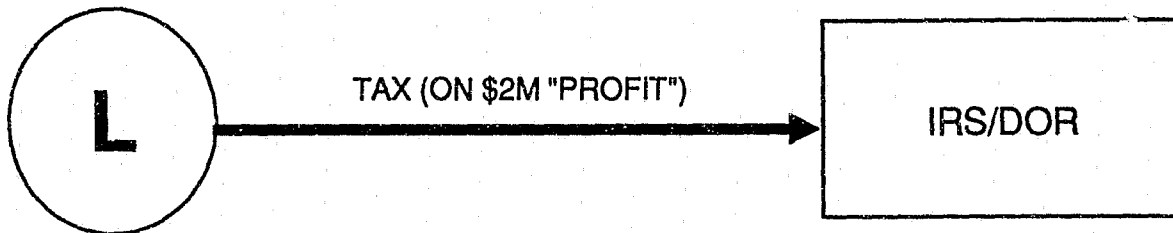
STEP 2



STEP 3



STEP 4

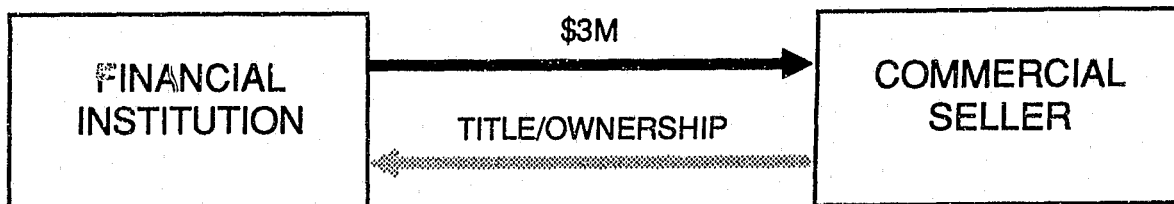


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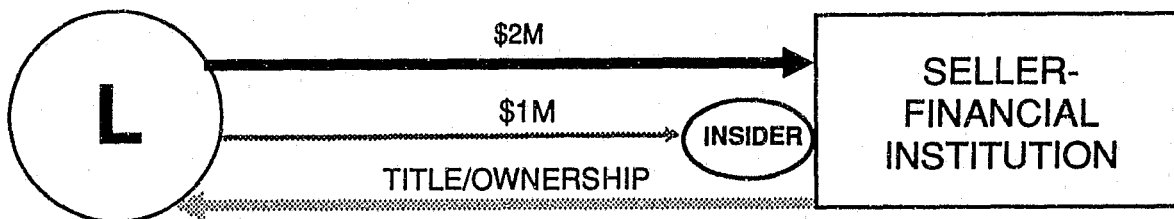
- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH OUT, DUAL-PRICING FINANCIAL INSTITUTION VICTIM*

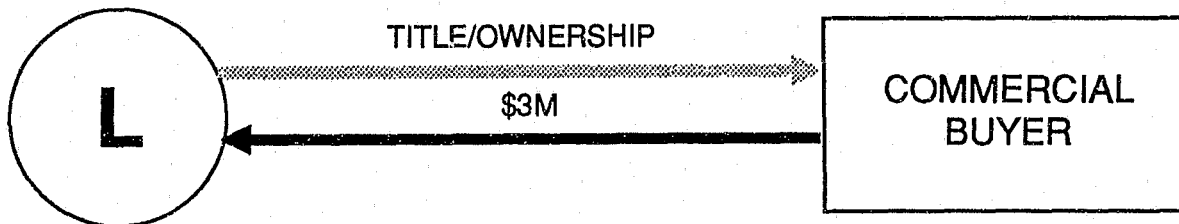
STEP 1



STEP 2



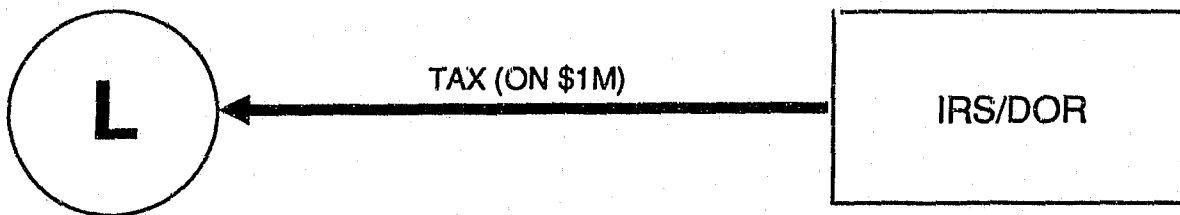
STEP 3 (LAUNDERER)



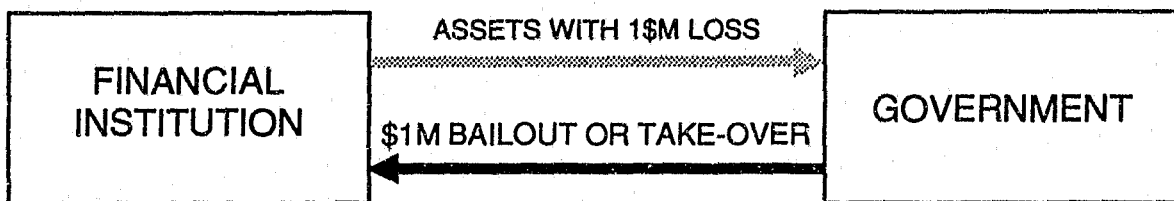
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- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

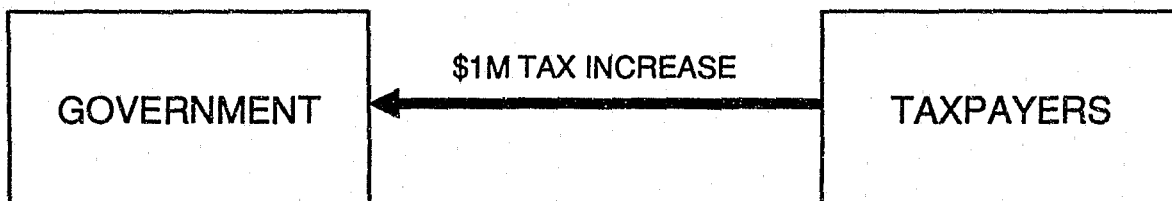
STEP 3b



STEP 3c (FINANCIAL INSTITUTION)



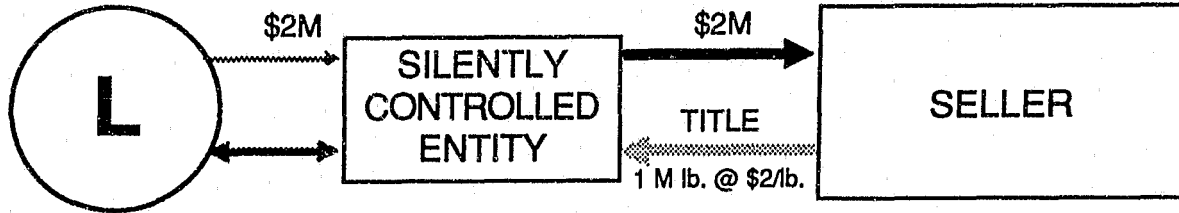
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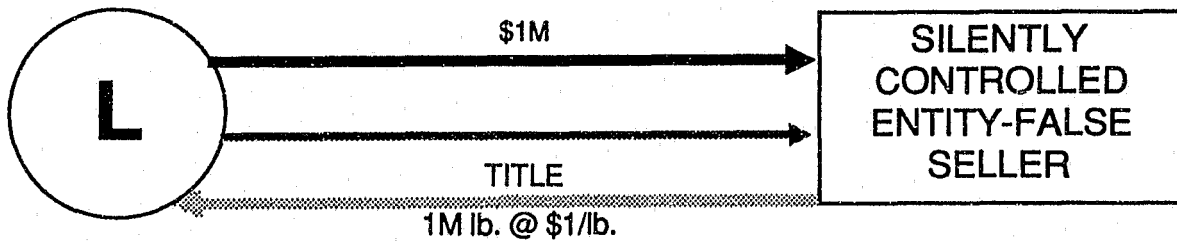
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- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH OUT, FALSE SELLER*

