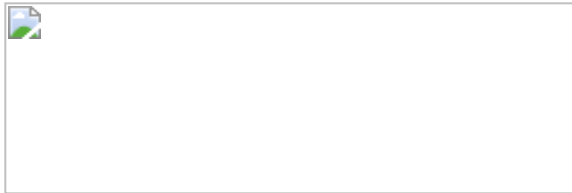


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**The Brazilian Law for Combating**  
**Money Laundering**



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**SUMMARY**

The purpose of the paper is to analyze the Brazilian law aimed at combating money laundering. The law 9.613/98 was approved after a long process which lasted almost three years. Because laws in Brazil, compared to those in the U.S, have a low degree of enforcement, the analysis took into account this characteristic and aimed at providing alternatives to reduce this problem.

The analysis compared the Brazilian law enacted to deal with money laundering to U.S legislation.

The U.S was chosen because it was the first country to pass an anti-money laundering law and in which lots of work has been done about this subject.

The paper also discusses the existent requirements for recording and reporting transactions mandated by Brazilian law. This discussion emerges from the fact that since the *Real*, the Brazilian currency, is not a convertible currency, money launderers must exchange it, if for instance, they intend to send their earnings abroad. Therefore, at least one transaction must be done through the foreign exchange market.

Acting in this market implies risk because the transaction (recorded according to Brazilian laws) might be selected for closer analysis by the Brazilian Central Bank.

However, there are lots of transactions taking place in the foreign exchange black market.

These transactions have no records. The only way to uncover them is to track the money bought in the foreign exchange.

This tracking requires the improvement of the efficiency of financial transactions recording norms and the creation of new ones. This paper intends to contribute to this goal.

## **MONEY LAUNDERING DEFINITION**

Money laundering is an activity aimed at concealing the unlawful source of sums of money. It consists of shedding the identity of the owners of the funds of illicit origin and using these funds through financial transactions before entering the legal circuit in various forms of investment. A simpler definition is the washing of dirty money to make it appear legitimate.

Typically, laundering is effected through legitimate markets, banks and other financial intermediaries, generally used as unwitting tools. In some cases, however, there are dangerous interconnections between the management of financial intermediaries and criminal interests.

Money laundering is an international problem which is closely related to drug trafficking which, in turn, is probably the most serious crime problem in the world today.

Thus, most of the legislation dealing with money laundering, since the first laws were passed, has been issued to combat drug trafficking. However, it is very important to consider that there are other varieties of crime (fraud, embezzlement, racketeering, corruption, prostitution, gambling, etc.) that make use of money laundering activities.

According to International Narcotics Control Strategy Report, for 1994, non-drug money laundering constituted, in Europe, at least one-fourth of illegal proceeds transferred through or being converted by West European financial institutions. This share was most likely higher in other parts of the world, notably Southwest, Southeast and East Asia.

Drug traffickers and organized crime generate huge amounts of cash in small denominations. These huge sums of cash are nearly worthless to mobsters unless they can be successfully tricked into the banking system – and thereafter into legitimate investments.

Through money laundering organized crime diversifies its sources of income and enlarges its sphere of action. The social danger of money laundering consists of the consolidation of the economic power of criminal organization, enabling them to penetrate the legitimate economy.

### **AN IDEA OF THE AMOUNT OF MONEY BEING LAUNDERED**

Because the illegal activities take place far from the eyes of the authorities it is quite difficult to measure the amount of laundered money. According to international agencies, drug trafficking is estimated to move approximately US\$ 400 billion per year worldwide.

Michael Herschman, is a founding membership of Transparency International, a German NGO aimed at combating corruption, and is President of Decision Strategies Fairfax International, an American firm that work consists in tracking dirty money and which clients are foreign governments. He says money laundering, in 1993, moved \$ 100 billion in the U.S. and \$ 500 billion worldwide, and that almost 35 % of this huge amount were proceeds of drug trafficking.

Michel Camdessus, Managing Director of the IMF, in his address at the Plenary Meeting of the Financial Action Task Force on Money Laundering (feb/98), said that the estimates of the present scale of money laundering vary from 2 to 5 percent of global GDP.

IMF considers FATF efforts to fight against money laundering as crucial for the soundness of the financial markets.

