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Money laundering occurs in almost every crime where there is a financial motive. People who commit most crimes have, at least as one of their motives, personal enrichment. Because of the need to hide the fact that wealth came from a criminal act, the criminals need to disguise the money. This forms the basis of all money-laundering and tax crimes. Completing the money-laundering activity generally involves a series of transactions designed to disguise the source of funds, so that these assets may be used without discovery by law enforcement. Through the money-laundering process the individual tries to transform the appearance of the funds derived from the illegal activity into funds having come from a legitimate source. There has been an emerging new system of money-laundering where the use of legitimate commercial trade activity is being used by criminals involved in illegal activity to disguise their criminally derived profits as coming from legitimate businesses.

This new system of using trade to assist in their money-laundering system may have far-reaching social consequences and may even rise to the level of threatening economic policies. In order for criminals to use trade and financial systems to complete their activity, they must manipulate these trade and financial systems for their own selfish ends.

In recent years, multi-national law enforcement investigations have shown that criminal organizations are international in scope and their criminal activities are utilizing financial institutions worldwide. With the rapid advancement of the Internet and the ability for individuals to use this vehicle to transfer funds and wealth, criminal organizations are globalizing their use of financial and trade industries. History has shown that as criminal groups

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* William Bruton, CFE has over 25 years experience as a criminal investigator. This report is written from his experience and from articles he has written, articles written by the Dept. of Justice and Treasury. The opinions expressed are those of the author and not necessarily those of the IRS.

start to use a legal system of any type, they start the process to control and manipulate the system for their own use. Unchecked, criminal groups could potentially control the means of capitol production for a political entity.

Modern financial systems permit anyone to transfer large amounts of dollars through computers and financial institutions. Illegal moneys have been laundered through every available method. This is only limited by one's imagination. Moneys have been laundered through currency exchangers, stockbroker firms, gambling houses, private banking facilities, offshore financial institutions, wire transfers, and trade financing, all with the objective to launder and hide the proceeds of illegal activity.

In recent years, money launderers have been receiving assistance from professional individuals such as accountants and lawyers. These individuals have been trained in the more sophisticated methods of investment and movement of wealth. Money launders have an impact on national economies by moving millions of dollars outside the normally regulated trade avenues. With this type of activity, nations may not be able to monitor national fiscal activities, levy taxes, collect customs import duties, and protect local businesses from unfair competition.

As in many black markets, where products are considered items with which to barter for value, the Colombian black market considers any national currency to be a tradable commodity that holds value. In order to understand the mentality of the peso exchange you have to appreciate and understand that national currencies are considered commodities to be exchanged and sold. The black market peso exchange has evolved into an economic system whereby the value of cocaine is traded for currency, and that currency is traded/sold for another commodity (consumer goods) or currency. The true ownership or title to the asset is only known by a currency exchanger (in this case Colombia Peso exchanger) who follows the transaction which is conducted in another country (in this case the United States). This system has been well documented both in testimony before the U.S. Congress and in the U.S. Courts. The inability for a national government to control this system of informal finances is well documented by the Colombian Trade Commission.

By way of simple introduction, it is necessary to define, in general terms, a basic working understanding of the Colombian black market peso exchange. This particular black market developed because of central government restrictions placed on access to foreign currencies used in conducting merchant trade.

Many black markets around the world start as a cottage industry in response to pent-up demand for some type of goods or service, or because of national economic or tax policies. In the case of Colombia, in the purchase of foreign goods for resale, the retailer must acquire U.S. dollars as a means to pay for goods from non-Colombian manufacturers. Access to dollars by Colombian citizens is regulated and administered by the central bank. This regulation by the central government was instituted to ensure that Colombian duties and taxes have been collected.

Because of the perceived over-regulation by the central government, a system was established which presented retailers with alternative means of paying for imported foreign goods. The Colombian black-market peso exchange offers the retailer the option of purchasing U.S. dollars, either outside government control or through the central government. While utilizing the Colombian black market the exchanger violates national laws. This system, because of its appeal and acceptance, has become institutionally accepted. A further hideous byproduct of the black market rests in the fact that the products purchased with black market funds give the appearance and aura of being of a higher quality, latest technology or a prestigious symbol. In essence, there has been created a public perception that a product imported legally, paid for through the national bank, and otherwise complying with all tax and customs laws would, by its very nature, be inferior. This perception, to some extent, is fostered by the black market itself, in order to generate a demand for black market products in deference to legitimately imported products. In essence, the desire by the central government to control its economy and currency has the opposite effect of creating an industry that has the converse effect on the goals and objectives of a controlled economy.