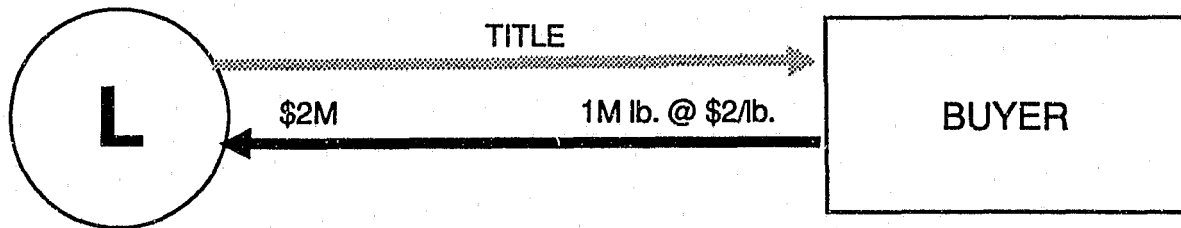
STEP 1



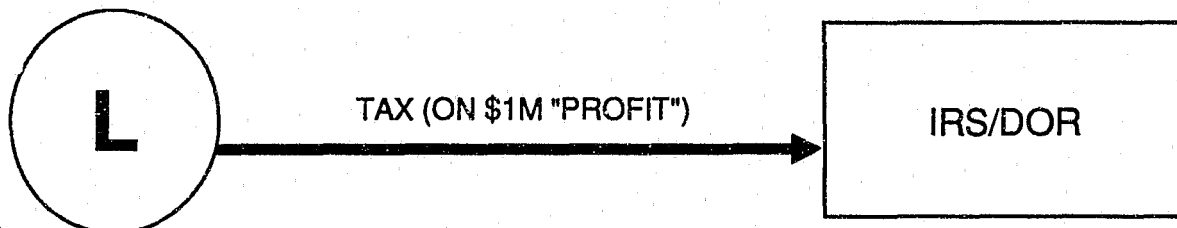
STEP 2



STEP 3



STEP 4

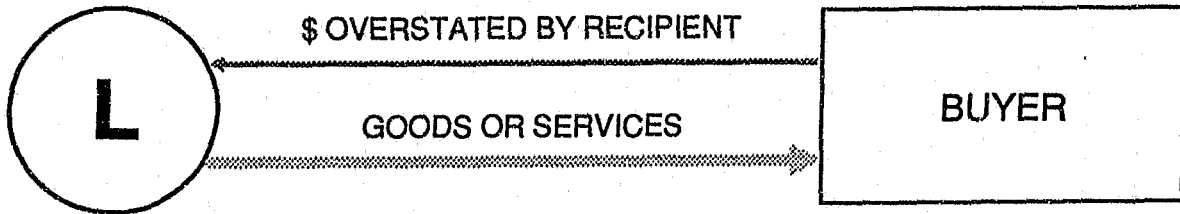


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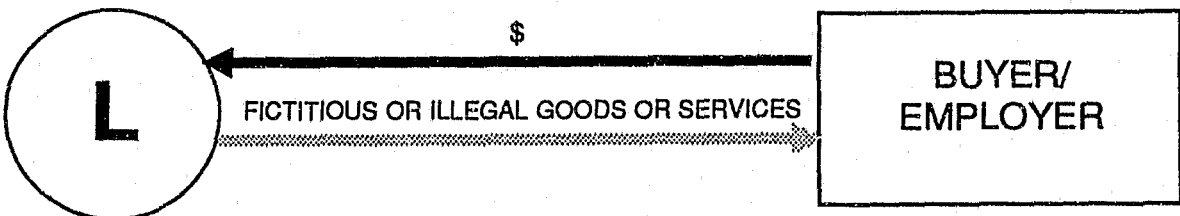
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- TITLE/OWNERSHIP
- CONTROL

CASH IN, CASH RECEIPT*

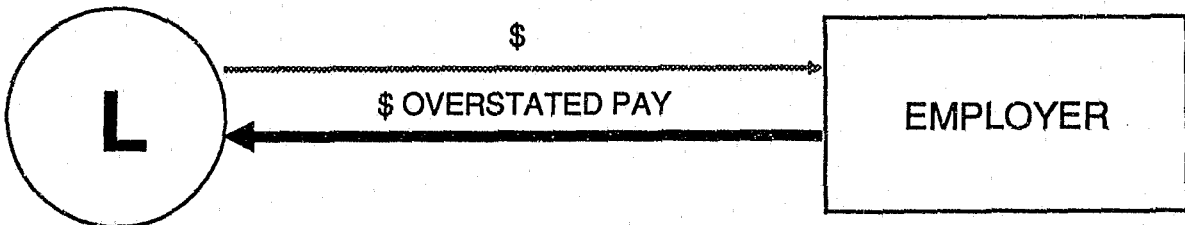
CASH BUYER/PADDING



FICTITIOUS GOODS/SERVICES



FALSE SALARY AMOUNT

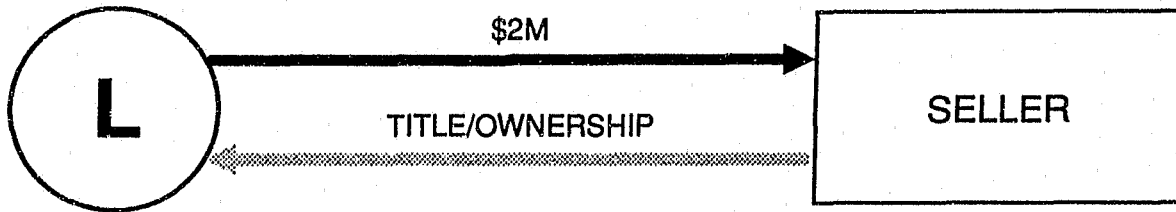


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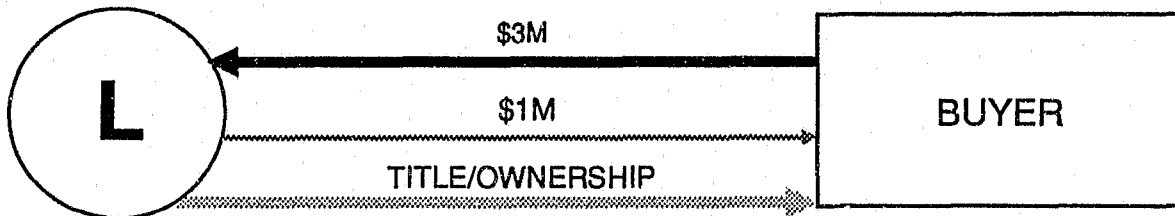
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- TITLE/OWNERSHIP

CASH IN, DUAL-PRICING*

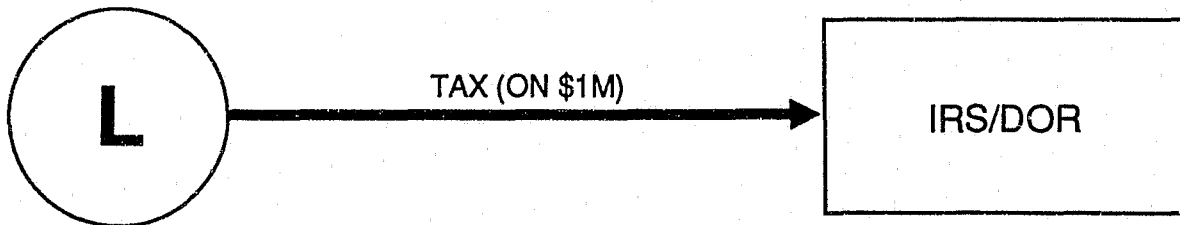
STEP 4



STEP 2



STEP 3

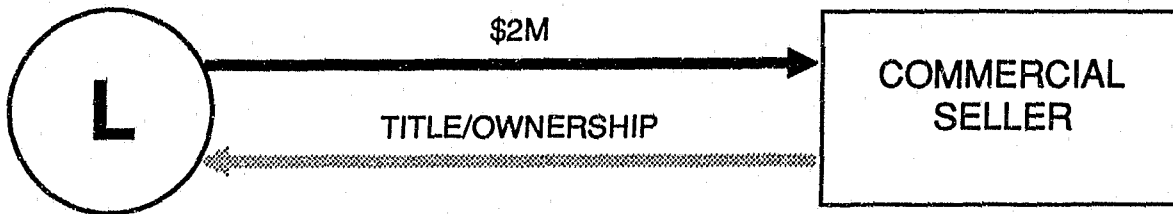


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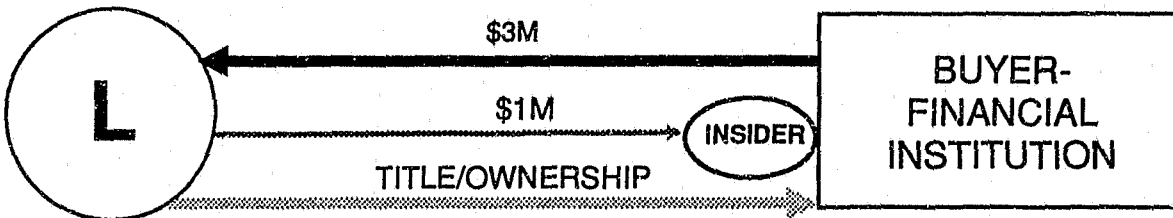
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- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP

CASH IN, DUAL-PRICING FINANCIAL INSTITUTION VICTIM*

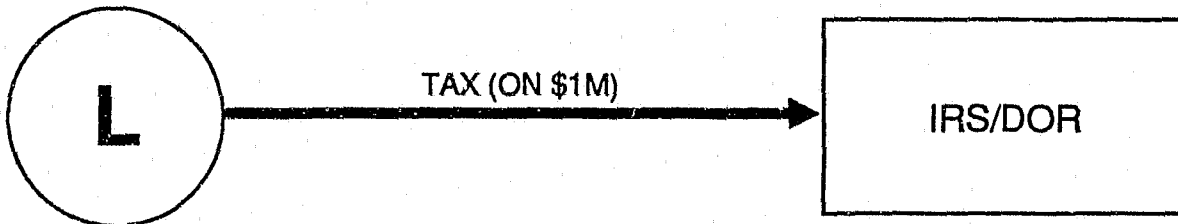
STEP 4



STEP 2



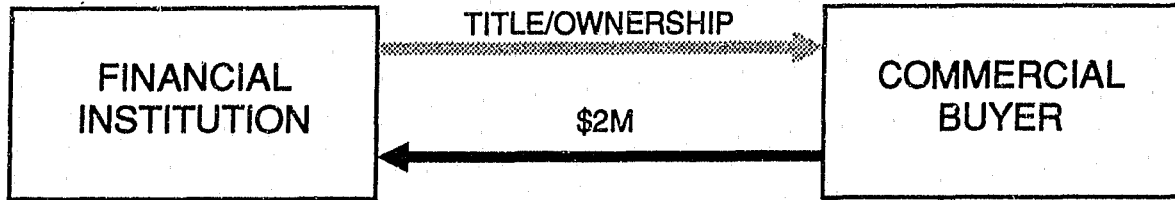
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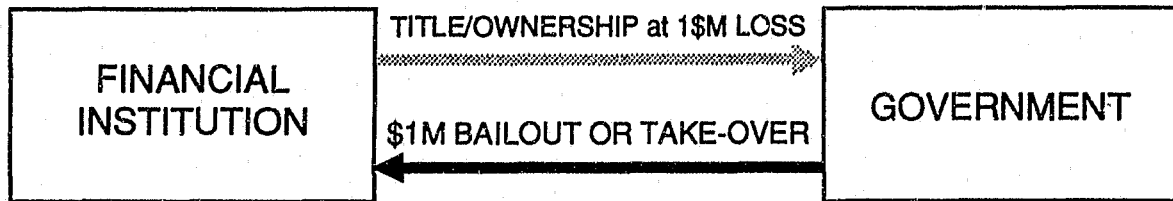
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- CASH TRANSFER
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- TITLE/OWNERSHIP

