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The significance of money laundering

The example of the Philippines

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Abstract

Purpose – The purpose of this paper is to examine money laundering generally and the response of one jurisdiction, the Philippines, to international pressure for anti-money laundering measures.

Design/methodology/approach – Money laundering is examined and described. The source of international consensus around the problem is considered. The multilateral response, including the pressure placed on the Philippines as a formerly non-compliant jurisdiction is examined. The initial measures of the Philippines were rejected. Finally the Philippine solutions that ultimately met with international approval are discussed: the establishment of a financial intelligence unit, the regulation of financial intermediaries and the provision of criminal and remedial measures are considered. Civil or non-conviction based forfeiture as a remedial device is given particular attention. Finally the limited jurisprudence on topic is examined.

Findings – The Republic of the Philippines has put forward anti-money laundering provisions that hold the prospect for success. Implementation will be challenging.

Research limitations/implications – Jurisprudence is still developing. This type of litigation takes time. As the financial investigation unit, the intermediaries and the courts respond to cases, there will be developments worthy of further research.

Practical implications – This paper looks at an international problem, money laundering, the multi-lateral response (only Nigeria and Myanmar are non-compliant) and the impact on the Philippines, their financial institutions and laws.

Originality/value – There is no comprehensive overview of the Philippine anti-money laundering law currently available. There is a book published out of Manila (quoted in the paper) but it is out of date and has not caught up to recent developments.

Keywords Money laundering, Criminal forfeiture, Philippines

Paper type Research paper

A remarkable international consensus has developed around the issue of money laundering in the last decade. This paper canvasses the implications of that consensus in one jurisdiction, the Republic of the Philippines[1]. Up until February 11, 2005, the Philippines had been in the list of non-cooperative countries and territories (NCCT) maintained by the Paris based Financial Action Task Force (FATF)[2]. Removal from that NCCT list led to government predictions of greater investment inflow and newspapers lauding the "blacklist" decision[3]. The prospect of continued membership in a rapidly diminishing club could not have been appealing: in 2004, Egypt, the Ukraine and Guatemala had been removed from the list; in 2005, Nauru abolished 400 shell banks and was removed from the list; only Myanmar and Nigeria remain at the

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time of writing. On June 30, 2005, the Philippine Financial Intelligence Unit (FIU) was admitted as a member of the Egmont Group[4].

This paper focuses on two issues. First, what is money laundering? How did a multinational consensus develop and manifest itself into the creation of an international task force and countless FIUs[5]? Of course, money laundering is a complex subject that can be, and in fact is, properly the subject of lengthy textbooks and treatises[6]. The second issue canvassed by this paper examines the response to money laundering in the Philippines, which involved enhanced regulation of financial intermediaries and the creation of an FIU. In addition, anti-money laundering measures were enacted consisting of criminal and regulatory prohibitions on money laundering and remedial civil measures to forfeit the proceeds of unlawful activity.

What is money laundering?

A British government report concluded in 2000 that "70 per cent of recorded crime is acquisitive (Cabinet Office (Performance and Innovation Unit), 2000)." Money laundering is a technique designed to make illicit acquisitive gains appear legitimate, usually by disguising the property's illegal provenance. Illicit gains are converted to a less suspicious form of property to conceal its criminal origin and to fabricate a plausible, legitimate source. Money laundering is no small problem. The International Monetary Fund estimates the aggregate level of money laundering at between 2 and 5 percent of the world's gross domestic product. That is a significant margin of error: between $590 billion and $1.5 trillion (US) (www.imf.org; www.fatf-gafi.org).

Why is money laundered?

If you are operating a profitable but illegal enterprise, your primary objective is to keep the enterprise running while avoiding the scrutiny of law enforcement. If you are caught selling drugs or smuggling people illegally, you are not only out of business, you are likely rotting in jail. To some extent, you can mitigate risks by engaging members of your enterprise in the unlawful activity. The foot soldier who carries drugs or cash across the border, for example, can be handled in a "need to know" manner that minimizes the risk of exposure to the operating mind of the enterprise. The profits that your criminal enterprise produces expose you in an entirely different way.