In the case of Colombia, the black market in consumer goods has existed for many years. It is only in the last 10 to 15 years that the drug traffickers have seized upon the opportunity to utilize this existing informal economic system. This is done in order to repatriate their wealth earned in another national jurisdiction. It is because this black market peso exchange system had become so efficient in the payment for and the smuggling of goods and currency that the drug trafficker has been able to enhance and improve upon an already existing system. The sheer volume of wealth involved in drug trafficking introduced into this black market system has evolved into its own personality. The black market system has matured into a financial system capable of controlling the fundamental basis of wealth with the potential to manipulate the ownership of various segments of an economy.

The Colombian black market peso exchange system has evolved into a four-step process, which relies upon an informal but tightly controlled "trust" system to ensure its continued growth. This system assumes an unlimited amount of currency and a desire for goods and services. The following represents its most basic components:

A system that can place currency into a monetary system or bank (placement)

- The ability to hide the source of the currency (layering)
- The ability to convert original currency or wealth into a currency of choice
- The ability to deliver goods while concealing the source of payments (integration)

In the United States, during the mid 1970s, Operation Leprechaun found that large boxes of currency were delivered to financial institutions. The placement of drug dollars into the monetary system of the United States was as simple as driving up to the front door, opening your trunk and being assisted by bank employees in depositing cash. The system of placing cash into the bank was as uncomplicated as walking up, filling out a deposit slip, and placing one million dollars in cash into an account, no questions asked. Because this system violates no U.S. laws, money-laundering statutes were instituted to disrupt this system of currency placement. Congress passed the Bank Secrecy Act of 1970, which imposes a duty on financial institutions to file a Currency Transaction Report (CTR) whenever a customer conducts a financial transaction in cash exceeding $10,000.

In 1986, in an effort to combat organized criminal activity Congress passed the Money Laundering Control Act of 1986. The statute criminalized the movement of money and wealth derived from specific unlawful activities. This law was designed, in part, to prosecute those who are engaged in a "specified unlawful activity" and those who are attempting to disguise the true source and nature of their illegally gained wealth. The law also assists in the seizing of the assets and profits of the specified unlawful activity.

During this time banks were the most efficient method of moving large bulks of currency. As an example, a kilo of heroin weighs 2.2 lb., which is then converted to currency in U.S. dollars of 5's, 10's and 20's weighing 10 times the original drug weight, even as much as 256 pounds. While it may be easy to conceal 2.2 pounds, it becomes impossible, in the same fashion, to conceal a package weighing 256 pounds. These figures are even more dramatic when you consider that a single trafficker may earn as much as $500 million in the United States from the sale of cocaine. The weight of the illicit currency would exceed 125,000 pounds of money. Because financial institutions routinely handle large volumes of currency, it became a system of choice to use financial institutions to convert this weight to either cashier's checks or wire transfers.

With the enactment of money-laundering statutes, banks and depository institutions became the first line of defense in penetrating and preventing drug traffickers from using our financial institutions to aid in their criminal enterprises. The new money-laundering statutes require financial institutions to strip the veil of anonymity that was an essential element for money launderers. The record-keeping system identifies depositors and allows the government regulators to trace and identify money-laundering groups. As a result of the identification, money-laundering groups must move to different systems to avoid detection.

In 1994, DEA Administrator Thomas Constantine and IRS Commissioner Margaret Richardson announced the close of Operation Dinero, ending a two-year undercover drug money-laundering operation coordinated between IRS and DEA. This operation also had international law enforcement assistance from the United Kingdom, Canada, Spain, and Italy. The investigation culminated in the arrest of 116 suspects and the seizure of more than a hundred million dollars in cash and nine tons of cocaine. This investigation highlighted the need for international law enforcement and regulatory agencies to cooperate in the investigation of international money-laundering rings.

Operation Dinero had two parts. The first part focused on currency pickups, both domestic and international. It identified the connection between Colombian drug trafficking and their money cell groups in the United States. The second part focused on the operation of a Class B bank established on the island of Anguilla, British West Indies. Once the undercover bank began operation, IRS and DEA undercover agents promoted the bank's services within the domestic and international criminal communities.