### **THE IMPORTANCE OF COMBATING MONEY LAUNDERING**

The short history of the money-laundering concept originated in the context of the growth of the drug trafficking phenomenon. At domestic and international levels the anti-money laundering policies of the last few decades have frequently been considered in the framework of drug legislation. Even though the need to launder crime proceeds has always been connected with a wide range of crimes, many countries only penalize drug money laundering. This impedes understanding of the

economic consequences of organized crime and limits the implementation of anti-money laundering policies.

Criminal organizations do not succeed unless they are able to launder their money. The major nations of the world are beginning to understand that.

Nowadays, the main tendencies taking place in the international markets both real and financial are the following:

- A. growth of the economic integration between countries;
- B. internationalization of the producing processes;
- C. growing role performed by non-financial institutions in the international financial transactions.

These tendencies are likely to intensify and, in spite of bringing unquestionable benefits, also complicates the prevention and repression of money laundering activities.

Because of the huge volume of money to be laundered and its concentration in few hands in a few countries; and also because of the higher likelihood of domestically money laundering being uncovered, money-laundering activity has been increasingly conducted internationally. Incentives for this change are: privatization of state-owned companies in many countries; the growth of stock markets in developing countries; absence of controls or questioning of international capital in tax haven countries; increasingly new financial products in the international financial market; the great need for foreign capital of economies in transition and developing countries.

The sophistication of the financial side of criminal activities increases with the size of the sums to be laundered and the extensiveness of the illegal activities that generate them. In some cases, organized crime wields a power capable to challenging the state itself.

The economical consequences of money laundering are harmful. The huge amount of illegal money and its laundering are able to destabilize economies and subvert political processes. Some examples of how dangerous money laundering is in terms of destabilizing or challenging countries are:

- a. the well known undermining of the integrity of Colombia's judicial, police and political systems. For instance, Ernesto Samper, President of Colombia, shortly after his victory in the 1994 presidential election, was alleged to have accepted campaign contributions from leaders of Cali drug cartel.
- b. Russian Mafia was proved to be buying up banks and, next, opening offshore agencies. Five Russian banking agencies in Antigua, a Caribbean tax haven, were closed because of suspicious of being laundering Mafia's money.

- c. Drug trafficking in Rio de Janeiro's slums, in Brazil, is alleged to be responsible for increasing violence in that city. Such violence has year after year reduced foreign tourists flow and, consequently, the wealth of the city.

By focusing upon money laundering, criminal enterprises can be demotivated through loss of their profits. Seized drugs can be replaced at a relatively low cost, but accumulated drug profits and subsequently acquired assets are not so easily replaceable.

As improved regulations and enforcement procedures restrict money laundering in formal financial systems, money launders will turn their efforts to non-traditional financial systems and transfer mechanisms, and to countries where regulations are weak or absent.

## **NEW CHALLENGES**

It is known money launders' creativity and their attempts at being a step forward of the enforcement authorities. Money launders, in order to perform their job, are always exploring new products or services provided by financial institutions and even by non-financial institutions.

"Cybercash" is the new product that can roll back decades of progress in the fight against money laundering. Enforcement authorities as one of the most threatening service at money launders disposal consider "Cybercash".

Experiments are under way around the world to market smart cards containing an electronic chip that can be filled or emptied with the equivalent of cash. The cards can be filled with cash from bank machines or over the telephone from a bank account. Money can move from one card to another, in person or by phone. And the holder of the card, operating in splendid anonymity, can use it for large or small purchases.

Mondex, one of most elaborate experiment, is an English project of the National Westminster and Midland banks along with British Telecom. Pilot projects are planned in San Francisco, Canada and Hong Kong. The latter is already Asia's greater center of money laundering.

Even some digital-cash providers admit electronic money has risks. David Chaum, founder of Digicash Inc., acknowledges that this company has already received requests from individuals who want to convert offshore bank accounts into digital money.

## **DESCRIPTION OF THE MONEY LAUNDERING PROCESS**

The phases of money laundering can go through bank and non-bank financial institutions and through non-financial institutions or all three in the same scheme. The main phases are commonly called: PLACEMENT; LAYERING; and INTEGRATION; which can occur in sequence or alone (laundering through one of these phases).

