

## Money Laundering: Concept, Issues and Challenges

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### ABSTRACT

*Money laundering is an International issue from the beginning. It is a curse to the whole world which supports illegal activities in the world economy in the form of terrorism, black money, hawala, tax evasion and other illegal activities. These kind of illegal activities not only affect the world economy but also threat to a human being. To control the money laundering activities, Indian Government has also taken some strict measures in the form of different acts. The present study focuses on the concept of money laundering, its affects, methods and techniques and also anti-money laundering act in India.*

**Keywords:** Money laundering, Anti-money laundering, The Prevention of Money Laundering Act, 2002

### **MONEY LAUNDERING**

In the present time money laundering has posed to be a conundrum globally. Money laundering has caught the attention of global media, banks, recovery agencies as well as common man. Money laundering has been maligned for an array of issues ranging from corruption to funding of illegal terrorist activities across the world.

Money laundering is a process whereby the proceeds of crime are transformed into legitimate money or assets. Money laundering is the processing of criminal proceeds to disguise its illegal origin. In other words, money laundering may be defined as the act of making money that comes from one source to look like it comes from any another source. INTERPOL's definition of money laundering is: "any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources". The act of money laundering is done with the intention to conceal money or other assets from the State so as to prevent its loss through taxation, judgement enforcement or blatant confiscation. The criminals try to disguise the origin of money obtained through illegal activities to look like it was obtained from legal sources because otherwise they will not be able to use it as it would connect them to the criminal activity and the law enforcement officials would seize it.

Article 1 of European Commission Directive defines Money Laundering as "The conversion of property, knowing that such property is derived

from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence(s) to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from serious crime.”

In India Section 2(1) read with Section 3 of the Prevention of Money Laundering Act, 2002 defines money laundering to any direct or indirect efforts of concealing the source of proceeds or property that is achieved via the means of committing crime. It includes both direct and indirect attempts and extends to extending aide to enable money laundering.

Drug traffickers, embezzlers, terrorists, corrupt politicians and public officials, smugglers are the different types of criminals who need to launder money. All these are involved in different types of criminal activities. Terrorism, financial crimes, drug trafficking and other crimes generate a large amount of money. Criminals find a way to use these funds without any suspicious activities. So they look for different methods by which they can use their black money as white money. This is the basic objective of money laundering. The main purpose of these activities to generate money for the group or for an individual.

In Indian context money laundering system has been equated with Hawala System. It is a system by which criminals collect the money for criminal activities such as drug trafficking, terrorism funding, smuggling, gambling etc.

## **STAGES OF MONEY LAUNDERING**

Money is laundered in the following three steps:-

### **Placement**

The first step is related to depositing cash funds in foreign banks. This step is called placement, as the funds are placed in foreign banks without drawing the attention of national authorities.

### **Layering**

The second step is linked to carrying out financial transactions, cash withdrawals, wire transfers, etc. and hiding the original source of money. This step is called layering, as the money launderer performs several financial transactions, which act as layers of cash. Online transactions, notably wire transfers, are the quickest way of layering, as multiple cash transactions can occur speedily through them.

### **Integration**

The third step is related to the use of money for investment or any other action. This step is called the integration of funds, as the laundered money is actually used at this stage. When money has reached this step, it becomes difficult or almost impossible for the A.M.L. authorities to track the laundered money, unless a trial or investigation

had started when the money was in the first or second stage.

All of the three steps are interconnected and must take place for the laundered money to be used in the foreign land. Nonetheless, if someone transfers large taxable sums of money to the foreign banks and does not withdraw the money there, i.e., if there is a placement of funds but no withdrawal or integration, then this would still be considered money laundering if the funds had been transferred without notifying the local government authorities and, in particular, if the amount had been transferred without paying tax on it.

## LITERATURE REVIEW

The origins of money laundering can be traced back to as early as 1930s in organised criminal activities (Bosworth-Davies & Saltmarsh, 1994). However, after September 11, 2001, worldwide efforts to combat money laundering and the financing of terrorism have become prime importance. The FATF has established an international standard against money laundering and terrorist financing and produced recommendations that should be adopted. The FATF measures are viewed as the leading international anti-money laundering standards that provide an enhanced, comprehensive and consistent framework for combating money laundering and terrorist financing. This framework serves as an international benchmark

for national governments to implement within their respective national jurisdictions, for the detection, prevention and suppression of money laundering and the financing of terrorism.

A group of studies have taken initiatives to examine the magnitude and scope of money laundering and terrorism financing problems (Schott, 2006; Biagioli, 2008; Zdanowicz, 2009; Walker & Unger, 2009) and investigated how the money is being laundered (Unger et al., 2006; Unger, 2007).