This undercover Class B bank operated in the same manner as any other offshore Class B bank. The undercover operation offered checking accounts, savings accounts, and wire transfer services. While in operation it offered third party "Mexican checks" for deposit. The Mexican checks came from currency smuggled into Mexico and used to purchase cashier's checks from Mexican banks that had U.S. correspondent accounts. These checks were in U.S. dollar amounts and written by the Mexican banks on accounts of their correspondent bank in the U.S. These checks were written to Hispanic-sounding names and endorsed over to our undercover bank. In addition, 300 million dollars in securities maintained in Europe were purchased with drug dollars in South America. The drug traffickers and peso exchangers routinely sent the undercover bank U.S. dollar checks, wire transfers etc. They then wrote checks on their account or wire transferred the money to another domestic or international bank account. With an analysis of the documentation surrounding the funds coming into the account and disbursement from the account, the U.S. government and the other governments cooperating in this effort gained intelligence that led to supplemental investigations both domestically and internationally.

The Colombian peso exchange system has brought the ability to hide the source of the illegal currency to the level of a fine art. This exchange system uses two parallel financial transactions in different countries. The exchange system starts with a drug trafficker contacting a peso exchanger indicating that he had a large sum of currency, for example in New York. In a separate transaction, a Colombian importer contacts a peso exchanger in Colombia with pesos, stating that he needs U.S. dollars to purchase goods in the United States, for example in Detroit. The currency exchanger purchases the currency in New York for as much as a 15 percent discount from the drug trafficker. He then "trades" the dollars for pesos to the Colombian importer at the discounted black market rate. The black market peso exchanger asks the drug trafficker into which account he wants the pesos deposited. He then asks the importer where he wants the dollars deposited in the United States for payment of the purchased goods.

Drug dealers have an almost unlimited source of currency. It has been estimated that the Colombia Drug Cartels may have generated as much as 10 billion U.S. Dollars of profit which they need to get back to their control. They need an efficient mechanism to deliver the profits to them in a means and method that makes them available to enhance their wealth. The Colombian businessperson needs U.S. dollars or other foreign currency in order to purchase goods and services for resale by him in Colombia. The Colombian black market peso exchanger has analyzed the needs of both of these parties. He has designed a system to alter the way financial transactions are legally conducted and fulfills the financial needs of both groups.

During the last seven years an important lesson has been learned by law enforcement. Law enforcement has identified criminal organizations that specialized in purchasing consumer products with illegally derived cash and exporting this wealth disguised as consumer products to South America. The movement of illegally derived moneys, via the purchase of products, is not limited to the United States. Drug organizations are utilizing this system around the globe. Where there is strict monitoring of financial transactions, criminal organizations are using the cash generated from illegal activities, purchasing products and then shipping/smuggling the products into another country. They are selling the product at a discount, and utilizing the sale of the smuggled products as justification for their enhanced life styles.

Law enforcement undercover operations have indicated that major drug criminal organizations are utilizing warehouses in Miami, Panama and Aruba to purchase consumer products with drug dollars. This merchandise is then delivered through shipping brokers to Colombia. In Colombia the products are then sold below average retail price. This system has created a very high demand for these types of sales.

On October 22, 1997, before the United States House of Representatives, Subcommittee on General Oversight and Investigations, Committee on Banking and Financial Services, Washington D.C., an individual testified anonymously and stated the following:

> "As a money broker, I arrange payments to many large U.S. and international companies on behalf of Colombian importers . . . These companies were paid with U.S. currency generated by narcotics trafficking. They may not have been aware of the source of this money. However, they accepted payments from me without ever questioning who I was or the source of the money. For two years, I acted as a money broker in Columbia. I brokered both the illegally and legally obtained dollars and pesos along with other licensed and unlicensed money brokers. During this time, I brokered several million dollars on behalf of the Cartel.
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> Upon my introduction to the business, I was amazed at the large numbers of brokers. In Columbia, brokers often operate in what can be described as a flea market atmosphere.

> Importers shop for United States dollars at the mall, traveling from office to office to get the best black-market exchange rate.
>
> The broker would be told which narcotics trafficker owned the money in United States, whether or not they asked, to instill the fear of reprisal into the broker so that they would not steal or misappropriate funds.
>
> I would like to offer my explanation of money brokerage. As an example, a coffee broker in Colombia needs to purchase a tractor from a United States tractor maker. He purchases the tractor for 500,000 dollars. He receives a tractor in Columbia but has pesos. He needs to pay the U.S. company in dollars. So the grower takes the pesos to the black-market money broker instead of using Colombian banks, because he can buy the dollars at a lower rate and avoids taxes and tariffs of up to 20 percent.
>
> The broker buys the 500,000 dollars in pesos from the coffee grower and charges in a commission for his service. The broker then approaches a financial representative of the Cartel who has 500,000 dollars in drug money on the U.S. streets. The broker buys the 500,000 dollars from the Cartel representative and pays for it with the farmer's 500,000 dollars in Colombian pesos, minus a commission he takes for getting the cash off the Cartel's hands. The broker receives the dollars and uses them to pay for the farm tractor in the United States. In this manner, the farmer's debt is paid to the U.S. company, the drug dealer has been paid pesos for his narcotics, and broker has received a commission from both parties."