**PLACEMENT:** the main methods are the following:

- a. *Physical Disposal of Cash Proceeds*: in order not to draw attention to the illegal source of cash and to avoid the risk of theft or seizure, criminals exchange small denominations bills for larger bills, deposit cash and buy financial instruments or otherwise dispose of cash promptly. This is the initial step of money laundering.
- b. *Structuring/"Smurfing"*: cash deposits are split in order to evade the obligation of recording or/and reporting the transaction when the amount involved exceeds a specified value.
- c. *Bank Complicity*: the placement is easier when bank personnel are corrupted, intimidated or controlled. Complicity is easier achieved when customer identification, recording of transaction and reporting requirements are voluntary rather than mandatory.
- d. *Casinos/Gambling establishments*: because these activities are cash intensive businesses and offer income with few audit trails, they are significant avenues for money launders wherever gambling is legally tolerated.

**LAYERING**: means separating illicit proceeds from their source by creating one or more layers of financial transactions designed to interrupt any audit trail. If placement was undetected, layering makes tracing proceeds extremely difficult.

What follows is an overview of the methods utilized in the layering process:

- a. *Creation of a False Paper Trail*: the intentional production of false documentary evidence to disguise the true source, ownership, location, purpose of or control over the funds.
- b. *Cash Converted into Monetary Instruments*: this conversion allows the proceeds to be more readily transported out of the country without detection, to be deposited into other domestic financial institution, pledged for loans, etc.
- c. *Tangible Assets Purchased with Cash and Converted*: it allows the asset, depending on its nature, to be resold domestically or exported and resold overseas, and the proceeds taken in a non-cash form. Two benefits offset transaction costs: the identity may be obscured by untraceable transactions; and the assets become more difficult to locate and seize.
- d. *Electronic Funds (or Wire) Transfers*: offer criminals speed, distance, minimal audit trail, and virtual anonymity amid the enormous daily volume of electronic fund transfers.

**INTEGRATION**: means the introduction of criminally derived wealth into the legitimate economy without arising suspicion. Integration schemes present laundered proceeds as normal investments, loans or reinvestments of earnings. Once placement and layering have been successfully accomplished, detection and identification of laundered funds at

the integration phase will normally be possible only through undercover infiltration or assistance by a source knowledgeable about the suspect nature of the funds.

What follows are methods utilized during the integration process:

- a. *Real Estate Transactions*: a shelf corporation using illicit proceeds can buy property. The property then can be sold and the proceeds appear as legitimate sale proceeds. A reduced price can be declared and partial payment can be made in cash to the seller, guaranteeing a paper profit when the property is resold at the true market value.
- b. *Front Companies and Sham Loans*: through front companies (usually incorporated in a country with corporate secrecy laws) laundered proceeds can be loaned to legitimate businesses, and to business belonging to the owner of the criminal proceeds, in transactions which cannot be traced beyond the front company. In this way the owner can pay its foreign laundering subsidiary interest on the loan and deduct it as a business expense, thereby reducing its tax liability.
- c. *Foreign Bank Complicity*: money laundering using foreign accomplice banks represents a higher order of criminal sophistication and presents a very difficult problem both at the technical and political levels. Such a bank can conceal many incriminating details relating to persons and transactions provide sham loans secured by criminal proceeds, while providing immunity from law enforcement scrutiny due to protective banking laws and regulations of another sovereign government.
- d. *False Import/Export Invoicing*: Fictitious transactions, overvaluation of exports and/or overvaluation of entry documents serve to justify transfers involving criminal proceeds.

Some clues about the profile of a typical money-laundering firm are the following:

- a. it has very few employees;
- b. it owns safes and a currency counting machine;
- c. it occupies only a small room;
- d. its equipment and fixture are only composed of microcomputers, telex, fax and telephones;
- e. its revenues are only resulting of financial investments and rendered services;
- f. existence of loans made to and/or taken from offshore companies.

## **MONEY LAUNDERING CASES**

An easier understanding of each money laundering phases and their sequence can be obtained from the following cases.

#### 1. Corporate America's Colombian Connection:

Colombian drug cartel has laundered drug money through the purchase of goods from many large American corporations (Sony, Procter&Gamble, Ford, Whirlpool, Reebok, and several others). However, there is no evidence these companies knew their goods were being purchased with drug money. But law enforcement authorities are convinced that many large corporations are ignoring obvious red flags. These include a sudden, inexplicable jump in sales to Latin American distributors; the presence of large quantities of their products in Colombia at suspiciously low prices; and checks drawn on the accounts of companies other than the ones receiving goods.