Other studies focused on the role of technology in money laundering compliance (Reuda, 2001), money laundering techniques and typology (Ping He, 2010; Irwin, 2011) and money laundering focusing on Hawalla (Bala, 2005). Generally, the findings revealed that the banking sector is the most risky sector.

Irwin et al. (2011) have examined the size of money laundering and terrorism financing problems, identifying threats and trends, the techniques employed and the amount of funds involved. The findings revealed that money launderers prefer to use techniques that maintain high levels of anonymity and appear innocuous. The sums of monies involved in money laundering and terrorism financing varies from AUD 68.5M for money laundering as compared to AUD 4.8M for terrorism financing cases. A review of the literature shows that there is a dearth of studies that have empirically examined

the issue of the compliance measures. Despite limited studies, some studies have examined the measures on combating money laundering and terrorism financing (He, 2007; Zhu & He, 2003).

Ping He (2010) examined money-laundering techniques and he discovered that the ways money is laundered include cash smuggling, making use of banks or insurance company, or making use of shell-company or front-company. He also found that criminals often prefer to launder money through non-face to face transactions. Studies in relation to money laundering and terrorist financing in Malaysia tend to focus on the development of statutes, regulations and conceptual rather than the actual implementation of these measures (Bala & Thanasegaran 2008; Araujo, 2008). The empirical studies that have examined money laundering and terrorist financing often focused on factors that underpin the pervasiveness of money laundering (Vaithilingam & Nair, 2007)

## CAUSES OF MONEY LAUNDERING

Several factors give rise to money laundering, and they may be present within a country or state, or might operate transnationally. Some of the most prominent factors that lead to money laundering are discussed below:-

### Tax Evasion

Tax evasion and money laundering: both are unlawful activities; both involve the violation of

laws; the acts are deliberate in both tax evasion and money laundering; and both of these offences disguise or conceal the money received. It was necessary to analyze the definition of tax evasion in terms of a crime because it has frequently been argued that the proceeds of tax evasion are different to the proceeds of conservative criminality. One of those arguments is that since the underlying conduct that generated the profit was legal, the non-payment of the subsequent tax on those profits could not be equated to the proceeds of criminal conduct. A counter-argument, however, is that although the underlying conduct is legal, the retention of money that should be paid over as tax is the actual criminal. One can take this argument a step further and state that where tax evasion is involved, it does not automatically indicate money laundering. However, where money is being laundered, the chances of tax evasion being part of the equation are perceived to be 100%.

### Weak Financial Regulations

Money laundering increases the probability that the financial institution itself will become corrupt or even controlled by criminal interests. The possibility is even greater in a developing country that criminal interests can eventually control an entire financial institution. First, such institutions tend to be smaller, which makes the task of control easier. Second, developing country financial regulation and supervision tends to be less rigorous than that in developed countries,

which themselves have problems with criminal penetration of institutions or lower-level fraud. There are many indications that the volumes of illicit funds in developing-economy banking systems are substantial. At such high levels, the influence of criminal interests over financial institutions becomes a serious concern.

### **Bribery**

Bribery is offering, promising, giving or accepting any financial or other advantage, to induce the recipient or any other person to act improperly in the performance of their functions, or to reward them for acting improperly, or where the recipient would act improperly by accepting the advantage. A bribe is essentially a corrupt transaction in which some form of benefit is either paid or offered to purchase the influence of the recipient. As with other forms of corruption, bribery is generally conducted covertly to avoid detection. Thus, while any benefit may qualify as a bribe, the most common payments and offers involved in bribery schemes are those that obscure the nature of the act. In addition, a system of money laundering may be employed to further conceal acts of bribery.

### **Corruption**

Corruption is a widespread phenomenon which used to be linked to poor countries until it was decided that it is a universal concept found in all countries whether developed or in the developing process across the globe, in the public or the

private sector. Corruption can be understood as the use of the public office for private gain and it is done through several criminal methods such as bribery, extortion, fraud, embezzlement, theft of public funds. In order to benefit effectively from the public goods, the source of all illicit gains has to be concealed. Thus, corrupt officials stole assets through the process of money laundering and if the process is successful there is no confiscation of the assets illegally obtained. When corruption takes place in developing countries the process of laundering the illicit gains happens through the international financial system.