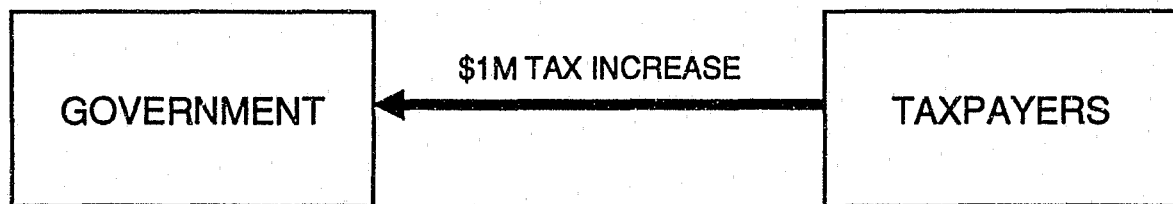
STEP 4a (FINANCIAL INSTITUTION)



STEP 4b



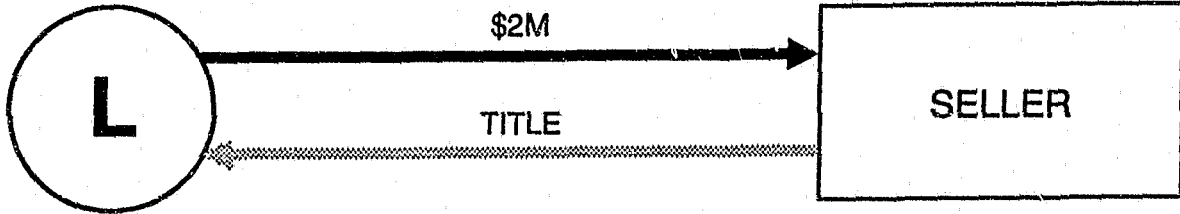
STEP 4c



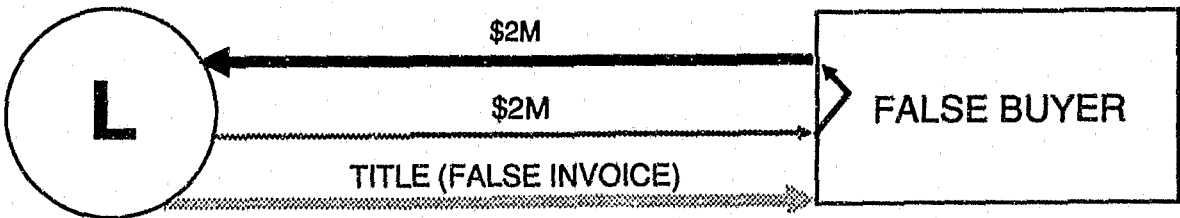
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- TITLE/OWNERSHIP

CASH IN, DUAL-PRICING*

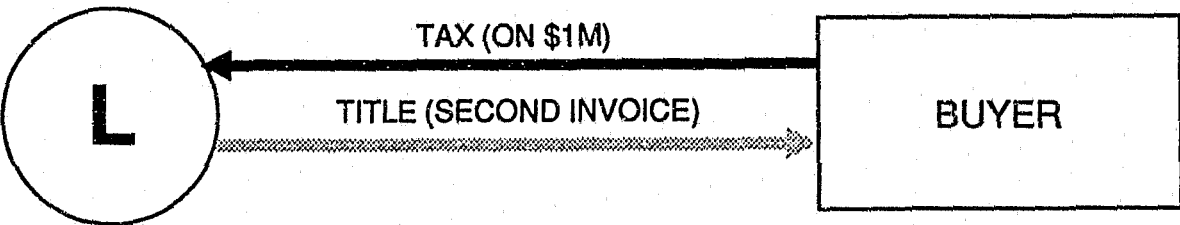
STEP 1



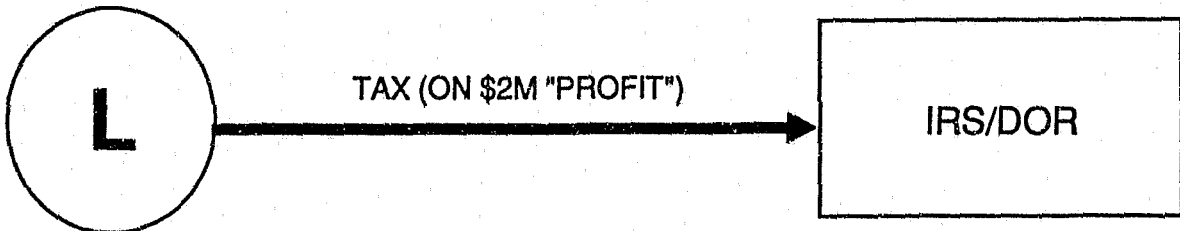
STEP 2



STEP 3



STEP 4

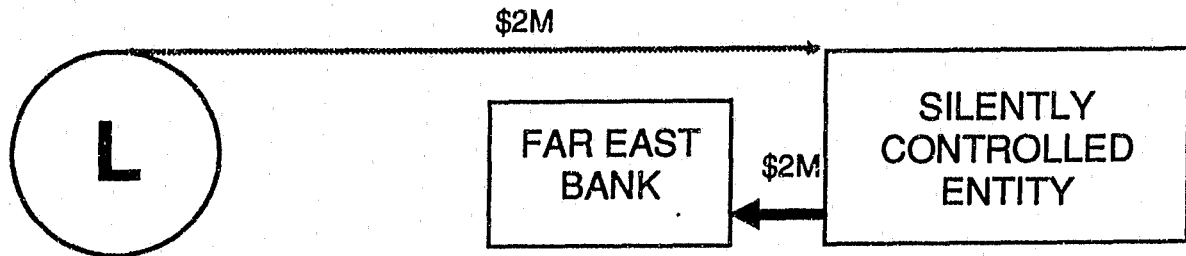


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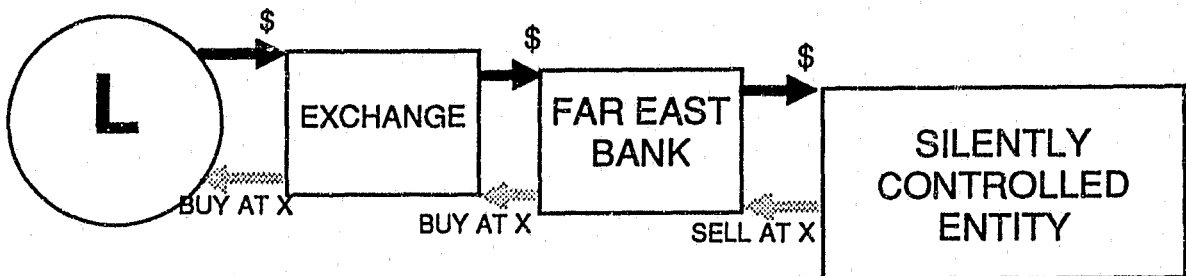
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- TITLE/OWNERSHIP

