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Effective sentinels or unwitting money launderers?

The policy effectiveness of combatting illicit financial flows through professional facilitators (lawyers, accountants and real estate agents).

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Abstract

As ‘gatekeepers’ to the financial system, lawyers, accountants and real estate agents play an indispensable role, intentionally or unwittingly, when criminals use their services to facilitate real estate transactions with illicit funds. Recognised as a high-risk, high-value sector for money laundering, empirical research in this area is, however, scarce. The important question then becomes how effective is the policy objective to detect and deter money laundering through professional facilitators in the real estate market?

This thesis answers that question with new empirical evidence drawn from New Zealand criminal proceeds real estate transactions facilitated by professionals. Unlike other countries where professionals are partly or wholly exempt from anti-money laundering regulations, obligations to detect and report suspicious real estate transactions have applied to professional facilitators in New Zealand since 1996, yet inexplicably there is almost no objective evidence in this area. This thesis uses primary sources including court records to fill a knowledge gap in the use of professionals enabling financial transactions with illicit funds. It concludes that policies to detect and deter laundering through professional facilitators achieved intended outcomes in just four percent of research cases over a 20-year period. It found that when presented with property transactions involving proceeds of crime, professionals were more often enablers than inhibitors. This thesis also maps characteristics empirically associated with criminal investment in real estate found to be more, and less, susceptible to masking by criminal actors. These new empirical findings represent a significant advance in knowledge because they point to policy, enforcement and regulatory settings to help transform professionals unwittingly enabling financial transactions with criminal proceeds into more effective sentinels.

This thesis also constructively critiques a new global framework for evaluating the effectiveness of anti-money laundering regimes against defined ‘outcomes’. With surprisingly little dialogue at the intersection of policy effectiveness/outcomes and money laundering scholarship and practice, the obvious question is whether the new methodology reflects an outcome-oriented effectiveness framework, as it purports. This thesis finds that it does not yet do so. This represents a significant contribution if it helps advance policy, regulatory and enforcement strategies and further research to improve crime detection and prevention capabilities and outcomes.

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I am indebted also to judges of the High Court and District Courts throughout New Zealand, especially Justices Paul Heath and Graham Lang. Two of Justice Heath’s judgments inspired me to think the research was possible. I later found that few judges outlined the role of professional facilitators in crime proceeds cases with such clarity. The research might not have overcome my naiveté without the support of judges and staff providing access to court files to help fill many gaps. After formally seeking more information about the research, Justice Lang metaphorically unlocked the doors to New Zealand’s largest court registry, and facilitated access to many others afterwards, enabling

the vision to be realised by a different route. Many others provided support and assistance during the research. These included Haydn Davies, Thomson Reuters (access to Westlaw NZ databases), Robin Anderson, NZ Law Society (access to NZLS library and legal research guidance), a real estate agency (unnamed by choice) and Sarah Gillies, CoreLogic NZ (real estate data), Guy Sayers, Ministry of Business, Innovation and Employment (real estate asset forfeiture data), Andrew Hill, Financial Intelligence Unit, NZ Police (Asset Recovery Unit summary analysis), and Rich Woodward, NZ Customs Service (border cash forfeiture data). Court staff in registries throughout New Zealand provided judgments and court orders not accessible by public and commercial databases, aiding the initial screening process. Access to primary source materials from identified research cases was enabled by judges and facilitated by court staff. Stephen Hewlett (Tauranga) offered the first practical response to logistical difficulties accessing data from dozens of registries throughout the country. Keith Brown, Jane Penney, Nathan Lewis and their Wellington colleagues facilitated centralised access provided by other courts. Data in Auckland court registries were too voluminous for such measures. On each visit, Gordon Sulliman estimated the access time likely required by the number of cubic metres of documents supplied, with remarkable accuracy. Thanks to Auckland and Wellington registry staff for hosting a researcher in their midst, and Matthew Howe for deciphering notes affixed to tagged documents. And to Dr Nicholas Gilmour, Dr Michael McFadden, Dr Mark Bennett, Professor Michael Macaulay and Rowan Bosworth-Davies, for many discussions mostly tangential to the research, in diverse Wellington cafes and an ancient London pub; as a reminder of thoughtful endeavour beyond policy effectiveness.