In a case such as that above, the actual flow of funds does not move from system to system. Therefore, tracing and following the money cannot be accomplished. The exchange system is started by a narcotic trafficker or Cartel organization in Columbia shipping drugs from Columbia to United States. The drugs are then sold for cash. The cash is brought to the trafficker's representative in the United States. The dollars are then accumulated in a stash house until directed by the Cartel financial adviser to release the dollars to a representative of the peso exchange system.

Under the peso exchange system, a Colombian businessperson will approach a peso exchanger and request to purchase dollars in the United States. The businessperson needs the dollars to pay for products he wishes to purchase in the United States. The peso exchanger would approach a "Duros," the financial representative of the drug Cartel, and ascertain the amount of U.S. dollars available on the black-market. If the official exchange rate is 1000 pesos per dollar, the peso exchanger would offer 800 pesos per dollar to the Duros. The exchanger would then sell the pesos to the businessperson for 890 pesos per dollar, for profit of 90 pesos. The businessperson would give the pesos to the currency exchanger, who would then deposit the pesos in a form requested by the Duros. The businessperson would then be asked where he wished the dollars to be transferred. Our experience has shown that these transfers do not necessarily contain the name of the businessperson in Columbia. The U.S. business(es) will then ship the requested products to the Colombian businessman.

What makes this system difficult for law enforcement is the fact that the communication between the two systems is done by cell phone, fax and beepers. No books and records are maintained in the U.S. for review by legal authorities. Once the transfer is done there is no traceable record of the flow of funds. As described in these two boxes in the above chart, the only overt relationship between these two systems are shown by the shipment of drugs to the United States and shipment of products from the United States to Columbia. For years, law enforcement has investigated using the philosophy of "follow the money." If one were to follow the drugs coming into the United States, being sold on the street, money going to the stash house and then deposited to a bank account at the direction of trafficker in Colombia, one would believe that the bank account where the dollars were deposited may be owned by the narcotics trafficker. There have been many investigations by the Department of Justice and U.S. Treasury Department that have followed this trail and made the assumption that they have found the bank accounts of the Colombian cartels. Further investigation showed that these accounts are owned by U.S. businesses, which sold products to the foreign businessperson and the dollars represented payment for these products. The U.S. businessperson claimed to be the innocent owner. In Operation Polar Cap, the U.S. Government froze over 700 bank accounts. The many owners of these accounts came forward to assert the claim of innocent owner. The accounts were then unfrozen when it could not be proven that the account owners had "knowledge" of drug funds entering their account.

The businesses being utilized by the peso exchanger are not limited to the United States. Investigations have shown that the peso exchangers and narcotics traffickers utilize businesses in whatever country they sell their drugs. We have been asked to conduct money pickups for the drug Cartel and currency exchangers in Europe, Asia, and Russia. This indicates that businesses are capable of being used by the Cartels in any country in which the Cartels sell their drugs.

During the last couple years I was asked by a U.S. business to look at information from some of their bank accounts. This was done at the request of the U.S. business to help them to identify whether they were targeted by a money-laundering peso exchange system. A review of their accounts showed the following:

1. They had received cashier's checks, which were credited to one of their customer's account. These cashier's checks were issued from a non-U.S. bank but were drawn on a U.S. dollar account from a U.S. correspondent bank. The cashier's checks were issued in various Hispanic names containing an endorsement on the back of the check. In some cases there were several endorsements, none of which contained the name of the customer to whose account these checks were credited.

2. The account also contained wire transfers. The wire transfers did not come from an account owned by the Colombian customer of the U.S. business.

3. The account contained cash deposits, but always under the $10,000 reporting requirement.

The U.S. business told me that this customer ordered the U.S. products and shipped these to Aruba for sale. I also found that this customer was arrested by U.S. law-enforcement for laundering drug money, but not because of doing business with this company.