Consider drug dealing, an illegal enterprise that produces large volumes of cash. Depending on the denominations, cash from street sales of cocaine weigh five to ten times as much as the drugs; by volume, currency takes up considerably more space than the drugs. In 1999, street sales of drugs in the US generated between 13 and 15 million pounds of cash (Nissman, 1999). This volume of cash creates several vulnerabilities. There is the immediate problem of taking the money off the streets. Forty-four pounds of cocaine can generate $1 million dollars which in $10 bills weigh 220 pounds. Gathering and transporting the money makes the dealer vulnerable to law enforcement[7] but also to theft from other dealers. Ostensible wealth and a lavish lifestyle without a legitimate income can attract the unwanted attention of law enforcement.

For someone breaking into the business of financially lucrative crime, there must be some level of frustration when they peer over the fence at the modern international financial system. Money moves around the world, across borders, at the mere click of a button. There are no border guards, customs agents or coast guard boats to evade. Traffic stops and drug detection dogs do not threaten money shipments. Underworld competitors cannot rob you. Staying with narcotics, the cartels moving cocaine from

Colombia to US markets require sophisticated transportation logistics; if the returning profits require the same methods to get money back to Colombia, you have doubled your risk. Finally, there is no point in risking your life for crime if you cannot safely enjoy the fruits of your labour.

The black market peso exchange

Staying with our example, the legitimate Colombian economy can only digest so many US 20 dollar bills. One long standing laundering technique, the black market peso exchange, was developed for precisely this reason. These are many variations on the scheme, however at its simplest you start with drugs moving north (Columbia is a major source country for cocaine and heroin) and being sold (the US is, unfortunately, a major importer). The drug profits, in the form of street cash, are sold at discounted rates to a Columbian peso broker. The broker then launders the cash in the US, often by placing the money in bank accounts and then, layering it into a series of business accounts. The broker then uses those business accounts to buy American products for export to Columbia. The products, which are limited in type only by the imagination, are then sold in Columbia in a peso denominated deal. The sale proceeds are then passed on to the cartel that originally shipped the drugs. In this way, a kilo of cocaine can be converted into benign assets like cases of liquor, footwear, a mainframe computer system or a plastics injection-moulding machine[8].

The money laundering: cycle

There are several steps involved in money laundering. "Placement" introduces proceeds of crime into the legitimate financial system. The simplest placement method is to deposit funds in a bank account. The variations on this are again limited only by the imagination: currency conversion; buying luxury items with cash; co-mingling illicit cash with cash generated in a legitimate business like a restaurant; paying off another's credit card; and so on.

If law enforcement never pursued proceeds, your money laundering job would be done. A bank deposit converts proceeds into income producing property tucked safely beyond the reach of your underworld competitors (money in a mattress or a safety deposit box does not earn interest). Law enforcement does attack proceeds. Some barriers are erected around the financial system, requiring intermediaries to report large cash transactions as well as suspicious transactions. Forfeiture proceedings, whether conviction-based or civil, are brought against assets that can be traced to unlawful activity. To evade the attention of FIUs and others, you need to "layer" your money. To layer is to distance the money from its illicit source. Funds are moved around: from bank to bank, from entity to entity, and from jurisdiction to jurisdiction. Nominees, trusts and front companies are often used in layering, as are purchases of securities and the co-mingling of accounts. The object of the enterprise is to obfuscate the audit trail and make it impossible to prove that the money has a tainted source. Integration, that is, integrating the money into the legitimate financial system for safe access and in some cases repatriation (moving money back to the country) can be the final step in money laundering (Schneider, 2004; Cassella, 2004).

The Philippines

The Republic of the Philippines is an archipelago of islands in South East Asia, host to 87 million citizens. The country faces challenges common to the developing world.

Corruption and graft remain a serious problem. The Philippine economy is gradually recovering from the Asian and global financial crises of 1997-1999. Filipinos abroad remitting wages home are critical to the Philippine economy; in 2001 US$6.23 billion in remittances came from 7 million Pinoys abroad[9]. There is a lot of legitimate money flowing across the border of the Philippines. Given that the Philippines consists of 7,107 islands, the physical borders of the country are very difficult to safeguard from contraband.

In 2000, partially in response to concerns raised by the FATF and others, the government began to take steps to address money laundering. Early steps were led by the Central Bank (Bangko Sentral ng Pilipinas or BSP) which issued a number of circular-letters designed to tighten banking regulations (for example, anonymous bank accounts were prohibited)[10]. This approach simply did not work. Banks felt themselves in a difficult position, caught between legislated enactments on bank secrecy and the non-legislated circulars of a regulator (Tirol, 2004). In response, the Philippine Congress enacted the Anti-Money Laundering Act of 2001 (the "Act")[11].