The steps of the laundering are described below:

1.a) the drug cartel accumulates dollars from street sales in secret stash houses in big cities throughout the U.S. To throw off the local police, stash houses are usually owned by families with kids and often have indoor garages where money can be safely unloaded.

1.b) In Colombia, a cartel representative sells the cash, which stays in the U.S, to a peso broker at a 15% to 25% discount. An independent intermediary, the broker immediately repays the gang with clean Colombian pesos.

1.c) Using dozen of runners in the U.S., peso brokers deposit the cash into bank accounts in small increments. To make the accounts appear legitimate; the so-called "smurfs" use them to pay ordinary expenses such as utility bills. The runners are typically unemployed Latin Americans. The smurfs open multiple bank accounts in different names, often using identity papers that have been forged or purchased from relatives of deceased Colombians.

1.d) the peso broker locates a Colombian businessperson that needs dollars to import U.S goods. To Colombian businesspeople, peso brokers offer an almost unbeatable bargain. To obtain U.S. dollars through legitimate commercial banks, Colombian must pay a tariff of at least 6,5% above the official exchange rate. Sales and import taxes can boost the cost of U.S. products by an additional 23% to 41%. Using a peso broker can help businesspeople sidestep some taxes. More importantly, they are able to buy U.S. dollars for less than the exchange rate.

1.e) In return for the business-person's clean pesos, the broker writes a check to U.S manufacturer or distributor from the smurf checking accounts.



1.f) unlike banks and other financial institutions, manufacturers and distributors have no systems in place to detect dirty money. So the orders, welcome as new sales, are shipped off to Colombia.

## 2. Money Laundering through Canada:

An estimated \$ 10 billion to \$ 12 billion in illegal profits from drug trafficking and other criminal activities are laundered through Canada each year. How a Toronto-based drug ring laundered over \$ 100 million before being detected in 1987 is described below.

2.a) a Canadian businessman sets up shop smuggling drug from Mexico through the U.S. into Canada.

2.b) he arranges for an associate to fly to London with briefcases full of illegal earnings up to \$ 500,000 at a time, in Canadian and U.S. currency.

2.c) the associate deposits the money in a British bank. The bank is told that the money comes from unhappy married people who are trying to hide the cash from their spouses during divorce proceedings.

2.d) the associate takes a flight to Britain's Channel Islands, where he contacts a "management company" from which he purchases a dozen or so "shelf" corporations complete with directors (hence "right off the shelf").

2.e) funds are wired from the London bank to the Channel Islands bank accounts of the shelf corporations, which are incorporated in Liberia, the Isle of Man, the United States and other countries.

2.f) the shelf companies wire the money from their bank accounts in the Channel Islands to the North American accounts of more than a dozen U.S and Canadian corporations under the smuggler's control.

2.g) many of these American companies then make loans to the drug trafficker. These loans are used to purchase homes and other property in Florida, South Carolina and Tennessee, as well as in Canada.

## 3. Law Firm's Downfall Exposed New Methods of Money Laundering

Hirsch, Weinig law firm was used by Cali cartel to facilitate and conceal its illegal activities. The scheme allegedly involved a dizzying array of drug couriers, wire transfers, and cash drop-offs – including a refrigerator-sized police locker located in the basement of New York's 48<sup>th</sup> Precinct .

Members of the group would pick up cash from street sales of cocaine and deposit the money into bank accounts controlled by the law firm. From that account, most of the money was wired into a private Swiss bank operated by

two other members of the group. And from Switzerland, the money found its way back to Cali.

The government's case alleges that a New York police officer, as well as a Los Angeles stock broker and a Bulgarian diplomat all acted as couriers for Hirsch, Weinig law firm.

During 1993 and 1994, this group allegedly laundered between \$ 70 million and \$ 100 million. The ring's fee was allegedly around 7%.

#### 4. Brokers Probed in Laundering Drug Money

Determined to bar dirty money from the U.S financial system, federal investigators probed several Wall Street brokerage firms on suspicion that some of their brokers were laundering illegal drug profits.