Statement of originality

This work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis.

Statement of originality - update

After this thesis was submitted for examination, two articles were submitted for publication. The first, “*Anti-money laundering effectiveness: Assessing outcomes or ticking boxes?*”, was accepted for publication by the *Journal of Money Laundering Control*. It draws directly from this unpublished thesis, in particular, from **chapter 6** and elements of **chapter 5**. A second article submitted for publication draws from **chapter 7** and elements of **chapter 10**.

Research question

How effective is the policy of detecting and deterring money laundering through professional facilitators in New Zealand’s real estate market?

The purpose of this research, in three quotes

Albert Einstein

Tribute to Pablo Casals, 30 March 1953 (Corredor, 1957, p.11).

He perceives very clearly that the world is in greater peril from those who tolerate or encourage evil than from those who actually commit it.

Sam Koim

Department of Justice and Attorney General, Papua New Guinea (Koim, 2012).

This is no theoretical process. When money that is supposed to build hospitals or buy medical equipment is used to buy real estate in Cairns or Brisbane, people die. And, quite frankly, those who turn a blind eye to this are as guilty as the offenders.

Ron Pol

From **section 2.7.1** below, discussing research case 18.

Professionals enabling the real estate transaction with illicit funds reported no concerns. It is unsurprising the accountant failed to report criminal activity that implicated him. Likewise, the vendor's solicitor; she was used unwittingly, missing or failing to understand the few red-flags observed. The outcome might have been different if the purchaser's solicitor and another lawyer who facilitated the offender's subterfuge had made further enquiries in the face of multiple identified indicators of the criminal activity their services assisted. Absent which, the result, plainly foreseeable, was equally clear. For a few hundred dollars for their services, the offender's large-scale criminal activity, and serious economic and social harm to local and regional communities, continued unchecked for another nine years. Serious crime was enabled, and perhaps inadvertently encouraged and invigorated, by the services of professionals.

Preface

A former law firm chief executive shared a personal observation:

I went to an auction where a young guy walked up, put in an opening bid of \$1 million and bought a property for well over market price. A guy I was talking to said 'drug money'. No one really cares where the cash is from, just that it shows up (Anon, 2016b).

Two news reports on the same day from separate continents illustrate differing perceptions about the use of professional facilitators (lawyers, accountants and real estate agents) to help launder criminal proceeds. After the United States government announced that it would monitor certain property transactions, a realtor claimed money laundering concerns were 'overblown.' He added, "We're going to say [to prospective buyers] 'we're not looking into your pocketbooks, your bank accounts. If you have money... we'll work with you'." (Iannelli, 2016). Meanwhile, in Nigeria, a country seeking US help to stem outflows from corruption and other crime, Professor Angwe regretted that "countries that readily accept stolen funds... were aiding people in looting funds that could have been used to improve dying infrastructures" (Ikhilae, 2016).

It was later revealed in New Zealand that hundreds of millions of the billions of dollars allegedly looted from a Malaysian development fund were funnelled into luxury real estate in Manhattan, Los Angeles, London, Singapore and Hong Kong, owned by secretive New Zealand trusts (US DOJ, 2016, Nippert, 2017, Low v Rothschild, 2017, Rewcastle-Brown, 2017a). The ownership structures facilitating alleged corruption on a grand scale were described as "planned deceptions" designed by lawyers. "By pretending that there is seriously any other substantial reason" for such mechanisms "is participating in the fraud" (Rewcastle-Brown, 2017b). When professionals facilitate such transactions, some may knowingly assist criminal enterprise. Many others may be unwitting. Others still may turn a Nelsonian eye, disassociating money from how it was generated, and the social and economic harm caused by profit-motivated crimes such as corruption, fraud, drugs-, arms- and human-trafficking. This thesis examines the use of professional facilitators by criminal actors, across the full spectrum of their participation in the process of enabling financial transactions with proceeds of crime.