COMBINATIONS, CURRENCY/COMMODITIES SPECULATION*

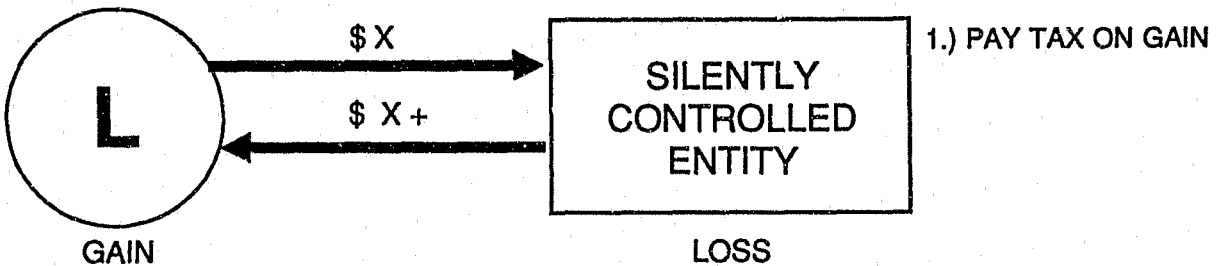
SET-UP



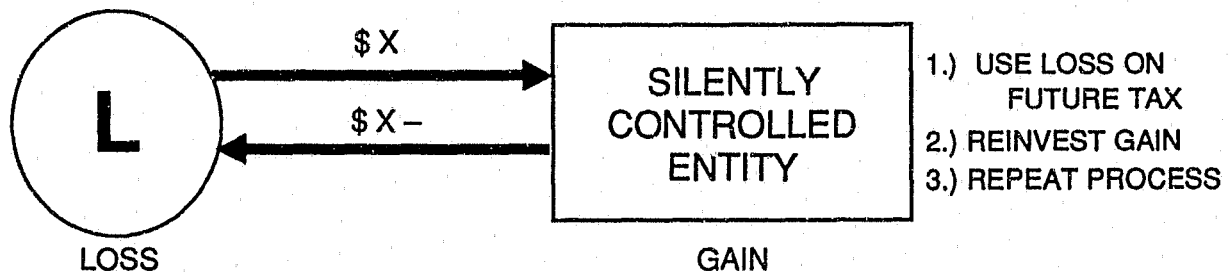
OPTION CONTRACTS



IF PRICE > X



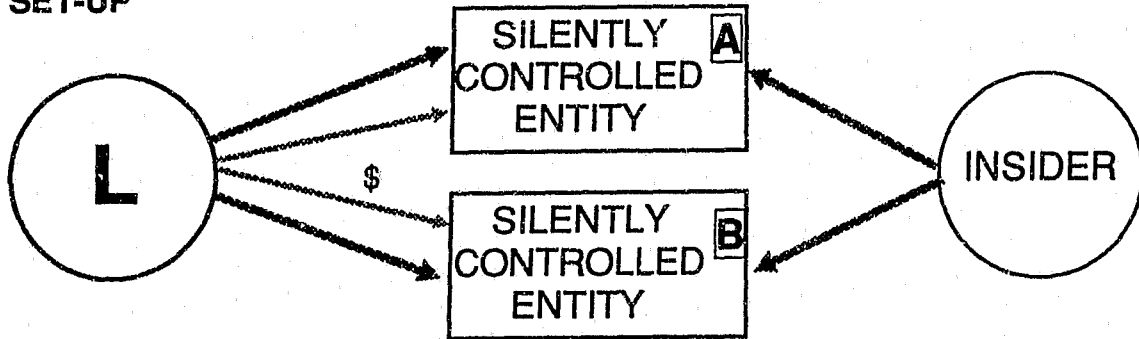
STEP 4



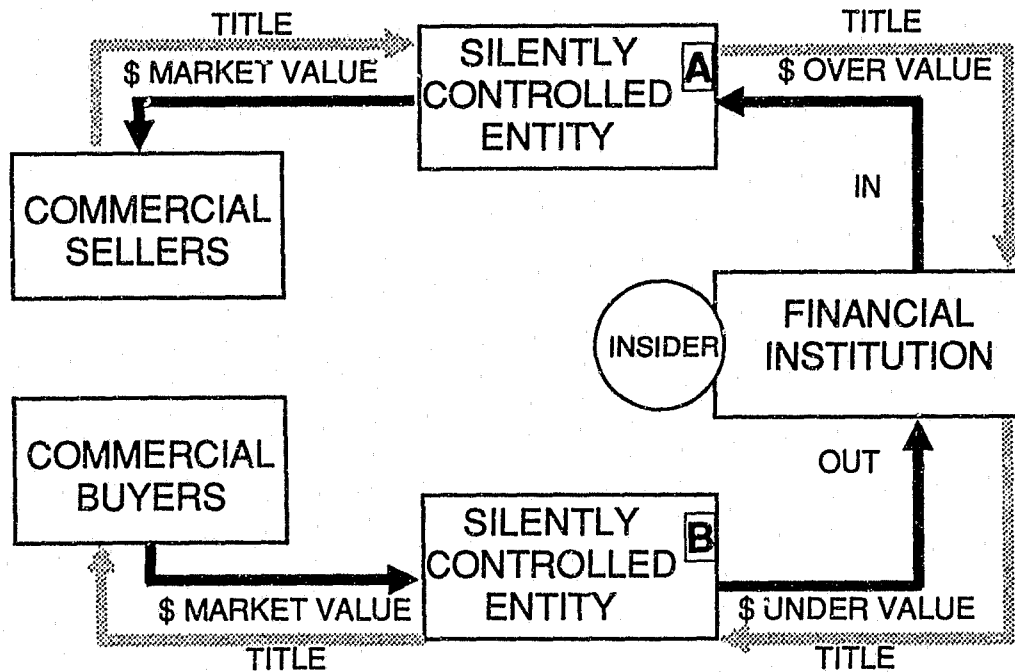
- *
 ————— CASH TRANSFER
 ————— VISIBLE MONEY TRANSFER
 TITLE/OWNERSHIP

COMBINATIONS, LOOTING A FINANCIAL INSTITUTION*

SET-UP



BUY LOW - SELL HIGH



*

- CASH TRANSFER
- VISIBLE MONEY TRANSFER
- TITLE/OWNERSHIP
- CONTROL

APPENDIX B

DRUG TRAFFICKING NETWORKS

Drug trafficking is a business activity. Its participants engage in it for profit on a continuous basis. An observer may discern the "business" structure by noting relationships formed by its participants in their repeated dealings. In observing the form of organization of the business, law enforcement may also learn important facts relating to its vulnerabilities. An accurate view of the organizational structure of the drug trafficking business may lead to new and more successful strategies of control.

Organizational Models

Drug trafficking is characterized by an absence of a formal corporate or military style of organization. Its form of organization is described here as a network. Network organization is a structure that arises naturally among people as they carry on continuous long-term activity requiring numerous participants.

Example of Legitimate Networks

Network organization is not inherently illegal. A number of legitimate industries offer examples of networks in operation. The real estate development industry in any given locality is a familiar example of business activity that uses network organization. It is typified by a network of people who interact at various levels of dominance with no single person in charge. Some individuals are recognized as having the power and ability to coordinate large ventures, however. These elite members may conceive of ventures or may, by their power and ability, assume dominant roles in ventures begun by others. They may control a group of participants through a formal mechanism, such as their own development company, but they depend heavily on being able to assemble people, capital, and assets controlled by others. This extended group of participants is generally gathered from contacts, acquaintances, past business associates, and known resources. Group members generally are recruited for a role they have performed before, such as financier, prime contractor, subcontractor, or seller. They retain substantial discretion and autonomy in performing their roles; if they do not agree with the method of operation, or believe it to be unprofitable to them, they may decline the invitation to join or may discontinue their association. Participants are rewarded for effective performance of their roles within a given venture, generally from the proceeds of the venture itself.

Participants often fulfill their own roles by further networking. For example, a building contractor taps his own network of subcontractors for certain tasks and a financier approaches his financial sources. The assets needed for the venture are those of the participants and are not owned by the venture itself as a separate entity. They are contributed with varying degrees of assurance and security, most often secured by other assets of the participants or even by their promise alone.

Opportunities developed by participants during the venture are generally their own to pursue; indeed, the hope of developing and pursuing derivative opportunities is often a major incentive for joining the venture. This structure of organization is ideally suited to taking full advantage of new opportunities rapidly, as fluid formation of projects and partnerships is the norm.

Participants, even dominant ones, often do not know the identities of all or even most of the other participants, and have only a general idea of each role being filled. Knowledge of others' activities is complicated by the fact that participants in the venture bring shifting subnetworks into the network and deal with nonmembers in their own names and capacities rather than as representatives of the venture per se.

The Drug Trafficking Model

Drug trafficking is structured on the network model; it is primarily a network structure containing more or less dominant figures in various roles. Like the real estate industry, with its roles of financing, developing, constructing, selling, and so forth, drug traffickers also tend to play definable roles. Cocaine trafficking, for example, requires production, processing, transportation, distribution, and money laundering. Other cocaine industry participants work closely with people who engage in criminal activities necessary to generate the money needed by purchasers, such as fencing and fraud. The real estate industry generates support service business roles, such as specialized legal and financial advice, contract law, tax specialists, and experts in licensing and regulation. The cocaine industry also generates support service businesses. They include criminal defense lawyers, specialized money launderers, and financial advisers.

The cocaine industry is not able to rely exclusively on contract law as an internal enforcement mechanism. It relies, instead, on violence for enforcement. The analogues to real estate's experts in licensing and regulation are the cocaine industry's "fixers," negotiators for territories, and providers of political protection.

Enterprises within the network may be integrated vertically, participating in several or even all of the roles of the industry, or they may specialize in only one role, such as money laundering, transportation, or distribution.

Network Strategies

Strategies of the criminal network are predictable because of its structure. The success of the individual participant depends on his power to reach out rapidly to trusted associates for financing, for needed physical assets, and for people to do specific tasks. While reaching out, he must be protected from external interference by competitors and especially by law enforcement, which in turn requires protection from disloyalty within the group. The dominant network member seeks to maximize his ability to bring his assets to bear on ventures—not only human, physical, and cash assets, but intangible assets as well. For example, willingness to use violence to enforce loyalty and a capacity to corrupt in order to obtain protection from law enforcement and from direct competitors are two of a participant's most critical assets. Finally, since contacts and familiarity with a given business are developed over time, personal experience is a key asset.

The participant's secondary strategy, beyond personal success in particular ventures, is to maximize the assets of his own enterprise and even those of the network as a whole. In keeping with this, the goal of the network as a system, or of particular enterprises existing within it over time, is to maximize the sum of all of its assets, a measure of both its power to take advantage of opportunities and its profitability in terms of both high profits and low risk. Network participants have some community of interests and goals that they pursue in loose cooperation despite internal competition. Corruption accomplished by one participant, for example, may benefit others. Similarly, an industry reputation for violence benefits all members by discouraging or silencing potential witnesses. Of course, cooperation today does not rule out treachery tomorrow.

These general principles are exemplified in a cocaine distribution enterprise. A given participant, say a wholesaler, seeks to maximize his "assets" so as to become or remain a dominant member. The assets he requires include dependable sources of good product, trustworthy transportation to and from his location, and a network of distributors. If he chooses to be personally responsible for transportation, he may elect to control such physical assets as load cars, planes, or recreational vehicles. He must also control safe locations for storing, cutting, and distributing the cocaine, and must develop a secure method of communication, such as a beeper setup. His greatest personal necessity, of course, is a sure method of converting cash received from distributors into usable personal gain through some laundering process. His most critical organizational need is to develop a secure method of paying for the goods, services, and property he must have to continue operations.