As a part of the investigation, customer accounts totaling more than \$ 10 million were seized at Merrill Lynch & Co., Dean Witter Discover Inc., Prudential Securities Inc. and PaineWebber Group Inc. for alleged violations of the Racketeer Influenced and Corrupt Organizations Law according to people close to the investigation and federal records in Manhattan.

At issue is whether the brokerage firms showed what courts call "willful blindness" -- i.e, firms do not want to know the origin of the money involved in the transaction although they realize it is suspicious -- in dealing with illegal drug profits.

Federal agents say the gradual phasing out of a bearer municipal bonds, which can be held anonymously, has moved more and more drug money into mainstream channels, such as brokerage accounts. The growing availability and popularity of private banking services and confidentiality they offer are contributing to the trend. Meanwhile, drug dealers like other investors have turned their backs on low-yielding bank certificates of deposit in recent years and gone shopping for higher returns – often promised by their brokers.

### **BRAZILIAN CASES**

#### 1. Fraud against INSS (National Institute of Social Security)

Jorgina Maria de Freitas Fernandes was convicted of R\$ 123 million fraud against INSS and sentenced to confinement for 25 years.

The money laundering was done through front companies (shelf companies) opened in tax haven countries (Virgin Islands and Panama). The illegal money was sent abroad using CC5 accounts.

CC5 accounts are bank accounts owned by both non-resident companies and people and can receive deposits in national currency. However, the possibility of converting this money into foreign exchange is restricted, except for non-

residential financial institutions. But, by transferring from non-resident shelf companies' CC5 accounts to financial institutions' CC5 accounts those restrictions are not more valid.

## 2. ENCOL's Bankruptcy

Pedro Paulo de Souza, 61 years old, founded ENCOL in 1951 and turned it into the greatest Brazilian building company. ENCOL has built almost 100,000 apartment complexes during 36 years. Nowadays, ENCOL is almost bankrupted.

An exam done after ENCOL facing this situation revealed that during Pedro Paulo's management the company made lots of illegal transactions. For instance:

- ENCOL had a huge amount of unrecorded money (adding up to R\$ 1.5 billion between years 1992-1996, according to estimates from new ENCOL's management);
- ENCOL owned "ghost" companies in tax haven countries and a checking account in a Swiss bank;
- ENCOL made hidden loans to Pedro Paulo's relatives;
- ENCOL used to sell more apartments that it really had.

As ENCOL embezzled almost 30% of this annual revenue, it had to get more money to maintain operations and in order to not arise suspicion about its financial situation.

To aim this target, ENCOL distorted the Brazilian building market. For instance, in Brasilia other building companies, in 1993, gave up selling apartments because ENCOL's price was 20% lower than other companies' prices.

ENCOL is also being alleged of tax evasion and foreign exchange evasion through their offshore shelf companies.

### 1. Money Laundering by Mail:

The Brazilian Federal Revenue Service seized in Viracopos International Airport, in Campinas, \$ 1,7 million owned by firms and people. The money was being sent abroad through courier firms.

According to Flavio Del Comuni, Superintendent of the Federal Revenue Service in the State of Sao Paulo, share of the money was from foreign exchange dealers, off-book money, and to pay irregular imports.

## **EFFORTS TO MAKE COUNTRIES COMBAT MONEY LAUNDERING**

In 1986, the United States became the first country in the world to criminalize money laundering, launching what has evolved into a global crackdown on the profits of crime.

Over the next decade, with the support of international organizations such as United Nations, Financial Action Task Force, and European Union, nations in every corner of the globe joined in the war on money laundering.

Today, nearly 100 countries around the world have legal frameworks in place that criminalize money laundering. Many of those countries also have regulatory systems which require the financial community to assist in detecting and reporting money-laundering activities.

As international pressure to crack down on money laundering increases, those countries that continue to allow criminals to abuse their financial systems become fewer, closing the international escape routes for criminal proceeds.

The Financial taskfor>

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### **Transferência interrompida!**

-7 to counter international money laundering, says that all governments should require banks to report suspicious transactions. Such disclosures are mandatory in many countries, including the United States. But some, including Switzerland and Canada, make it voluntary, while others prohibit it under banking secrecy laws.

The FATF cannot impose its decisions, but shames governments into adopting them by publicizing lax controls, dubious practices and alleged corruption.