If there is value in this new research, delusions of relevance and impact (Cohen, 1988, p.30) in ‘speaking truth to power’ (Wildavsky, 1979) are shattered if Lord Keynes’ observation is accurate that "there is nothing a government hates more than to be well-informed; for it makes the process of arriving at decisions much more complicated and difficult" (cited in Banks, 2009b) and hinders “policy-based evidence making” (Alldridge, 2016, p.13). It is, however, arguably the absence of data that hampers effectiveness. "Without evidence, policymakers must fall back on intuition, ideology, or conventional wisdom", and "the resulting policies can go seriously astray" (Banks, 2009a, p.5). This resonates in the context of contemporary anti-money laundering practices driven by a dominant narrative arguably poorly connected with the effectiveness and outcomes discourse. This thesis joins the nascent discussion at the confluence of those strands. It asks not whether we have rules, or the extent to which they are complied with, but whether they work. It provides new empirical evidence on the role of professionals enabling financial transactions with proceeds of crime, it measures policy effectiveness, and it offers original analysis on the global anti-money laundering ‘effectiveness’ and ‘outcomes’ framework. Evidence may complicate the decision-making process but, if relevant, it extends the scholarship and, if timely, may assist policymakers and practitioners advancing evidence-based decision-making for better outcomes.

Chapter outline

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3 Money laundering and its control	Establishes the basis for original analysis and new empirical findings
4 Professional facilitators and real estate	
5 Policy effectiveness and outcomes	
6 The FATF effectiveness framework	Original analysis
7 Comparative review, and revisiting a 'new' effectiveness measure	
8 The extent of professionals' activities enabling criminal transactions	New empirical findings
9 The nature of professionals' activities enabling criminal transactions	
10 Conclusion, implications, future research	Conclusion

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1 Introduction & summary of findings

Criminals use legitimate businesses like banks and ‘gatekeeper’ professionals that facilitate access to the financial system - such as lawyers, accountants and real estate agents - to launder the proceeds of crime. Anti-money laundering legislation therefore co-opts some of these private actors to detect and report suspicious transactions. But, having such rules is one thing. Whether they work is another.

Notwithstanding coordinated global standard-setting and monitoring, it has proven difficult to claim any objective measure of policy success. The United Nations observed in bureaucratic understatement that the “success rate of identifying criminal capital flows is limited”. It estimated that only about 0.2% of criminal proceeds is seized globally.

In comparison, more than 20% of the globally produced illicit opiates are being seized and more than 40% of the cocaine. The question that arises is whether money launderers really are so much smarter than drug traffickers, or whether there is something wrong with the existing control system? The problem does not seem to be a lack of international instruments... but, more likely, shortcomings in the implementation of existing instruments (UNODC, 2011, p.131).

Since December 2014, the effectiveness of anti-money laundering regimes has been evaluated against ‘outcome’ measures developed by the Financial Action Task Force (FATF), as the global standard-setting body. Whether the new system has had a material and demonstrable impact, however, remains untested. Scholars have found gaps in the global anti-money laundering system, and questioned its effectiveness (Halliday et al., 2014, Levi and Reuter, 2006, Fisher, 2014, Sharman, 2017, Findley et al., 2015, Findley et al., 2014), but the laundering of criminal proceeds into real estate remains a "big hole", under-researched and poorly understood by researchers, regulators and policymakers (Hudson et al., 2014). Scholars also seek more information on the role “played indirectly by third parties in laundering processes, such as...lawyers...and real estate agents who...inadvertently aid criminals" (Unger et al., 2006, p.163).

This research posits that the real estate and professional services sectors may hold clues to anti-money laundering policy effectiveness. Real estate is a prominent target for

“large-scale” laundering (FATF, 2014d, pp.7, 31, FATF, 2007b, OECD, 2007), with professionals as "indispensable players" (Nelen, 2008, p.754). With banks stepping up efforts to close their doors to illicit funds, and "criminals always seek[ing] new ways to move the proceeds of crime" (Henning, 2015), it follows that the use of professionals may be increasingly attractive. Government agencies also perceive money laundering extending beyond banks, through non-financial businesses and professions (US State Department, 2016, p.1, AUSTRAC, 2015a), into property transactions (AUSTRAC, 2015b, NZ FIU, 2015), and in other areas where professionals’ expertise is “crucial” (Europol, 2013, p.14).