As a precondition to enjoyment of his profits, he must also maintain the loyalty of key personnel assets and of all persons who have sufficient knowledge to do harm if the enterprise is investigated. He may seek loyalty by developing personal ties, by paying well, or by promoting the reputation of his group for size, longevity, and ruthlessness. He may also pay special attention to screening potential associates. Some of these tactics are carried to extremes in outlaw biker groups and La Cosa Nostra, both of which emphasize barriers to membership. Ethnic drug enterprises emphasize familial and financial ties.

Finally, the dominant network member must seek favorable relationships with other dominant participants in the industry, including law enforcement, to facilitate present and future ventures. His future power is directly dependent on his closeness to more powerful figures and those who can provide necessary goods and services.

Component Analysis

Viewed as the sum of its components, the network has other important law enforcement implications. The delivery of drugs to consumers requires a number of acts in furtherance of the overall objective. The drug must be produced, processed, transported, and distributed; profits must be laundered for network expenses and personal use; and the entire delivery process must be concealed and insulated from competitors and law enforcement. Each of these tasks is a component of the network as a whole. If a particular component is necessary to the ultimate delivery of a particular drug, its successful elimination stops the flow of drugs through the network, even if other components are still capable of functioning well. The idea of attacking vulnerable components of the drug industry is, of course, as old as drug enforcement. Interdiction, which attacks the transportation component, is an obvious example of the application of this observation.

Dividing drug trafficking networks into components provides a powerful analytical tool. Different drug networks have different components depending on many circumstances, including the drug involved, its origins, the background and methods of key participants, and local market factors. The formulation of component diagrams and their uses are described below.

The Network Diagram

A diagram of the general drug network model follows as *Exhibit B-1 (page 53)*.

Each component of the general drug trafficking industry is represented as a triangle. The size and shape of each triangle reflect the size and "shape" of the component it represents. It has been observed that at the lowest level of participation within an activity, there are a relatively large number of participants, and at the highest level there are relatively few. A tall triangle indicates greater distance between the highest and lowest levels within the component, and a flat triangle indicates

a relatively shorter spread between high- and low-level participants. For example, if marijuana were grown in State A on ranches typified by a ranch owner-operator, a midlevel of foremen, and a large group of poorly paid casual wage laborers, the production component of the domestic marijuana industry for State A would be a very flat triangle. If the marijuana were marketed through sales to a small number of large dealers, who in turn sell to increasingly smaller wholesalers, who sell to retailers, who sell to user-sellers, who sell to casual users, the sales component of the local marijuana industry in State A would be a tall triangle.

Exhibit B-1 is a generalized example. A diagram of a specific drug delivery network in a given area would reflect the particular components of that industry and their peculiar shapes and sizes. A network diagram can aid in visualizing the flow of drugs and money, the component makeup of the industry, and some of the significant facts about the internal composition of the components themselves.

Using the Network Diagram for Strategy Planning

A network diagram is static. It depicts the circumstances in the particular drug network (or, of course, any other criminal industry) at a given time and has several strategic functions.

The creation of a diagram requires discussion of the network among those who have direct information. It gives structure to the discussion, allows different points of view to be examined systematically, and provides a basis for compromise and for reasoned arguments favoring one proposed diagram or another. Through formulation of such diagrams, narcotics officers, supervisors, prosecutors, and analysts are encouraged to share and debate the economic and sociological circumstances that go into strategy formation.

The model, once completed, may suggest strategies of network control. Three lines of inquiry are suggested.

First, key components should be examined for vulnerability. Each component identified should be assessed for its necessity to the industry, its potential vulnerabilities, and possible plans of attack using reasonably available resources and considering the likely network response to such attacks. For example, a methamphetamine diagram would include precursor chemical supply as a component. If reduction of the possession and sale of precursors could realistically be accomplished, it should be considered as a goal of the methamphetamine control effort.

The second use of the model is a corollary of the first. Components not only must function if the network is to provide drugs, but they must function in concert. Therefore, links between key components may be vulnerable even when the component itself is less vulnerable. Cooperation and communication between components can be disrupted in a number of ways. Individuals responsible for strategy planning should remain alert to opportunities between components, as well as within specific components.

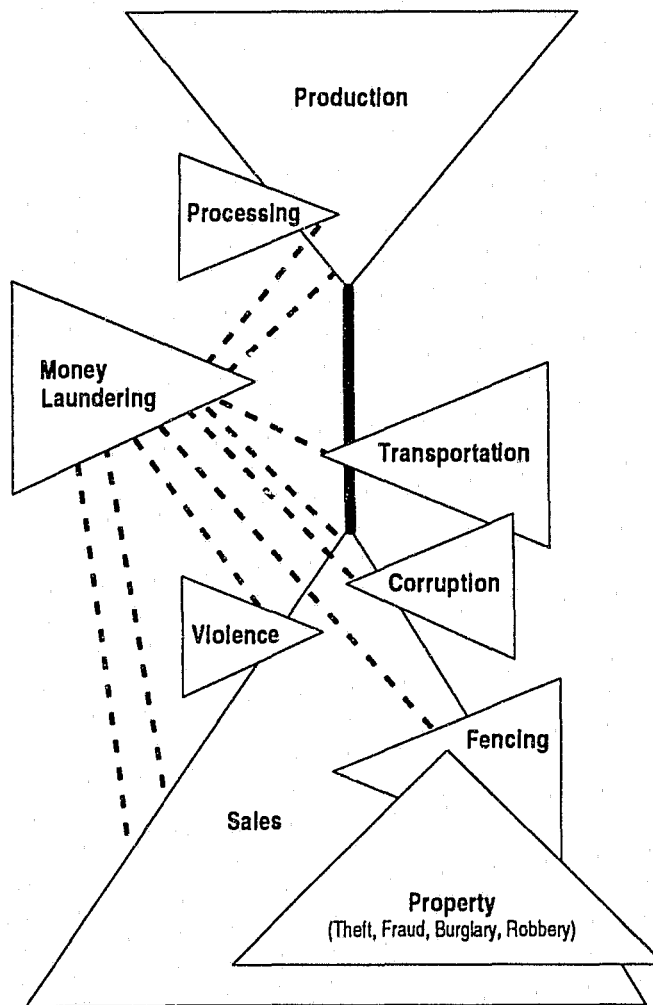
The third line of inquiry suggested by the diagram is identification of key assets, both physical and human, for removal. Strategic types of assets should be identified first. Then, as intelligence develops, specific items and people should be selected. The specific types of things or people designated as "key" depends in large part on the judgments made earlier regarding which links between components are keys to the particular attack.

The model-testing process may also help prevent strategic errors in assessing vulnerability by helping to visualize the likely results of a particular strategy. For example, the likely result of attacking the upper echelons of indigenous ghetto heroin dealers may be their replacement by competing traditional organized crime dealers, who may be less susceptible to prosecution due to

established corruption. The original plan of attack could, therefore, result in a net gain in the power of the network. The strategy could be amended to prevent strategic error by including a policy of first selecting organized crime defendants.

The objective of relating specific information about a given drug subindustry to a model and examining the model systematically for strategic suggestions is to create a plan to change the realities of that subindustry. If the effort succeeds, the model will change to reflect the new circumstances. The strategy formation process must therefore continue to evolve as the subindustry and other circumstances change.

Exhibit B-1 General Drug Network Model



APPENDIX C

SAMPLE LEGISLATION

To some extent, a money laundering strategy will depend on an adequate statutory foundation. Money laundering, in the sense of the knowing participation in the finances of crime, is prosecutable under such general theories as aiding and abetting, facilitation, and conspiracy. Specialized money laundering legislation, however, has proven extremely useful. Federal racketeering (RICO) and Continuing Criminal Enterprise (CCE) legislation in 1970 has been followed by RICO statutes in 29 states to date. Starting with Arizona's money laundering statute in 1985, the states and the federal government have specifically criminalized money laundering. Legislation and administrative action in related fields may be of great importance as well. Several states, including Florida and Georgia, have duplicated the federal Bank Secrecy Act's Currency Transaction Report (CTR) system at the state level. California has improved on the idea by gaining access to Treasury Department computer tapes of California CTR transactions. Those computer tapes are transferred to state officials on a regular basis. This process cuts out the cost of inputting the same federal CTR information again by California state personnel. Arizona's use of a similar program is discussed in the body of this report.

The Arizona state statute follows as *Exhibit C-1 (page 57)*. Some states have subjected money laundering to civil remedies, including forfeiture. The most effective state civil legislation subjects a money launderer to joint and several liability for the gross gain of an entire enterprise and subjects an entire enterprise to forfeiture if it is used for money laundering. Substantial civil liability for money launderers not only is appropriate (and even poetic) justice, but also is attractive to judges and juries who may hesitate to treat money laundering as the moral and legal equivalent of dealing narcotics. In jurisdictions where such statutory authority, or legal theories or authority that may accomplish the same goal through different means, is not available, enactment of such legislation should be a top priority.

The next generation of civil remedies statutes will provide specific liability for facilitators of criminal networks. A partial model for such liability, excerpted from a comprehensive model legislation package, is attached as *Exhibit C-2 (page 59)*.

Regulatory action may also be needed to counter the use of unregulated money transmitters for the purpose of money laundering. Money transmitters, especially the casa de cambios at the Mexican border, have become a major money laundering mechanism.