The FATF issued, in 1996, 40 recommendations aimed at revising standards to adjust to global money laundering trends as well technological innovations in the financial services industry.

The recommendations perform a dual role: they make it more expensive for money launders as well as set an international standard.

The central ideas of these recommendations are:

- Countries should implement the decisions of the "Convention against Traffic of Narcotics and Psychotropic Substances", approved in 1998. The Convention in this article 3 establishes countries should have legislation criminalizing money laundering.
- countries' banking secrecy legislation should not be an impediment for international cooperation to fight money laundering;
- countries' laws should include means to promote international cooperation and mutual assistance in investigations to fight money laundering. Laws also should permit extradition of criminals convicted of money laundering.

Mandatory reporting of suspicious activities by financial or non-financial institutions is crucial in assisting investigators uncover laundering. Without the support and the active participation of the financial services industry, there is no alternative of helping investigators.

The tendency is to encourage the development of self-discipline and self-regulation within individual markets. A particularly useful form of international cooperation could be the exchange of administrative information concerning not only financial flows but also the markets for products, corporate control and labor. The aim is automatic detection of anomalous situations on the bases of significant deviations from the norm. Without the prejudice of confidentiality, the exchange of information could be a potent tool for tracing the routes taken by the proceeds of criminal activities.

In general, in the battle against organized crime information is a crucial weapon. Criminal organizations fear effective information systems in the hands of authorities. In turn, they use information bases of their own to defend themselves and expand. The interest of organized crime in taking over banks and financial institutions stems in part from the enormous strategic criminal potential of the information that banks have about customers and markets.

## **BRAZILIAN LAW AND BACKGROUND**

Brazil is one of the most important target countries for the practice of crimes related to money laundering. And there are many reasons for that. Brazil has continental extension and frontiers with almost all of the South American countries. In addition, Brazil counts on an efficient and modern banking system, which facilitates fast and diversified financial transactions. Another considerable fact is that the monetary stability, caused by the implementation of the Real Plan and the high internal interest rates, which attracted great sums of assets.

However, the control of the Brazilian banking system activities is not efficient. For instance, controls on foreign exchange brokerage firms are considered weak.

According to international specialists in organized crime, Brazil is one of the ten most preferred countries by criminals willing to launder money.

Tommaso Buscetta, the first mobster to break *omerta*, the Mafia's oath of silence, and to cooperate with enforcement authorities fighting against Mafia, says that Brazil is the mobsters' paradise. As an example, Antonio Salomone, a mobster who was convicted in Italy, has lived in Sao Paulo for 12 years in the most complete freedom.

Experts worry that Brazil could be the next big growth area for South America's illegal drug trade. They say Brazil is a big country, which makes money laundering easier, and there are large areas with little or no government control.

Their worries are based on the hypothesis that Colombia's small size hurts Colombian traffickers, because Colombia's ability to absorb the bulk of drug trafficking income is

limited.

According to the 1997's Strategic Report on drug trafficking Control, issued by Department of State of the United States, Brazilian government does not control efficiently its financial system, thus making easy to money launders to operate in the country.

The report classifies Brazil in the second most important rank in terms of priority to review laws to deal with money laundering. The main criticisms are the absence of anti-money laundering law and the severe banking secrecy legislation, which makes difficult to get information about suspicious transactions.

The Department of State relates also that it has received information that Brazilian companies (hotels, insurance companies, building companies, transportation companies) are being bought by foreign criminal organizations in order to launder dirty money.

The U.S Department of State, in 1994, published an approach attempted to analyze cross-cultural and cross-country data in terms of anti-money laundering policies. Table I shows this evaluation for countries which are considered having High or Medium Priority to improve their anti-money laundering policies.

Although the Item VIII of the Table I, in the Brazilian case, shows "?", the more appropriate analysis should have been "Y" . In 1992, two years before the Table publishing, Brazilian Central Bank had already issued a norm (Resolution 1.946/92) establishing procedures for identification of people who receive or pay by cash, no matter whether the currency is national.

The Resolution also mandates that money shall be only sent abroad through banking wire transfers, excluding cash (national or foreign currency) below a specified amount.

Brazilian Central Bank issued, as a result of Resolution 1.946, Circular 2.207/92 setting up forms to record the transactions aforementioned.