The 2001 statutory response did not satisfy the FATF. On February 14, 2003, the government was told to tighten up the threshold for reporting covered transactions, loosen or eliminate bank secrecy barriers and make the law retrospective in application. Amendments to the Act were signed into law on March 7, 2003 just over a week before the FATF's deadline; had the deadline not been met, international counter measures would have been implemented[12]. Those counter measures would have impacted the ability of Philippine financial institutions to conduct business abroad and could well have interrupted the critical flow of overseas wage remittances.

The Act took a number of important first steps. Money laundering was classified as a criminal offense[13]. The Anti-Money Laundering Council (AMLC) was established. AMLC's governance in structure is unique and potentially awkward. The Governor of the BSP (Central Bank) chairs the Council and the Chair of the Securities and Exchange Commission (SEC) as well as the Commissioner of the Insurance Commission (IC) sit as members. AMLC acts first and foremost as an FIU. The Act mandates that all financial intermediaries regulated by the BSP, SEC and IC must send in covered transaction reports[14] and suspicious transaction reports[15]. There is nothing unusual about placing an FIU within a structure of a Central Bank. Typically, this is done for two reasons: the Central Bank is a normal interlocutor for financial institutions, hence there is an existing relationship within the framework; additionally, there is some comfort in the fact that the Central Bank buffers financial institutions from law enforcement (IMF/World Bank, 2004). Here the model departs somewhat in that the Philippines AMLC also institutes investigations. Again law enforcement investigators reside the FIUs of other jurisdictions (Ireland and the UK, for example) but oversight of the investigating role is usually given to traditional law enforcement bodies like the police. Finally, AMLC plays a role with the three remedial devices under the Act. First, AMLC can bring, through the office of the Solicitor General, civil forfeiture proceedings; secondly, AMLC can refer prosecution complaints to the Department of Justice or the Ombudsman (who prosecute government officials). Thirdly, AMLC can implement measures to counteract money laundering. Presumably, a BSP circular would be an example of this[16].

Money laundering offences

Money laundering disguises the proceeds of an unlawful activity. The Philippine Act defines what "unlawful activity" means through a list of predicate offences, ranging from drugs and jueteng (gambling – a version of the numbers racket) through to kidnapping, swindling and corruption. There are three specific money laundering offences: transacting with proceeds, facilitating money laundering and failing to disclose to AMLC covered and suspicious financial transactions. Transacting, the main offense, requires the state to prove three elements: one, there was a transaction or attempted transaction of proceeds; two, the proceeds are derived from an enumerated predicate offence; and three, the defendant knew the proceeds were derived from the predicate offence. Convictions, which will be difficult to obtain, can generate sentences of 7-14 years and fines of not less than US$55,000 "but not more than twice the value of the monetary investment or property involved in the offence." Facilitating convictions can lead to sentences of 4-7 years; non-disclosure to AMLC convictions can net 6 month-4-year sentences[17].

Civil asset forfeiture

Remedial provisions to attack assets through forfeiture are a necessary cornerstone of any anti-money laundering regime. Launderers do not particularly fear fines. They do fear losing their illicit gains. The provisions passed in the Philippines are, to say the least, intriguing. First of all, proceeds are addressed through a civil asset forfeiture process. While this has been in use for a long time in the US, the common law use of non-conviction forfeiture is a relatively new innovation[18]. Civil forfeiture is regarded by some as a critically important tool with which to combat corruption[19]. Generally, a court is asked to consider in a civil *in rem* proceeding the origin or provenance of a particular piece of property[20]. If the court finds, on a civil standard (balance of probabilities or preponderance of the evidence) that the property is a proceed of unlawful activity, the court can order forfeiture to the state. Generally, statutes provide statutory defences to third parties with legitimate property interests[21]. This type of forfeiture is non-conviction based, meaning that a conviction or even a criminal charge is not a precondition for a proceeding.