Arizona drug investigators have encountered casa-de-cambio money laundering on a massive scale. A single account held in an Arizona bank by a Mexican casa, used to launder money for a major importation cartel, did over \$30 million worth of transactions per year. The drug transporter receives the payment for drugs at the wholesale transaction in the U.S. He smuggles the cash into Mexico by courier and has it deposited in the casa. The casa has an account in an Arizona bank in the name of the casa. If the deposit is by cash (and not the common method of wire transfer), the CMIR prepared upon entry to the U.S. and the CTR completed at the bank upon deposit are in the name of the casa or the courier. No trail leads to the drug transporter/depositor, but the casa operator uses the funds as directed by the depositor.

For example, if the depositor wants to buy Arizona real estate, he simply calls the casa operator and tells him the escrow number, the name of the straw party who is purporting to make the purchase,

and the amount to be sent. The casa operator buys a cashier's check in the name of the straw person, payable to the escrow, and sends it to the escrow office. Even if the cashier's check is traced, it leads only to the "omnibus account" of the casa. Arizona, in cooperation with the Conference of Border States' Attorneys General and with the assistance of FinCEN and the newly formed Money Transmitter Regulators Association, is preparing legislation to regulate money transmitters. A draft of that legislation is outlined in Exhibit C-3¹ (page 61).

NOTE

¹ The initial draft of this legislation was prepared by James Preston and others in the Arizona Attorney General's Office. The draft included here reflects substantial changes and improvements that have grown out of conferences with regulatory and industry representatives.

Exhibit C-1

Arizona State Statute

§ 2317. Money laundering; classifications; definitions

A. A person is guilty of money laundering in the second degree who:

1. Acquires or maintains an interest in, transacts, transfers, transports, receives or conceals the existence or nature of racketeering proceeds knowing or having reason to know that they are the proceeds of an offense.

2. Makes property available to another by transaction, transportation or otherwise knowing that it is intended to be used to facilitate racketeering.

3. Conducts a transaction knowing or having reason to know that the property involved is the proceeds of an offense and with the intent to conceal or disguise the nature, location, source, ownership or control of the property or the intent to avoid a transaction reporting requirement under title 6, chapter 12. 1

B. A person who knowingly initiates, organizes, plans, finances, directs, manages, supervises or is in the business of money laundering is guilty of money laundering in the first degree.

C. Money laundering in the second degree is a class 3 felony. Money laundering in the first degree is a class 2 felony.

D. In this section:

1. "Acquire" and "proceeds" have the same meaning as prescribed in § 13-2314.

2. "Financial instrument" and "racketeering" have the same meaning as prescribed in § 13-2301.

3. "Transaction" means a purchase, sale, trade, loan, pledge, investment, gift, transfer, transmission, delivery, deposit, withdrawal, payment, transfer between accounts exchange of currency, extension of credit, purchase or sale of any financial instrument or any other acquisition or disposition of property by whatever means.

Amended by Law 1991, Ch. 151, § 5.

1 Section 6-1201 et seq.

Historical and Statutory Notes

The 1991 amendment rewrote subsecs. A and D.

Cross References

Money laundering, reports by transmitters and investigations by attorney general, see §§ 6-1241, 6-1242.

Exhibit C-2

MONEY LAUNDERING: MODEL CIVIL SANCTIONS

SECTION [] MONEY LAUNDERING AND ILLEGAL INVESTMENT: PENALTY: CIVIL SANCTIONS

(a) (1) IT IS UNLAWFUL FOR ANY PERSON WHO KNOWS THAT THIS PROPERTY INVOLVED IS THE PROCEEDS OF SOME FORM OF UNLAWFUL ACTIVITY, TO KNOWINGLY TRANSPORT, RECEIVE OR ACQUIRE THE PROPERTY OR TO CONDUCT A TRANSACTION INVOLVING THE PROPERTY, WHEN, IN FACT, THE PROPERTY IS THE PROCEEDS OF SPECIFIED UNLAWFUL ACTIVITY.

(2) IT IS UNLAWFUL FOR ANY PERSON TO MAKE PROPERTY AVAILABLE TO ANOTHER, BY TRANSACTION, TRANSPORTATION OR OTHERWISE, KNOWING THAT IT IS INTENDED TO BE USED FOR THE PURPOSE OF COMMITTING OR FURTHERING THE COMMISSION OF SPECIFIED UNLAWFUL ACTIVITY.

(3) IT IS UNLAWFUL FOR ANY PERSON, KNOWING THAT THIS PROPERTY INVOLVED IN THE TRANSACTION IS THE PROCEEDS OF SOME FORM OF UNLAWFUL ACTIVITY, TO KNOWINGLY CONDUCT A TRANSACTION WHICH, IN FACT, INVOLVES PROCEEDS OF SPECIFIED UNLAWFUL ACTIVITY, THE PURPOSE OF WHICH, IN WHOLE OR IN PART, IS EITHER TO CONCEAL OR DISGUISE THE NATURE, LOCATION, SOURCE, OWNERSHIP, OR CONTROL OF THE PROPERTY OR TO AVOID A TRANSACTION REPORTING REQUIREMENT UNDER STATE OR FEDERAL LAW.

(4) IT IS UNLAWFUL FOR ANY PERSON, KNOWING THAT THE PROPERTY INVOLVED IN THE TRANSACTION IS THE PROCEEDS OF SOME FORM OF UNLAWFUL ACTIVITY, TO KNOWINGLY ENGAGE IN THE BUSINESS OF CONDUCTING, DIRECTING, PLANNING, ORGANIZING, INITIATING, FINANCING, MANAGING, SUPERVISING, OR FACILITATING TRANSACTIONS INVOLVING PROPERTY WHICH, IN FACT, IS THE PROCEEDS OF SPECIFIED UNLAWFUL ACTIVITY.

(b) AS USED IN THIS SECTION—

(1) THE TERM "PROCEEDS" MEANS PROPERTY ACQUIRED OR DERIVED DIRECTLY OR INDIRECTLY FROM, PRODUCED THROUGH, OR REALIZED THROUGH, AN ACT;

(2) THE TERM "PROPERTY" MEANS ANYTHING OF VALUE, AND INCLUDES ANY INTEREST IN PROPERTY, INCLUDING ANY BENEFIT, PRIVILEGE, CLAIM OR RIGHT WITH RESPECT TO ANYTHING OF VALUE, WHETHER REAL OR PERSONAL, TANGIBLE OR INTANGIBLE;

(3) THE TERM "SPECIFIED UNLAWFUL ACTIVITY" MEANS ANY ACT, INCLUDING ANY PREPARATORY OR COMPLETED OFFENSE, COMMITTED FOR FINANCIAL GAIN WHICH IS PUNISHABLE [AS A FELONY] [BY CONFINEMENT FOR MORE THAN ONE YEAR] UNDER THE LAWS OF THIS STATE, OR, IF THE ACT OCCURRED OUTSIDE THIS STATE, WOULD BE PUNISHABLE [AS A FELONY] [BY CONFINEMENT FOR MORE THAN ONE YEAR] UNDER THE LAWS OF THE STATE IN WHICH IT OCCURRED AND UNDER THE LAWS OF THIS STATE, INVOLVING:

(i) TRAFFICKING IN CONTROLLED SUBSTANCES, HOMICIDE, ROBBERY, EXTORTIONATE EXTENSIONS OF CREDIT, TRAFFICKING IN EXPLOSIVES OR WEAPONS, TRAFFICKING IN STOLEN PROPERTY, OR OBSTRUCTION OF JUSTICE;

(ii) [REFERENCE TO SUCH OTHER STATE OFFENSES AS ARE APPROPRIATE];

(iii) [FOR STATES WITH STATE RACKETEERING OR CRIMINAL PROFITEERING STATUTES, REFERENCE TO THE RACKETEERING OFFENSES, E.G, ILLEGAL INVESTMENT IN AN ENTERPRISE, ILLEGAL CONTROL OF AN ENTERPRISE, ILLEGAL CONDUCT OF AN ENTERPRISE];

(4) THE TERM "TRANSACTION" INCLUDES A PURCHASE, SALE, TRADE, LOAN, PLEDGE, INVESTMENT, GIFT, TRANSFER, TRANSMISSION, DELIVERY, DEPOSIT, WITHDRAWAL, PAYMENT, TRANSFER BETWEEN ACCOUNTS, EXCHANGE OF CURRENCY, EXTENSION OF CREDIT, PURCHASE OR SALE OF ANY MONETARY INSTRUMENT, OR ANY OTHER ACQUISITION OR DISPOSITION OF PROPERTY BY WHATEVER MEANS EFFECTED.

(c) A PERSON WHO VIOLATES:

(1) PARAGRAPH (1), (2) OR (3) OF SUBSECTION (a) OF THIS SECTION IS GUILTY OF A CRIME AND UPON CONVICTION MAY BE IMPRISONED FOR NOT MORE THAN [] YEARS, FINED NOT MORE THAN [] OR TWICE THE VALUE OF THE PROPERTY INVOLVED, WHICHEVER IS GREATER, OR BOTH;

(2) PARAGRAPH (9) OF SUBSECTION (a) OF THIS SECTION IS GUILTY OF A CRIME AND UPON CONVICTION MAY BE IMPRISONED FOR NOT MORE THAN [] YEARS, FINED NOT MORE THAN [] OR TWICE THE VALUE OF THE PROPERTY INVOLVED, WHICHEVER IS GREATER, OR BOTH;

(d) A PERSON WHO VIOLATES ANY SUBSECTION OF THIS SECTION IS SUBJECT TO A CIVIL PENALTY OF THREE TIMES THE VALUE OF THE PROPERTY INVOLVED IN THE TRANSACTION, IN ADDITION TO ANY CRIMINAL SANCTION IMPOSED.