Fortunately, since March 3, 1998, Brazil has not been included anymore in the list of countries, which had signed Convention of Vienna and since then had not enacted anti-money laundering law.

In that date, the bill aimed at combating money laundering – proposed in 1995 by Nelson Jobim, Minister of Justice at that time – was approved.

The law's approval enables Brazil to be respectable interlocutor in the 2<sup>nd</sup> Summit of Americas, in April 1998, in Chile.

This meeting, which involves all South, Central and North American countries, will include the launch of a new initiative to combat drug trafficking. The initiative includes the creation of a research center in Panama. The idea will be implemented and have the support of the U.S government.

This initiative is in accordance with the worldwide understanding that economy has not been the only beneficiary of globalization. So has criminal organizations, which most profitable is the drug trafficking.

The Brazilian government, besides supporting the idea, uses the understanding aforementioned to explain the increasingly violence in Brazilian biggest cities, especially Rio de Janeiro. Fernando Henrique, President of Brazil, even before being elected has continuously insisted that violence does not end in Rio de Janeiro's border. Its origin is drug trafficking, a multinational business, and ends in the great consumer centers.

Considering that the Brazilian law was enacted also in order to show the Brazilian effort to pursue the best policies to fight against money laundering, a comparison to others countries legislation is required to evaluate whether this was achieved or not.

The American legislation dealing with money laundering is considered one of the most complete and severe and it is shown next. Its analysis will provide subsidies to evaluate the Brazilian law.

## **U.S. LEGISLATION**

The first American legislation enacted to deal with money laundering, known as Bank Secrecy Act (BSA), went into effect in 1970. This law created a series of reporting and recordkeeping requirements related to transactions involving currency or monetary instruments over \$10,000. It mandates:

- a) bank and other financial institutions are required to report currency transactions over \$10,000 by or on behalf of the same person on the same business day. The report must be made to the IRS (Internal Revenue Service) on IRS Form 4789 (Currency Transaction Report - CTR). Exceptions: transactions conducted between domestic banks and for transaction conducted by banks with certain retail businesses and government agencies.
- b) a Customs report (Custom Form 4790) must be filed by persons who transport or ship currency or monetary instruments over \$10,000 into or out of the United States. The report is known as "Report of Internal Transaction of Currency or Monetary Instruments" (CMIR).
- c) citizen and resident aliens are required to file a report with the IRS (IRS Form 90-22-1) if they maintain a financial interest in or signature authority over a foreign bank account with a balance of over \$10,000 during a calendar year. The report is known as "Foreign Bank Account Report" (FBAR).
- d) the Treasury Department is required to maintain a consolidated database of the information collected on the three reporting forms.
- e) records must be maintained for a wide variety of financial transactions conducted by banks and other financial institutions.

However, this law faced several obstacles to be effectively enforced. One obstacle was that many banks were reluctant to come forward with the necessary information for fear of liability under State law. Bankers challenged the constitutionality of the law and that issue was not settled until 1974 when the Supreme Court ruled that the law did not violate the search and seizure provision of the Fourth Amendment.

Further, some institutions were applying the recording and reporting requirements, but were also notifying their customers of the pending investigations under the Right to Financial Privacy Act.

Another problem was that the Act could not resolve the diplomatic issues of tracing funds in foreign banks, which tracing requires the cooperation of foreign governments.

In 1980, the regulations were changed so that banks could no longer exempt non-bank financial institutions and foreign banks (including foreign subsidiaries) from the currency reporting requirements.

In 1984, the BSA was amended to drastically increase penalties for non-compliance with the currency reporting requirements. Most offenses had their maximum jail term increased from one year to five years.

The most significant anti-money laundering legislation enacted was the Money Laundering Control Act of 1986. It established the crime of money laundering where previously no such crime had existed. It also made several significant amendments to the BSA, including:

- a) it a crime to structure transactions to evade the reporting requirements of the BSA;
- b) banks were required to obtain statements from accountholders whose accounts were to be exempted;
- c) civil and criminal penalties were further increased. Persons committing willful violations faced a maximum jail term of 10 years.

Also included in the Money Laundering Control Act was an amendment to the Right to Financial Privacy Act that made it easier for banks to furnish suspicious transaction information to federal enforcement agencies without running the risk of being sued by customers.