There are some preconditions for a civil forfeiture proceeding in Philippine law. First, the money must be frozen by the Court of Appeals (the rules of civil procedure also allow freezes to be sought at the trial level). Second, there must be a covered transaction report made (US$9,200). This has several implications. If the financial institution fails to report, even in a clear money laundering case, a precondition for civil forfeiture is not met. Thirdly and most importantly, civil forfeiture only applies to money laundering with an institutional financial intermediary[22]. If AMLC is successful in pursuing civil forfeiture cases, they will motivate money launderers to look at other devices (purchases of luxury goods, jewellery, gold and so on) which do not require a traditional financial intermediary. Only money instruments are subject to civil forfeiture.

Freezing

AMLC can make an *ex parte* motion to freeze property for up to 20 days. The motion can either be brought to the executive judge of the regional trial court or the Court of Appeal (a decision of which reverts to the trial level and then, curiously, could later be appealed to the Court of Appeals). AMLC must show probable cause that the property is "related" to a predicate unlawful activity. In the Philippine judicial system, the Court of Appeals has original jurisdiction for certain types of writs (*mandamus*, prohibition, *certiorari* and so on)[23].

Rules of procedure

The 2003 statute delegated a number of critical mechanical items respecting civil forfeiture to the judiciary who have passed applicable rules of civil procedure. The original intent, expressed by Congressman Locsin, was to rely on existing rules regarding escheated property and to the extent necessary borrow from the rules of other jurisdictions[24]. The escheat rules, which were designed to deal with issues like dying intestate, proved to be wholly inadequate. The author of this paper was invited to meet with senior members of the judiciary in April 2005 and again in February 2006 to discuss how rules are applied in other jurisdictions. The rules of procedure were finalized on November 15, 2005[25].

Presumptions

The rules enacted by the judiciary implement the legislative scheme and touch on a number of critical issues. This unusual role has been specifically delegated by Section 12 (a) of the Act. The rules stipulate that civil forfeiture is non-conviction based[26] and the standard of proof generally is civil. The rules also provide for a series of factors the court should consider in determining where the preponderance of the evidence lies. Is the value of the property not commensurate with the respondent's earning capacity? Is the transaction a "clear deviation" from the respondent's previous transactions? Is an account held by a nominee owner[27]? Have transactions been structured to avoid currency transaction reporting rules? Is there no "apparent underlying legal or trade obligations, purpose or economic justification to the transaction?" Strictly speaking, these are not presumptions. If the answer to any of the question is yes, then unless contradicted, a court can make a factual finding that the property is involved in money laundering.

Philippine authorities will have a variety of techniques available to them. For example, a net worth theory compares the legitimate income of a respondent with their current assets and inviting the court to draw an inference[28]. Authorities can compare the income declared for tax purposes (where some citizens tend to under report), against the holdings of a respondent. Actual holdings might also be compared with a statement required by law. An unscrupulous defendant in a divorce proceeding might tend to understate their assets; they might similarly inflate their holdings and earnings to obtain a mortgage from the bank.

Forfeiture process

Following a freeze of assets, AMLC (represented by the Solicitor General) will file and serve a written petition naming a respondent, the property and the grounds for forfeiture. The respondent must file an opposition within 15 days, failing which there will be an *ex parte* default judgment. There are currently enormous delays in the Philippine court system. The rules propose several devices to overcome that problem, including the use of pre-trial conferences to sift evidence and simplify issues[29]. These provisions could invite a challenge from respondents on due process and the right to a fair hearing. Following a trial, judges must issue their rulings within 30 days.

Third party claims

Persons and companies may assert an interest in the property or a claim as a creditor on forfeited property if they were not a party to the actual forfeiture proceeding. Those claims might come from creditors, both secured and unsecured[30] as well as victims of theft and fraud. The court then can sort out those claims in a subsequent proceeding.