## **METHODS OF MONEY LAUNDERING**

### **Structuring of Money**

If the criminal only needs to move a few million dollars a year, the simplest way to launder cash without detection is "structuring"—having people deposit random amounts into variously named accounts at many different banks. They will also buy bank drafts from various financial institutions to circumvent thresholds for transaction reporting. Then a middleman can ship the compact negotiable for deposit elsewhere. Due diligence rarely catches this activity. Laundering of accounts held by relatives or friends is also popular. One small-time drug trafficker had his wholesalers deposit money into his account using the "Interacts" bank tellers. He then withdrew the money to purchase money

orders in which he sent out of the country both to purchase more drugs and for safekeeping.

### **Smuggling**

Smuggling gets the cash out of the country, with strict bank reporting laws, and into the countries with strict bank-secrecy laws. Thereafter the proceeds can be layered and repatriated or smuggled back in the form of non-cash financial instruments. Smuggling through physical transportation method is popular with launderer, as it leaves no paper trail.

### **Laundering through trade**

The criminal might also choose to repatriate the money as business income. They may take over a company that engages regularly in international trade in goods and/or services then divide the payments between "suppliers" in several countries, alternate between wire and written forms of remittance and ensure that the nominal recipients appear to have sound business reputations. Service companies are the best for there are no clear rules against which to check the prices being charged to the domestic company. Money launderers also receive the assistance of accountants, notaries, lawyers, real estate agents, and agents for the purchase and sale of luxury items, precious metals, and even consumer durables, textiles, and other products involved in the import-export trade.

### **Round Tripping**

Launderers purchase expensive round trip airline tickets and return them for a cash refund upon completion of a portion of the journey. Travel agencies as front are also utilized for their capacity of wire transferring the funds.

### **Bank Control**

Under this method, money launderers become major shareholders of a bank in a foreign or local region where there is weak scrutiny related to money laundering. Hence, by making an investment in the bank and gaining some shares, the money launderers try to gain influence over the bank and perform money laundering through it without scrutiny as it becomes a major client of that bank. This kind of money laundering is very rarely identified because the financial regulatory authorities consider the movement of currencies from the bank as usual cash proceeds.

### **Cash-Oriented Businesses**

Dirty money can be added to the cash revenues of a legitimate business enterprise, particularly those that are already cash intensive, such as restaurants, bars, and video rental stores. The extra money is simply added to the till. The cost for this laundering method is the tax paid on the income. With companies whose transactions are better documented, invoices can be manipulated to simulate legitimacy. A used car dealership, for example, may offer a customer a discount for paying cash, then report the original sale price on

the invoice, thus “explaining” the existence of the extra illicit cash. A slightly more sophisticated scheme may allow a criminal to profit twice in setting up a publicly traded front company with a legitimate commercial purpose—first from the laundered funds commingled with those generated by the business, and second by selling shares in this company to unwitting investors.

### **Money Laundering through Real Estate**

Real Estate transactions serve as a legitimate business, yet they are cash intensive. Real Estate and Properties may be sold and bought under fraud names or through shell companies and can serve as collateral in further layering transactions.

### **Foreign Exchange**

Currency Exchange Bureaus are not heavily regulated as banks, so sometimes they are used for money laundering transactions. Huge foreign exchange transactions are said to be shifting these small business enterprises.

### **Hawala**

Another way to move money is an underground system known as **hawala**. “For many people in remote areas of the world, the hawala system is faster, cheaper and more reliable than Citibank,” Wechsler said. Organized through a series of informal chits and promises, such a system can move huge amounts of cash. None of it crosses borders, and except for personal notes there’s no record of the transactions. Hawala remittance

systems are a fast, safe and cost-effective way to transfer funds both domestically and internationally without using formal financial institutions. As such, it is an informal fund transfer system that runs in parallel to – and usually independently from – the formal banking system. Such systems were originally developed to facilitate trade between distant regions at a time or in regions where conventional banking instruments were either absent, weak or unsafe.

### **Third- Party Cheques**

Banks and Financial Institutions always need to be aware of the potential for money laundering through the use of third-party cheques. A third-party cheque is a cheque made payable to a payee who then transfers the rights to the cheque to a third-party by endorsing the check over to that third-party. Many individuals and businesses have legitimate reasons for using third-party cheques for their transactions, but such checks are also often used to launder illicit funds. For example, bank regulators have reported that significant numbers of U.S. dollar third-party cheques have been presented to banks located overseas, even though both the payee and payor appeared unconnected to the country where these cheques were presented for payment. When negotiated, the cheques became part of international letter packages sent to correspondent banks in the U.S.