Moreover, systemic gaps are believed to adversely affect policy outcomes. FATF evaluators say that the absence of money laundering controls on professionals has a “negative impact” on effectiveness (FATF and APG, 2016a, p.8), and calls into question “the effectiveness of the preventive measures in the financial system as a whole” (FATF and APG, 2015, pp.7, 13, 91). Yet, without such controls in many countries, there is arguably no policy to detect and deter laundering through professionals in jurisdictions such as Australia and Canada, and for research purposes limited data from which to assess effectiveness. In contrast, basic money laundering controls have applied to professionals in New Zealand’s real estate sector for two decades (FTRA 1996).

This thesis responds to calls for empirical evidence, and helps close part of an implicit effectiveness gap (Halliday et al., 2014, FATF, 2013b) in an under-researched area of scholarship and practice. Framed in policy effectiveness, it uses primary data from criminal asset forfeitures to fill a knowledge gap in the role of New Zealand professionals facilitating real estate transactions with criminal proceeds. It also assesses the global anti-money laundering ‘effectiveness’ methodology.

After briefly noting the key findings and contributions respectively of the research, below, this chapter concludes by outlining the remaining structure of this thesis.

Summary of key findings

1. **Limited policy effectiveness.** The research found that policies to detect and deter money laundering through professional facilitators achieved intended outcomes in just four percent of assessable research cases over approximately a 20-year period.

2. **Professionals were found more often unwitting or wilfully blind enablers than inhibitors of criminal activity.** When presented with real estate transactions with the proceeds of crime, more than a third of professionals enabling such transactions were duped by criminals misusing their services. No red-flag criminal indicators were assessed visible when their services were used to help facilitate criminal endeavours. Nearly a third were assessed unwittingly used by criminals. They faced relatively few red-flag criminal indicators, and missed or misunderstood their significance. Nearly another third of professionals enabling financial transactions with illicit funds was assessed as wilfully blind (or as behavioural scientists might contend, wishfully blind (Ariely, 2013, p.2)), failing to inquire further, or at all, notwithstanding multiple identified criminal indicators.

3. **Prosecutions are a poor indicator of professionals facilitating criminal transactions.** The paucity of prosecutions of professional facilitators was found not to be a reliable indicator of their role enabling criminal transactions. The research isolated more instances exhibiting at least as many red-flag criminal indicators as in the few cases prosecuted. All identified prosecutions related to transactions in the first decade of the research period, notwithstanding a consistently high proportion of facilitators assessed as unwittingly used or wilfully blind in the second decade. Counter-intuitively, law changes early in the second decade markedly increased the ability to prosecute for wilful blindness in appropriate cases, yet none eventuated.

4. **Professionals were found to be involved in a wide range of financial transactions with crime proceeds.** Professionals were identified facilitating a wide range of financial transactions with criminal proceeds, including incorporating companies, establishing trusts, preparing contract and trust documents, and reviewing and varying existing contracts. Some acted as trustees, established trustee companies and conducted litigation potentially involving criminal proceeds. Others lodged formal notices preserving or releasing interests in property acquired with illicit funds, advised 'straw-man' property owners, and acted as conduits for payments to banks or as funding channels to other professionals enabling financial transactions. Some professionals received criminal funds, arranged their payment overseas, or advised colleagues enabling real estate transactions with criminal proceeds.

5. **Red-flag criminal indicators were ranked in order of importance.** This thesis produced the first ranked list of characterisations empirically associated with criminal investment in New Zealand's real estate market. Thirty-two factors were assessed, and ranked in order of observed empirical frequency. Differences between complicit and non-complicit facilitators were also identified. Rankings are useful because much of the literature offers only generic lists of red-flag criminal indicators, with little or no indication of their relative importance based on empirical evidence.
6. **The empirically mapped distribution of red-flag criminal indicators exposed where criminals can (and do) exploit gaps.** The research found that criminals shield professionals and others associated with financial transactions (such as banks) from indicators of criminal activity. Distribution maps of red-flag indicators illustrate criminal characteristics more, and less, susceptible to masking by criminals, and can help improve policy, regulatory, enforcement and compliance effectiveness.
7. **Information asymmetry, as between banks and facilitators, and between facilitators, was empirically isolated.** The research findings did not support the proposition that banks are inherently better placed than professionals to identify criminal real estate transactions. Nor is the policy issue resolved by imposing anti-money laundering controls on banks *and* facilitators, due to gaps found *between* banks and facilitators. A lack of knowledge by one, of red-flags visible only to the other, presents a policy gap not filled by requiring *both* to detect/report suspicions.
8. **More legislation may not be the (only) answer.** The usual response to policy failure, more regulation, may be simplistic. Increased money laundering controls may reinforce and extend professionals' obligations, but the core policy question remains the same. If duties to detect and report suspicious real estate transactions have not proven as effective as intended, will 'more of the same' produce a materially different result? The findings in this research suggest other solutions oriented towards policy, regulatory, enforcement and compliance effectiveness.
9. **Targeted net for bigger fish.** This thesis also examines an underused policy effectiveness indicator recognised by the United Nations. It suggests that, despite the global ubiquity of money laundering controls, the 'success rate' of current policy settings represents little more than a rounding error in criminals' accounts as they