Forfeiture cases to date

At the time of writing, there have been no significant forfeiture cases under the recently enacted money laundering laws[31]. There are two interesting cases related to corruption that occurred during the Marcos regime. Jolly Bugarin was a public official from 1967 to 1986, retaining the position of Director of the National Bureau of Investigation. Throughout his career he earned a total of 743,243.65 (PHP or Philippine Pesos). At first blush, it appeared that the assets he acquired during that period were close to ten times the value of his gross income (PHP6,313,632.56). Under anti-corruption laws, forfeiture of unexplained wealth in the hands of a public official is mandated[32]. A proceeding was brought in 1987. At the trial, Bugarin adduced evidence as to his income and expenses; the court ruled that his wealth was not unexplained and dismissed the forfeiture action. In 2002, fifteen years after the initial petition was launched, the Supreme Court issued an *en banc* ruling overturning the trial court decision[33]. The challenges inherent in Philippine forfeiture law are amply demonstrated by both decisions. First, while Bugarin was employed as NBI Director, he was also employed by a private law firm “in his spare time” as a consultant on document evaluation, ballistics and the like. Both courts ultimately found that extra income to be a legitimate way to “explain” part of his wealth. Even taking that income into account, the appellate court found a manifestly disproportionate gap between his legitimate income and property. Properties acquired between 1968 and 1980 (the net value of which was three times the gross earnings, public and private) were finally forfeited in 2002. Given the speed at which money moves, Philippine authorities obviously face extraordinary challenges.

The case of the Marcos estate demonstrates where the Philippine system stands in relation to other systems, particularly those of Switzerland and the US. The Republic of the Philippines requested the Swiss government to freeze bank accounts related to the Marcos. This was done fairly quickly. A total of $658,175,373.60 (US) were transferred to an escrow account, eventually moved to the Philippines and then forfeited. A subsequent attempt by Imelda Marcos and others to overturn the forfeiture was not successful. In a ruling that bodes well for the prospects of the anti-money laundering provisions discussed above, the court affirmed a settled legal proposition in the Philippines that civil asset forfeiture proceedings are *in rem*, civil and most importantly not penal[34].

Conclusions

The international consensus on the need to address money laundering has proven both powerful and persuasive. Only two countries, Myanmar and Nigeria, remain on the list of NCCT at the time of writing. That said, the Republic of the Philippines face some daunting challenges. Corruption is a continuing problem. The economy is improving, but it still has not fully recovered from the Asian financial crisis of 1997 – 1999. Geographically, the country has difficult borders to police (7,107 islands) and 7 million Filipinos remit money from wages earned abroad. That said, important first steps have been taken. Key agencies like the AMLC and the Ombudsman's office understand the challenges they face. With the recently enacted law, they now have important tools with which to face those challenges.

Notes

1. I was invited to be a resource speaker at the Philippines Action Program for Judicial Reform which held the Best Practices Roundtable Discussion: Court Rules and Procedures in Money Laundering/Civil Asset Forfeiture Action on April 28, 2005. A follow up conference was organized with the Judicial Institute in February 2006. Judge Susan Mollway, a federal judge of the 9th District, offered an expert perspective in US law. The author is grateful to the sponsors of the event: USAID, the American Bar Association Asia Law Initiative and Rule of Law Effectiveness Program (ROLE). The author is particularly grateful for the efforts of James Agee (ROLE) and Vic Acquino of the AMLC. The views expressed in this paper are solely those of the author.
2. The Philippines, along with Indonesia and the Cook Islands were removed from the NCCT list at the FATF Plenary XVI on February 11, 2005. See www.fatf-gafi.org
3. Esteves (2005), The Philippines is one of the most dangerous places in the world to be a journalist. From 1986 to the time of writing (July 2005) 67 journalists have been murdered. International Federation of Journalists *Culture of Impunity in the Philippines* at www.ifj.org
4. An international network of FIU formed in 1995 at a meeting at the Egmont-Arenberg palace in Brussels (see www.egmontgroup.org).
5. Beyond the FATF, there is interest in this issue from a variety of organizations ranging from the United Nations (www.imolin.org) to the Asian Development Bank (www.adb.org).
6. See, for example, Hubbard *et al.* (2004), Williams and Whitney (1999), Blunden (2001) and Robinson (1998).
7. There are countless cash courier cases, *US* v. *$99,900* (2003), 69 F. App 757 (6th Cir) is but one example.
8. See, for example, FINCEN Advisory, Issue 12, June 1999. US law enforcement have made concerted efforts to address the Black Market Peso Exchange; it is difficult to measure how prevalent its use is today.
9. www.txtmania.com/trivia/filipinos.php (excerpts from the *Book of Pinoy Facts & Records*).
10. BSP Circular No. 251, July 7, 2000. This particular circular, one of many, imposed the know-your-client rule on bank and non-bank financial institutions.
11. Republic Act No. 9160, signed into law September 29, 2001 and in effect October 17, 2001.
12. RA No. 9194 (An Act Amending RA No. 9160) was signed into law and took effect March 23, 2003. Despite the FATF request, the law was not applied retrospectively, although the legislative drafting is less then clear (Sections 22 and 23). The implementing rules and regulations had previously been enacted effective April 2, 2002.
13. Section 4. Amendments to the relevant banking laws were enacted to permit a prosecution. ss. 9(c) and 22.
14. Cash transactions in excess of US$9, 200 within one banking day – s. 3(b).
15. Any transaction where certain circumstances exist such as: there is no underlying legal or trade obligation, purpose or justification; the client is not properly identified; the amount is