(e) [REFERENCE TO STATE RACKETEERING STATUTES, IF ANY, MAKING MONEY LAUNDERING A PREDICATE OFFENSE AND INCORPORATING CIVIL FORFEITURE REMEDIES.]

Exhibit C-3

Arizona's Money Laundering/Money Transmitters

Legislation of 1991

H.B. 2329

The Arizona Legislature, in its 1990-1991 session, enacted a comprehensive bill designed to protect consumers against the financial failure of money transmitters and to provide law enforcement with regulatory, reporting, civil and criminal tools to prevent and remedy the use of money transmitters in the facilitation of financial crimes. The bill, H.B. 2329, 1) regulates money transmitters; 2) requires comprehensive financial transaction reports to be made to the Attorney General's Office; and 3) amends A.R.S. § 13-2317, Money Laundering, to expand the basic offense and to create two new offenses which are operative in both criminal prosecution and predicates for civil racketeering remedies.

I. The Statute

Rationale

This act furthers the alliance between legitimate commerce and law enforcement against money laundering and protects consumers from loss in the event of the failure of a money transmitter to whom they have entrusted money.

Drug money flows through Arizona at the rate of \$2-\$4 billion per year, according to conservative law enforcement estimates. The cash excess in the Federal Reserve Bank in Los Angeles, to which Arizona banks send their excess cash, rose by 2,192% from 1985 to 1988. State officials need transaction reports from businesses to study, detect and prosecute money laundering effectively. These reports are required by federal law, but are not available to state banking or prosecutive authorities. This act makes comprehensive reports available to state authorities and to the Attorney General. The act also makes it a state crime to falsify or avoid such reports.

The use of non-bank financial institutions has risen dramatically over the past ten years. Millions of Americans have no bank account and pay bills through the purchase of money orders and similar "payment instruments." Hundreds of millions of dollars are in the process of payment through this means at any given time. These payments are not federally insured, so they are only as certain as the issuer of the instrument. Several large failures have occurred in other states, causing scores of millions of consumer dollars to be lost. The consumers who use these services tend to be poor people who can least afford losses. The weak economy increases the risk of substantial loss.

Arizona has been one of only a few states that do not regulate money transmitters. This act protects consumers by assuring that only people with financial stability, fraud free histories, and the ability to cover their outstanding obligations engage in this quasi-banking industry. The act requires financial reports and access to records to assure that the Superintendent of Banking knows

of imminent failures in time to prevent consumer losses. It gives him the same kind of powers to take preventive steps that he has in connection with other similar businesses.

This act is the product of over a year of drafting and meetings among industry representatives, the Superintendent of Banking, the Attorney General's Office, national regulatory associations and state and federal money laundering law enforcement specialists. It creates a workable and well-integrated approach to both its money laundering and licensing goals, one that emphasizes the needs of industry and minimizes expense to industry and to the public.

II. Section by Section Analysis

Article 1 - Regulation

Sections 1, 2 and 3 - Amendments to Title 6 - Various conforming amendments are made to the financial regulation laws to accommodate the new chapter 12, set fees etc..

Section 4 - Licensing for money transmitters similar to present licensing of banks, money lenders, mortgage bankers, and others.

6-1201 - Definitions.

6-1202 - Requires a license for covered activity and establishes jurisdiction over activity occurring in this state.

6-1203 - Exempts from licensing governmental entities, banks, bank holding companies, credit unions, savings and loans, savings banks and other financial businesses now licensed under Title 6. Also exempts check cashers and foreign money exchangers that do not engage in transactions beyond those two lines of business.

6-1204 - The application process is similar to that for other licensed financial businesses.

6-1205 - A licensee must maintain a bond for the protection of people injured by the licensee's default or fraud. The bond is \$25,000 for up to 5 locations, \$100,000 for more than 5 but less than 21 locations, an additional \$5,000 each for each location over 21 but fewer than 200 locations, to a maximum of \$250,000, and an additional \$5,000 for each additional delegate to a maximum of \$500,000. The licensee may post alternatives to a bond.

6-1206 - Licenses must be granted or denied within 120 days of application, or the application is deemed approved. Provision is made to keep track of the names and addresses of new branch offices and delegates, but they can be added by the licensed business before approval is obtained.

6-1207 - Licensees may do business through branch offices.

6-1208 - Licensees may do business through delegates, called "authorized delegates." The Superintendent of Banking has the power to do examinations and issue orders to prevent abuses by delegates similar to powers over similar financial businesses. Licensees are assured some protection

against wrongdoing or default by their delegates, but are responsible to the public for the acts of their delegates.

6-1209 - The Superintendent may issue cease and desist orders.

6-1210 - The Superintendent has suspension and revocation powers as in other cases.

6-1211 - Quarterly and yearly financial reports are required.

6-1212 - Licensees must be able to cover what their customers have entrusted to them.

6-1213 - Regular records must be kept and made available for examinations.

6-1214 - Licensees must stand behind their money orders, etc.; if their delegate in Arizona goes bankrupt, they must make good on the money orders their delegate sold to customers here.

6-1215 - Transaction records sufficient to give victims of default or investigators a paper trail must be kept.

6-1216 - A person cannot buy control of a licensee if they could not have gotten a license themselves. Provision is made to prevent licensing issues from delaying business deals.

6-1217 - Arizona courts and the Superintendent have jurisdiction even if the person failed to get a license.

6-1218 - People who claim to be delegates of others who have no license are prevented from escaping liability.

6-1219 - A false statement in connection with licenses is made a class 3 felony. Failure to permit lawful investigation is made a class 6 and felony.

Article 2 - Money Laundering

6-1241 - Licensees, delegates and money transmitters are required by state law to conform to various current reporting requirements as defined in current federal laws. These laws require transaction reports to branches of the U.S. Department of Treasury that are useful in developing and updating money laundering strategy and detecting and prosecuting specific money laundering activity. The state requirements adopt federal law and regulations so that the affected businesses do not need to learn any new system or new forms. Compliance with the federal law is deemed compliance with state law. Whatever form of compliance is permitted federally, electronic or otherwise, is permitted under the new state law. Duplicate records do not even have to be made unless the federal reports are not made available to the state.

6-1242 - The Attorney General is given access to money transmitter records.

Section 5 - Amendments to A.R.S. § 13-2317 - Money Laundering

Two new subsections and some definitions are added to criminalize facilitation of racketeering by supplying property knowing that it is intended for use to facilitate racketeering and to criminalize conducting transactions with knowledge that the property involved is criminal proceeds and with the intent to conceal or with the intent to avoid one of the transaction reporting requirements created in new chapter 12 of Title 6.

Section 6 - The effective date of the licensing provisions of the chapter is delayed until November 1, 1991 to provide smooth transition for industry. The balance of the bill is effective as of 90 days from the end of the legislative session, meaning about September 19 - 20, 1991.

III. Effects on Enforcement

A. Regulatory Enforcement

Regulation of money transmitters as such is new to Arizona. The major effects of this statute will be in three related areas.

First, regulation will prevent entry into the business by unsuitable corporations. Applicants who do not demonstrate suitable "financial condition and responsibility, financial and business experience, character and general fitness" will not be accepted.

Second, licenses may be suspended or revoked for general competence, experience and integrity reasons, or for insolvency. The superintendent has broad discretion to apply A.R.S. § 6-1210 to remove licenses for such reasons for the protection of the public.

Third, licenses may be revoked for failure to comply with the various anti-money laundering provisions or reporting requirements. Even the conduct of an authorized delegate may result in the loss of a license if the authorized delegate violates title 13, chapter 23 (covering organized crime and racketeering, including money laundering) title 6, chapter 12 or rules adopted under title 6, chapter 12, if the delegate's conduct was the "result of a course of negligent failure to supervise or...of the willful misconduct of the licensee." These provisions are of great practical significance, because major money transmitters (American Express, Traveller's Express, Western Union, etc.) have enormous economic incentive to police their own delegates and thereby avoid revocation proceedings. Loss of a license in one state may automatically trigger proceedings in other states against the same licensee, with huge economic risks to the major operator. Law enforcement may therefore rely on the licensee to cooperate in the investigation of their own delegates and, more importantly, in their maintenance of internal compliance programs designed to assure strict compliance with required reporting and recordkeeping provisions.

Transaction Reporting Requirements

The transaction reporting requirements of new A.R.S. § 6-1241 generally parallel current federal transaction reporting requirements on those who must make reports, the contents of the reports and the circumstances that trigger the obligation to report. The reports are designed to provide law enforcement with data from which law enforcement may make general resource allocations, improve geographic and business sector targeting, focus on specific individuals and businesses, and assist in the proof of cases under investigation. The reports are:

6-1241(A) - Suspicious Transaction Reports

The suspicious transaction report is a successor to the current voluntary system of reporting suspicious financial transactions. The obligation is on all money transmitters, as defined in A.R.S. § 6-1201(10). The form of the report is within the discretion of the Attorney General, and is not yet finalized. A copy of the current voluntary form, called an "MLR," is attached as Appendix 1. The new form will be similar.

6-1241(B) - Currency and Foreign Transactions Reporting Act Reports

This subsection also applies to all money transmitters, but, unlike 6-1241(A), only imposes a duty to report if the transmitter is required to file under 31 U.S.C. 5311-26 and the relevant federal regulations. It therefore does not impose a reporting duty on non-transmitters or on any person who is not presently obliged to file under federal law. These criteria have different effects on different reports. The reports required under 6-1241(B) are:

1) Cash Transaction Reports ("CTR's")

A money transmitter must file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to the transmitter if the transaction involves more than \$10,000 in currency. Under various circumstances, multiple transactions are to be totalled and treated as a single transaction ("aggregated") for the purpose of reporting. The CTR form currently in use is attached as Appendix 2.