### **Credit Cards**

Funds can be repatriated through a debit or credit card issued by an offshore bank without leaving a financial trail. The banks assure their clients that the card account information is protected by the same rules that protect the other account information. Bills incurred at home can also be settled by an offshore bank through their deposit account or even more discretely by an offshore company. Scammers and tax evaders using this method may soon hear a tax man knocking on their door.

### **Insurance Sector**

Life and general insurance policies are purchased with crime proceeds and thereafter cashed in early. Redemption is made through a cheque issued by the insurance company. The cheque appears to provide a legitimate source. The penalty payment for early redemption is accepted as a laundering cost. As an investment, life policy would make a larger maturity payment to the offenders. The funds come from a non-taxable and apparently legitimate source. Launderers can use policies as collateral too for loans

### **Security Market**

The problem of money laundering in the securities markets does exist, and on a large scale. Criminals are well ahead of law enforcement in this field. The primary opportunity for laundering is in the complex derivatives market. The

persons thoroughly familiar with the systems can use the derivatives markets for laundering. Securities regulators and law enforcement must each improve and increase their investigative capabilities, and must work together to attack the problem.

### **Cyber Crime**

When laundering the proceeds of crime, criminals need to be quick and efficient. For this reason, and also given the specificity of cybercrime, the majority of organizers and perpetrators of cybercrime-related criminal schemes tend to be well-educated and technically competent individuals, meaning that the money laundering methods developed by them can also be quite complex and unconventional. The choice of tools and mechanisms used by criminals to launder cybercrime proceeds is quite diverse. Conversion of stolen funds into cash is common because the movement of cash outside the banking system is nearly impossible to track.

## **EFFECTS OF MONEY LAUNDERING**

### **ECONOMIC IMPACTS**

#### **Vulnerable Emerging Markets**

Vulnerability of emerging markets is one of the biggest economic impacts of money laundering. Emerging markets affected by money laundering in those areas where it is established. Emerging markets are more vulnerable to the impact of



money laundering because financial regulatory authorities give more attention to well-established and strong markets than to emerging ones.

### **Damage to the Private Sector**

Money laundering impairs the development of the legitimate private sector through the supply of products priced below production cost, making it therefore difficult for legitimate activities to compete. Criminals may also turn enterprises which were initially productive into sterile ones to launder their funds leading ultimately to a decrease in the overall productivity of the economy. Furthermore, the laundering of money can also cause unpredictable changes in money demand as well as great volatility in international capital flows and exchange rates.

### **Failure of Banks and Financial Institutions**

Money laundering is the main reason for failure of banks and financial institutions in an economy. It may cause a liquidity problem to the financial assets of the bank. It may result in the bankruptcy of banks and other financial institutions.

### **Reputation**

Nations cannot afford to have their reputations and financial institutions tarnished by an association with money laundering, especially in today's global economy. Confidence in markets and in the signalling role of profits is eroded by

money laundering and financial crimes such as the laundering of criminal proceeds, widespread financial fraud, insider trading of securities, and embezzlement. The negative reputation that results from these activities diminishes legitimate global opportunities and sustainable growth while attracting international criminal organizations with undesirable reputations and short-term goals. This can result in diminished development and economic growth. Furthermore, once a country's financial reputation is damaged, reviving it is very difficult and requires significant government resources to rectify a problem that could be prevented with proper anti-money-laundering controls.

### **Decline in Tax Revenues**

Money laundering diminishes government tax revenue and indirectly harms honest taxpayers. It also makes government tax collection more difficult. This loss of revenue generally means higher tax rates than would normally be the case if the untaxed proceeds of crime were legitimate.

## **SOCIAL IMPACTS**

There are significant social costs and risks associated with money laundering. Money laundering is a process vital to making crime worthwhile. It allows drug traffickers, smugglers, and other criminals to expand their operations. This drives up the cost of government due to the need for increased law enforcement and health care expenditures (for example, for treatment of

drug addicts) to combat the serious consequences that result. Among its other negative socioeconomic effects, money laundering transfers economic power from the market, government, and citizens to criminals. In short, it turns the old adage that crime doesn't pay on its head.