not commensurate with the business or financial capacity of the client and so on. Section 3(b-1).

16. There are also procedures for international co-operation (s.13 of the Act).
17. The offences are set out in Section 4 and the penal provisions are in Section 14. There are also offences for failure to keep records and malicious reporting (Section 9). Fines for facilitating are US$27,600-US$55,000 and US$1,900-US$9,200 for non-disclosure offences.
18. The first US laws were passed in 1789 although civil forfeiture laws were not widely used until the mid-1980s. Australian provisions, those of New South Wales particularly, effectively date back to 1990. Other countries include Ireland (1996), South Africa (1998), Canada (2001) and the UK (2002) (Simser, 2005).
19. Turner, B Supporting Legislation and Action on Recovery of Stolen Assets and Money, a paper sponsored by the OECD and Transparency International. www.oecd.org/dataoecd/41/31/34098272.PDF
20. In the case of instruments, property that makes the labour of crime easier, the court is asked to examine the use of property in the context of unlawful activity. For example, in the US the government must show that facilitating property has a substantial connection to an offence. See, for example, *US* v. *Real Property* in Section 9 (2004), 308 F. Supp.2d. 791 (E.D. Mich).
21. In the absence of such a defence, the forfeiture can "relate back" to the point at which the property becomes a proceed or instrument and destroy all prior and intervening property interests. See *Bennis* v. *Michigan* (1996), 516 US 442.
22. There are conviction-based forfeiture provision for matters like corruption. See *Republic of Philippines* v. *Bugarin* (January 30, 2002), GR No. 120508 (Sandiganbayan, 3rd Div).
23. Section 10. Tirol (2004, p. 106). The injection of the Court of Appeal is an anomaly created by statute; the rules address this be enabling a second trial court track.
24. Section 10. Tirol (2004, p. 167). The injection of the Court of Appeal is an anomaly created by statute; the rules address this be enabling a second trial court track.
25. Rules of Procedure in Cases of Civil Forfeiture… A.M. No. 05-11-04-S.C.
26. Therefore, a charge or conviction is not a precondition to a proceeding and an acquittal is not a bar (s.27).
27. This provision is subject to "unless authorized under existing law" which would permit properly created trusts and bailments and so on.
28. See, for example, *NSW Crime Commission* v. *Attallah* (2003) NSWSC 1000.
29. A pre-trial conference is required within 30 days of the close of pleadings (s 22).
30. In most forfeiture regimes, unsecured creditors do not have an accountable interest in property subject to forfeiture. See: Cassella (2001).
31. *Republic of Philippines* v. *Acutin* (2005 – unreported – #03-107315 – Trial Court); *Republic of Philippines* v. *G. Cosmos Phils Ltd* (2005 – unreported – #03-107311 – Trial Court); and an interlocutory order in *Republic of Philippines* v. *Baligad* (2005 – unreported – #74618 – Court of Appeal).
32. Republic Act 1379, An Act Declaring Forfeiture in Favor of the State Any Property Found to Have Been Unlawfully Acquired by Any Public Officer or Employee and Providing for the Proceedings Thereof.
33. *Republic of the Philippines* v. *Sandiganbayan and Bugarin* (January 30, 2002: G.R. No. 102508). See www.supremecourt.gov.ph/jurisprudence. The trial decision was issued in 1991.
34. *Republic of the Philippines* v. *Sandiganbayan and Marcos* (2003) GR No. 152154 November 18, 2003. Not surprisingly, there has been considerable litigation. *Hilao* v. *Estate of Ferdinand*

Marcos (2004), 393 F. 3d 987 is an example of the interplay between the US, Swiss and Philippine system.

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