2) Casino Reports

Casinos are separately required to file forms similar to the CTR by federal law, and therefore by A.R.S. § 6-1241(8). Since casinos are not legal in Arizona, this will have limited application.

3) Reports of Transportation of Currency or Monetary Instruments ("CMIR's")

Federal law requires that each person who physically transports (including mails or ships) or causes to be transported or attempts to transport currency or other monetary instruments in an aggregate amount of over \$10,000 at one time in or out of the United States, or receives such currency or monetary instruments from abroad, must make a report of that event. A monetary instrument includes currency, traveler's checks, and negotiable instruments or securities in bearer form or made to a fictitious payee or in such a form that title passes on delivery. The federal requirements contain numerous exemptions for legitimate commercial entities. The state statute automatically incorporates all of the federal exemptions. It further reduces its impact by requiring reports only of "money transmitters," *not* of all "persons." Therefore, individuals and businesses who are not money transmitters as the term is defined in A.R.S. § 6-1201(10) are not required to make a state CMIR report. The CMIR form is attached as Appendix 3.

4) Reports of Foreign Financial Accounts ("FBAR's")

Under federal law, each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) that has an interest in or authority over a bank, securities or other financial account in a foreign country must report that relationship each year. These are sometimes called "Foreign Bank Account Reports" or "FBAR's." As with CMIR's, the Arizona requirement applies only to money transmitters, and not to all persons. These reports may have great significance despite the limited application, since non-bank money transmitters such as casa de cambios will have to disclose Mexican accounts. The FBAR form is Appendix 4.

6-1241(C) - Reports of Receipt of More Than \$10,000 in a Trade or Business (Form 8300)

All persons engaged in a trade or business, whether or not they are money transmitters, who receive more than \$10,000 in cash or a cash equivalent in one transaction (or in two or more related transactions) must file a report of the transaction. The report is to contain the information contained in the federal IRS Form 8300. The 8300 form is attached as Appendix 5.

6-1241(D) \$3,000 Logs

All money transmitters who are required by federal law to keep so-called "\$3,000 logs" must keep them for the Attorney General as well. These logs are required whenever a financial institution sells a bank check or draft, cashier's check, money order, or traveler's check for \$3,000 or more in currency (including contemporaneous purchases totalling \$3,000). If the purchaser has a deposit account with the financial institution their identity must be verified and the basic information about the transaction noted: name, account number, date, branch, type of instrument, serial number, and dollar amount. If the purchaser does not have a deposit account, their identity must be verified by identification provided, including the identity of any person for whom they are dealing, and the same data collected and logged. The logs must be available for inspection at any time.

6-1241(E) Targeting Projects

The banking superintendent may require additional recordkeeping in a specified geographic area for a sixty day period. This provision is modeled on 31 U.S.C. 5326. It is intended to allow the superintendent to gather financial report data on a more comprehensive basis than allowed by the other financial reporting requirements, and to address specific money laundering problems.

Non-Duplication of Reports

The financial transaction reports required by A.R.S. § 6-1241 are of four types: CTR's (including casino reports), CMIR's, FBAR's, and 8300's. The Arizona Attorney General's Office has been operating under a Memorandum of Understanding (MOU) with the U.S. Department of the Treasury since 1989 for access to Arizona-related CTR's and CMIR's. This MOU allows the Attorney General to obtain computer tapes containing all of the Arizona-related CTR's and CMIR's on a regular basis from the federal data center. Access is very inexpensive, since no data entry is required, and is rapid enough to be useful.

The FBAR's relating to money transmitters and the 8300's are not covered by any memorandum of understanding.

New A.R.S. § 6-1241(G) recognizes the present MOU and the possibility that access arrangements may change in the future. It provides that the filing of a report with the appropriate federal agency is deemed to be compliance with the parallel state requirement "unless the attorney general has notified the superintendent that reports of that type are not regularly and comprehensively transmitted by that federal agency to the attorney general." Therefore, no business now filing CTR's or CMIR's in compliance with federal law need file any different or additional report with the state, because the current MOU results in the regular and comprehensive transmittal of those reports to the attorney general. The same is not true of FBAR's or 8300's, however. These will have to be separately made to the attorney general.

Immunity from Liability

A.R.S. § 6-1241(H) and (I) are companion provisions to A.R.S. § 13-2315(D), which provides protection from civil liability for financial institutions that notify law enforcement of possible racketeering violations. These new provisions broaden that protection to cover the broader range of persons involved and to cover keeping and filing reports as well as divulgence of information.

B. Criminal Enforcement

Three substantive changes have been made in A.R.S. § 13-2317. First, the operative verbs in 13-2317(A)(1) have been expanded by the addition of "transacts." This clarifies the statute's application to a person who is involved in a transaction but never has a relationship with the property involved beyond that of, for example, a provider of services, and never has any interest in the property itself. A money transmitter, financial institution or other person may "transact" property under circumstances in which the applicability of "transfer" would be in doubt. The act also defines

"transaction." The wording of the definition is from a DOJ, NAAG, NDAA model statute, which in turn, modified federal law.

New 13-2317(A)(2) is also from the model statute. The model statute, in turn, adapted it from various "illegal investment" provisions, and restructured it to serve its present purpose. This provision is now a sister to the 1990-91 revision to A.R.S. § 13-2308, "Participation in or assisting a criminal syndicate," creating new 13-2308(C):

A person commits assisting a criminal syndicate by committing any felony offense, whether completed or preparatory, with the intent to promote or further the criminal objectives of a criminal syndicate.

Both are targeted at the facilitator, and both fill gaps in the coverage of the general facilitation statute, A.R.S. § 13-1004 or add specific coverage to its provisions. A.R.S. § 13-2317(A)(2) demonstrates that 13-2317 is intended to criminalize all aspects of knowing participation in the finances of crime, whether the participation occurs through provision of property or services and whether it occurs before or after the underlying criminal conduct.

New 13-2317(A)(3) integrates the new reporting requirements into 13-2317. Several aspects are noteworthy. First, unlike 13-2317(A)(1), there is *no* requirement here that the proceeds actually be the proceeds of racketeering. The circumstance portion of this subsection is satisfied if the person knows or has reason to know that the property involved is the proceeds of *any offense*. "Has reason to know" is the same standard as that in 13-2317(A)(1), adopted from A.R.S. § 13-1802(A)(5) relating to the possession of stolen property. "Offense" is defined in 13-105(20), a definition that is broad enough to include minor offenses and offenses that occur outside of Arizona. Thus, knowledge, proven directly or by inference, that the property is the proceeds of any offense, coupled with *either* an intent to conceal or disguise the nature, location, source, ownership or control of the property *or* an intent to avoid a transaction reporting requirement, constitutes a class 3 felony.

Two additional criminal enhancements were added directly to Title 6. New A.R.S. § 6-1219 makes it a class 3 felony to make false statements in connection with licenses and a class 6 felony for a licensee to refuse to permit lawful investigation. The refusal to permit language is a reference to new A.R.S. 6-1242, which authorizes investigations of money transmitters and of all persons engaged in a trade or business in connection with reporting requirements or money laundering and requires that all money transmitters and financial institutions "shall make their books and records available to the attorney general during normal business hours."

C. Civil Enforcement

H.B. 2329 provides the foundation for a broad civil remedies attack on money laundering and thereby on any criminal enterprise, syndicate or industry that requires money laundering for continued vitality.

Regulatory action forms the first level of civil enforcement. First, the licensing provisions relating to money transmitters will preclude operation of such businesses by those whose background, reputations or financial instability forecast unreliability. Second, license maintenance requires

continued adherence to strict standards, including keeping records and providing the required financial reports. Businesses suspected of money laundering will become vulnerable to law enforcement investigation coupled with regulatory action. For example, a series of undercover transactions or transactions that come to light in an investigation of a customer may lead to license revocation.

Civil racketeering actions form the second level of civil enforcement. Money laundering, including the type of money laundering that flows from evasion of reporting requirements, is a racketeering predicate listed in A.R.S. § 13-2301(D)(4). Therefore, under A.R.S. § 13-2314, property used to facilitate the offense is subject to forfeiture, as are enterprise assets of an enterprise conducted through money laundering and the proceeds of such an offense. A business used to launder drug money may be subject to forfeiture in its entirety. As with criminal liability, A.R.S. § 13-2317, especially its new provisions, works in tandem with A.R.S. § 13-2308(C) relating to assisting a criminal syndicate. The statutes add a significant risk of financial loss to facilitation of criminal conduct. This risk is intended to counter the motive of financial gain. The knowing provider of goods or services to criminal conduct now bears a substantially increased risk of financial loss. The risk is calculated to prevent people from engaging in the provision of the goods and services. Without these goods and services, sustained organized conduct is not possible.

The use of civil racketeering remedies is expected to be the most effective of the various potential enforcement modes. Money laundering is by its nature a form of facilitation—a service that is vital to the underlying offense but does not necessarily involve actual contact with the underlying offense. A financial advisor to a drug lord, for example, need never touch or see the drugs. Because of the qualifications needed for success as a money launderer, the money launderer tends to be an educated person, and may be a professional person as well. They are, in short, in a position to obtain sympathy from a jury and escape criminal liability based on the jury's feeling that they should not be imprisoned for their role in the drug enterprise, however essential it may have been. The same group of citizen jurors, however, will not be at all reluctant to require disgorgement of the launderer's wealth or to assess financial remedies based on participation in a facilitator's role.

H.B. 2329 represents a major improvement in Arizona's attack on money laundering. It combines regulatory, reporting, criminal and civil remedies in a comprehensive treatment of money laundering. It is now up to law enforcement to fully develop the potential tools that the Legislature has provided.