## **ANTI-MONEY LAUNDERING IN INDIA**

In India, before the enactment of the Prevention of Money Laundering Act 2002 (PMLA), the following statutes addressed scantily the issue in question. The major steps that incorporated measures to address the problem of money laundering in India were:-

- The Income Tax Act, 1961
- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA)
- The Smugglers and Foreign Exchange Manipulators Act, 1976 (SAFEMA)
- The Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPSA)
- The Benami Transactions (Prohibition) Act, 1988
- The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988
- The Foreign Exchange Management Act, 2000, (FEMA)

### **Anti-money laundering legislation in India**

To achieve the objective to curb money laundering, the Prevention of Money-laundering Bill, 1998 was introduced in the Parliament. The Bill was referred to the Standing Committee on Finance, which presented its report on 4th March, 1999 to the Lok Sabha. The Prevention of Money-Laundering Bill having been passed by both the Houses of Parliament received the assent of the President on 17th January, 2003. It came on the Statute Book as THE PREVENTION OF MONEY-LAUNDERING ACT, 2002 (15 of 2003)

### **The Prevention of Money Laundering Act, 2002 (PMLA)**

**Prevention of Money Laundering Act, 2002** is an Act of the Parliament of India enacted by the NDA government to prevent money-laundering and to provide for confiscation of property derived from money-laundering. PMLA and the Rules notified there under came into force with effect from July 1, 2005. The Act and Rules notified there under impose obligation on banking companies, financial institutions and intermediaries to verify identity of clients, maintain records and furnish information in prescribed form to Financial Intelligence Unit - India (FIU-IND).

The act was amended in the year 2005, 2009 and 2012.

On 24 Nov 2017, In a ruling in favour of citizens' liberty, the Supreme Court has set aside a clause in the Prevention of Money Laundering Act, which made it virtually impossible for a person convicted to more than three years in jail to get bail if the public prosecutor opposed it. (Section 45 of the PMLA Act, 2002, provides that no person can be granted bail for any offence under the Act unless the public prosecutor, appointed by the government, gets a chance to oppose his bail. And should the public prosecutor choose to oppose bail, the court has to be convinced that the accused was not guilty of the crime and additionally that he/she was not likely to commit any offence while out on bail- a tall order by any count.) (It observed that the provision violates Articles 14 and 21 of the Indian Constitution)

### **Objectives**

The PMLA seeks to combat money laundering in India and has three main objectives: -

- To prevent and control money laundering
- To confiscate and seize the property obtained from the laundered money; and
- To deal with any other issue connected with money laundering in India

### **Salient features of the Act**

#### **Punishment for Money –Laundering**

The Act prescribes that any person found guilty of money-laundering shall be punishable with rigorous imprisonment from three years to seven

years and where the proceeds of crime involved relate to any offence under paragraph 2 of Part A of the Schedule (Offences under the Narcotic Drugs and Psychotropic Substance Act, 1985), the maximum punishment may extend to 10 years instead of 7 years.

#### **Powers of attachment of tainted property**

Appropriate authorities, appointed by the Govt of India, can provisionally attach property believed to be "proceeds of crime" for 180 days. Such an order is required to be confirmed by an independent Adjudicating Authority.

#### **Adjudicating Authority**

The Adjudicating Authority is the authority appointed by the central government through notification to exercise jurisdiction, powers and authority conferred under PMLA. It decides whether any of the property attached or seized is involved in money laundering.

The Adjudicating Authority shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and subject to the other provisions of PMLA. The Adjudicating Authority shall have powers to regulate its own procedure.

#### **Presumption in inter-connected transactions**

Where money laundering involves two or more inter-connected transactions and one or more such transactions is or are proved to be involved in money laundering, then for the purposes of adjudication or confiscation, it shall be presumed that the remaining transactions form part of such inter-connected transactions.

### **Burden of Proof**

A person, who is accused of having committed the offence of money laundering, has to prove that alleged proceeds of crime are in fact lawful property.

### **Appellate Tribunal**

An Appellate Tribunal is the body appointed by Govt of India. It is given the power to hear appeals against the orders of the Adjudicating Authority and any other authority under the Act. Orders of the tribunal can be appealed in appropriate High Court (for that jurisdiction) and finally to the Supreme Court.

### **Special Court**

Section 43 of Prevention of Money Laundering Act, 2002 (PMLA) says that the Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under Section 4, by notification, designate one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or

group of cases as may be specified in the notification.

### **FIU-IND**

Financial Intelligence Unit – India (FIU-IND) was set by the Government of India on 18 November 2004 as the **central national agency** responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

### **CONCLUSION**

Money laundering has been recognized as a major crime at all the level where as domestic level as international level. Smugglers, terrorists, black money owners, drug trafficker and others use different methods for money laundering to finance their illegal activities. Although many steps has been taken by the Government to prevent money laundering at international level. Money laundering affects the economy adversely by devaluating capital, increasing inflation rate, affecting interest rates and in many other ways. Indian government has taken many actions to control the money laundering activities in our

country. Many laws had been applied to control the money laundering activities according to time to time. The Prevention of Money Laundering Act, 2002 was the main act which had been passed by the government to control the money laundering activities in India.

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