conduct and expand profit-motivated criminal enterprises. This thesis suggests that an advanced form of ‘follow-the-money’ policing and new strategies may be needed for an order-of-magnitude change to help make crime unprofitable, beyond the rhetoric.

10. **The research can be replicated in other jurisdictions and for other financial transactions.** New Zealand was selected as a research subject because it has long-standing anti-money laundering obligations on professionals in specified classes of financial transactions, but the methodology developed to operationalise the identification and assessment of red-flag criminal indicators is jurisdictionally neutral, irrespective of anti-money laundering obligations. Nor is the methodology restricted to real estate. It is possible to identify, assess and rank characteristics empirically associated with criminal investment in any class of financial transaction.

Contribution to scholarship and practice

Complementing the findings summarised above, this thesis makes the following contributions to the literature and practice.

1. **New empirical findings: How lawyers, accountants and real estate agents facilitate criminal financial transactions.** This thesis fills a knowledge gap with new empirical research outlining how lawyers, real estate agents and accountants are used to facilitate financial transactions with proceeds of crime in New Zealand real estate transactions. It offers policy, regulatory and enforcement strategies and research suggestions to enhance crime detection and prevention capabilities, and outcomes. It also suggests strategies to assist the transition of professionals unwittingly enabling financial transactions with criminal proceeds into more effective sentinels.
2. **Constructively assesses the new global effectiveness and outcomes framework for evaluating anti-money laundering regimes.** With few existing connections between disciplines, this thesis constructively critiques the new global anti-money laundering ‘effectiveness’ methodology from an overarching policy effectiveness and outcomes framework. Drawing from the outcomes discourse and evaluations of anti-money laundering regimes (notably Australia and Canada), it finds that the methodology does not (yet) reflect an outcome-oriented policy effectiveness methodology as it purports, and suggests prospective solutions.

3. **Advances a nascent conversation that the standard ‘incremental’ approach of extending money laundering controls is not working as intended.** This thesis joins and extends discussion postulating that the global anti-money laundering regime, viewed objectively from an outcomes perspective, has not clearly demonstrated any material and compelling evidence of effectiveness. Logically, therefore, the standard ‘incremental’ approach, of extending existing obligations to new private actors and financial transactions, is unlikely to have a substantial policy effectiveness impact.
4. **Assesses anti-money laundering policy effectiveness, and revisits interdiction rates as a ‘success rate’ measure.** This thesis reintroduces interdiction rates (the proportion of criminal funds seized or forfeited by enforcement authorities) as a ‘success rate’ indicator of policy settings and activities enabling the identification and disruption of profit-motivated crime, and assesses anti-money laundering effectiveness in jurisdictions that apply different policy settings to professional facilitators: New Zealand, Australia, Canada and the United Kingdom (with European Union and global comparators). Notwithstanding the global ubiquity of money laundering controls, and claims of policy success, it finds that the amount of crime proceeds interdicted, in a range of countries assessed, and globally, is little more than a rounding error in the accounts of profit-motivated criminal enterprises.
5. **New investigative tool assesses the nature and extent of professionals’ involvement in facilitating criminal financial transactions.** This thesis operationalises [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED], the new assessment methodology can also be used as an investigative and compliance tool, with specialist analytics to detect complicit, wilfully blind and unwitting professionals enabling financial transactions with criminal proceeds.
6. **New methodologies for ranking and mapping characteristics empirically associated with criminal investment.** By rank-ordering red-flag criminal indicators and mapping characteristics empirically found to be more, and less, susceptible to

masking by criminal actors, this thesis advances the literature and practice, which typically lists generic red-flags with little or no indication of their relative importance.