The Colombian Government Trade Bureau in Washington D.C. has expressed to many law enforcement officials their concern for the effect that the black-market exchange system is having on their legitimate business people.

This concern can be best explained as follows:

Narcotics traffickers are continually concerned with the Colombian government's attempt to eliminate their illegal activity. A new law being enforced by Colombia is the illegal enrichment law. The illegal enrichment law states that if income reported on a tax return comes from an illegal source the tax rate will be over 50 percent. Narcotics traffickers are also concerned with estate planning. Because of the drug traffickers' enormous wealth and assets, they are attempting to enter into legitimate commercial enterprises in order to give the appearance that their wealth is derived from legitimate activity. They either create their own front companies or utilize businesses and other commercial entities to repatriate the proceeds of their narcotics trafficking from an underground economy. Narcotics traffickers want to be able to become part of the "country club" set. Therefore, they have started businesses and have taken over companies using their narcotics proceeds to further the economic benefit of these entities.

Let us take a hypothetical example of how this process is working. Imagine there exists five wholesale outlets for products manufactured by ABC Corporation in Atlanta, GA. Four of these outlets comply with all currency, tax and customs import duty laws. The fifth outlet gets its' U.S. currency from the black-market, imports its products illegally from Panama or Aruba and smuggles them into Colombia.

The first four outlets import 1,000 products, paying $100.00 U.S. each. The narcotics trafficker has drug money in New York with which to purchase his products. He is accustomed to paying a peso exchanger a discount of 30 percent to place his narcotics proceeds into a financial institution. He now has the ability to use his drug money to purchase the products from ABC Corporation in Atlanta, GA and smuggles them into Colombia in order to sell them at his store.

The first four outlets, in order to make a profit, must sell the products purchased from ABC Corporation in Atlanta, GA for more than $100 each. The narcotics trafficker has already made a significant profit on the sale of drugs and does not need to earn any money selling products of ABC Corporation.

In fact, if he sells the product at the exact price he paid for it, he will have already reduced his total business expenses by 15 percent. The 15 percent is the cost he would have paid the currency exchanger to convert the dollars to pesos if he did not use the purchase of products to get his drug money converted. The use of front companies, where legitimate products are sold, offers narcotics traffickers a tremendous advantage in legitimizing their illegal underground wealth. If they were to move 100 million dollars through this process each year, narcotics traffickers could file tax returns showing the profits from this business. A narcotics trafficker could visit with the "country club set" and say he was the president of this very profitable organization.

What happens to the other four businesses that cannot compete with the drug trafficker in selling ABC Corporation's product for the same price? They're faced with only three alternatives. Use the black-market and violate currency regulations, tax and Customs laws; go out of business or sell the business to the drug trafficker. Many of the businesses cannot compete with the narcotics trafficker and his financial advantage. Therefore, the narcotics trafficker starts to control the vast majority of the industry within the circle he competes. Let's take our story one step further. Now the narcotics trafficker has become the largest purchaser of products from ABC Corporation. In order to maintain an inventory level large enough to supply his newfound South American vendors, ABC Corporation establishes a multimillion-dollar manufacturing facility in the Pacific Rim. This manufacturing facility employs several hundred people and has boosted the economy of that area.

As the South American business market grows, it becomes more important to ABC Corporation. After several years, ABC Corporation will be asked by the narcotics trafficker for "special" services to aid in the trafficking of drugs or the trafficking of illegal currencies. This could be as simple as a request to borrow the company plane when it comes to visit from the States or to carry a package from the U.S. to Colombia. When ABC Corporation says it will not participate, the drug trafficker says, "I will switch from selling your product to selling a competitor's product within two days." Now ABC Corporation, who has become financially dependent on the South American vendor, finds itself on the horns of a dilemma.

While only part of this story is true, if we do not take corrective action the entire story may become a reality.

Conclusions

Corporations and businesses need to establish a "know your customer" policy. These types of policies have been established for several years by financial institutions in order to prevent criminal groups from laundering drug dollars through their institutions. Because of the success of this policy, drug organizations are moving their drug profits through the use of international commerce. The following is an example of some policies that would assist corporations:

1. Establish customer identification and documentation requirements.

2. Establish payment policies that require the payment to be received from the established bank account in the name of the customer.

3. Prohibit the use of third party checks for payment credited to customers account.

4. Develop policies requiring the reporting of suspicious payment activities.

5. Consider the establishment of a compliance officer who has broad authority to monitor and insure compliance with relevant laws. This is especially critical where products are being exported to high-risk areas.