7. **Intelligence-led policing initiatives to help make crime unprofitable, beyond the rhetoric.** Building on a theoretical operational policing continuum concluding with ‘intelligence-led policing’, and findings that enforcement agencies currently interdict a small proportion of criminal proceeds, this thesis suggests practical opportunities to identify, prosecute and deter higher-order profit-motivated criminal offending.
8. **Methodology to locate data and identify relevant transactions with proceeds of crime enabled by professional facilitators.** The methodology, data collection, case selection, operationalisation and coding developed to identify relevant criminal transactions was used to uncover new empirical evidence of professionals facilitating transactions with criminal proceeds. It is equally applicable in any jurisdiction with proceeds of crime legislation, irrespective of anti-money laundering obligations; to support evidence-based policy development or further research.
9. **Minor adjustments suggested in the McConnell/Marsh policy effectiveness spectrum and the presentation of global anti-money laundering ratings.** This thesis suggests a visual representation of McConnell/Marsh policy effectiveness gradations between success and failure. It also suggests incremental advances to elements of FATF’s ‘effectiveness’ methodology which currently evaluates anti-money laundering regimes on 11 ‘outcome’ measures but describes overall effectiveness only in broad thematic terms. Average ‘effectiveness’ and risk ratings can be calculated (and ranked) for each jurisdiction, and for each ‘outcome’. The data can also be displayed in a format graphically illustrating relative ratings.
10. **Illustrates scope and scale of definitional changes to US State Department effectiveness findings.** Prompted by the March 2017 release of the US State Department’s thirty-second annual International Narcotics Control Strategy Report, this thesis briefly reviews the frequency of changes made since 1998, graphically illustrating the relative magnitude of the latest changes, potentially the most significant transformation since its introduction.

Remaining thesis structure

This brief introductory chapter concludes by summarising the remaining structure of the thesis. Outlining a case study methodology to identify, operationalise and assess relevant data, using underexamined evidence of professionals facilitating real estate transactions with crime proceeds, **chapter 2** provides a methodological basis for new empirical findings. **Chapters 3-5** then provide a theoretical base for the research findings. They also detail the manifold research design insights that shaped development of the methodology outlined earlier, in **chapter 2**.

Specifically, **chapter 3** outlines money laundering and its global system of controls. It places laundering in a broad ‘proceeds of crime’ context and introduces criminal justice policy effectiveness concepts increasingly associated with ‘outcome’ over ‘output’ measures. **Chapter 4** examines the role of professionals enabling real estate transactions, as a high-value, high-risk area for money laundering. The overarching policy effectiveness and outcomes literature outlined in **chapter 5** allows us to think systematically about the extent to which policies achieve their objectives, and as the basis to develop a framework to assess anti-money laundering policy effectiveness.

Those introductory chapters provide the theoretical base for new findings, in two parts: original analysis; and new empirical evidence.

In relation to the first component of new findings (original analysis), **chapter 6** offers original analysis of the new global anti-money laundering ‘effectiveness’ methodology. It draws from a thin strand of scholarship connecting the outcomes and money laundering literature, applies the outcomes lens of **chapter 5**, and finds that the new methodology does not (yet) fully reflect the outcome-oriented policy effectiveness framework it purports. A complementary comparative review in **chapter 7** fails to find meaningful policy effectiveness differences between countries that apply anti-money laundering obligations over some, none, or all facilitator professions. It tests prospective policy effectiveness measures, settles on interdiction rates as an interim metric, and finds that the amount of criminal proceeds interdicted by authorities is little more than a rounding error in the accounts of criminal enterprises.

In relation to the second component of new findings (empirical evidence), also framed in the outcomes lens of **chapter 5**, and drawing from the methodology in **chapter 2** and

theoretical base of **chapters 3-5, chapters 8-9** deliver new empirical findings to help close a knowledge gap in the role of professionals facilitating financial transactions with illicit funds in New Zealand's real estate sector. These chapters also make new empirical findings about the effectiveness of policies to detect and deter such transactions.

The thesis concludes in **chapter 10** with further policy implications and a research agenda to help advance the development of evidence-based policy settings, and regulatory and enforcement strategies, targeted for effectiveness.