## **ANALYSIS OF THE BRAZILIAN LAW DEALING WITH MONEY LAUNDERING**

The best way to evaluate the Brazilian law aimed at combating money laundering is to verify whether it meets the main recommendations of FATF and eliminates the criticisms from other countries or agencies in a more advanced stage of fighting against money laundering. The analysis should be also takes into account the comparison of the Brazilian legislation to other countries' legislation where the laws are considered most severe and complete. Then, the comparison should at least consider the U.S. legislation,



once U.S. was the first country in the world to enact such legislation and which have made lots of efforts to convince other countries to have their own legislation to fight money laundering, and which legislation is considered very severe and detailed. Besides, U.S. suffered, as shown before, several problems in order to enforce its legislation and were able to fix it thus making it effective.

The analysis begins with the first topic that shows how interested a country is to fight money laundering. This topic is related with which kind of money laundering was considered a crime, i.e., which are the sources of dirty money.

The Brazilian law n. 9.613/98 embraces not only drug money laundering but also laundering of money from several other offenses such as: terrorism, smuggling or trafficking of weapons, kidnapping for ransom, crime against Public Administration, crime against the national financial system, and committed by criminal organizations.

In this aspect Brazilian law is advanced because there are countries which laws consider only drug money laundering. However, Brazilian law is more specific compared to U.S. law. For instance, the Brazilian law specifies the offenses while American law, more specifically the Money Laundering Act of 1986, mentions " ... some form, though not necessarily which form of activity, that constitutes a felony under State or Federal law, regardless of whether or not such activity is specified...".

Thus, the American law might include tax evasion money laundering once tax evasion is considered a crime under Internal Revenue Code. The Brazilian law intentionally excluded such crime. An amendment to the bill was proposed to include tax evasion but it was rejected.

Senator Romeu Tuma, who was responsible to send the final bill draft to be voted and who analyzed amendments proposed, justified the exclusion of tax evasion. He said that money-laundering activity implies the introduction of money from illegal activities and the increasing of agent's wealth. Thus, as tax evasion maintains the wealth by no tax payment instead of increasing the wealth, the amendment was rejected.

It was also taken into account that once the amendment was approved the bill would have to return to the Chamber of Representatives to be appreciated again. This possibility would imply in the need for more time to approve the bill. It would be difficult to guess when the re-exam would be done.

Considering that lots of Brazilian political scandals involving crimes against the Public Administration, in which money related to the offense was sent abroad using intermediaries, the inclusion of such offense money laundering must be seen as another important tool to demotivate this kind of crime.

For instance, according to O ESTADO DE Sao Paulo newspaper (12/03/97), Fausto Solano Pereira, a brokerage firm owner, acknowledged, during "CPI dos Titulos Publicos" hearings, to have participated of R\$ 8 million laundering .

This scandal involves the alleged primary market sale of municipal government securities for a price quite lower than market value. After the secondary market sale, share of the huge profits gained in the transaction were returned to the members of the government responsible for securities issuance.

If at that time the anti-money laundering had already been enacted, Fausto Solano would have been sent to jail or would have been more cooperative.

Other positive aspects can be seen throughout the Chapter I of the Brazilian law, such as:

a) it establishes as penalties confinement for 3 up to 10 years and fine.

It includes the reduction of the penalty or even its substitution by a penalty of deprivation of rights when the defendant cooperates with the law enforcement authorities.

The latter item is important tool to combat organized crime. The betrayal among criminals must be stimulated. Criminals have no reason to cooperate to uncover more about other people involved in a crime if criminals know they will also sent to jail and/or are afraid of the consequences of their betrayal.

For instance, the mobster Tommaso Buscetta - who broke the Mafia's oath of silence and who is now in federal witness protection program in the U.S. - provided valuable information to American law enforcement authorities enabling them to crash down a heroin distribution ring that operated in the U.S. between 1979 and 1984. The ring was known as Pizza Connection due to the fact that the dealers owned pizza parlors that served as "fronts" for their drug dealing activities.

The Brazilian law, like American law, makes possible the seizure of assets possessed by the defendant or assigned under his or her name that derive from money laundering. It is also allowed the sharing of the seized assets with foreign governments whether or not these governments have such international treaty or convention with Brazil.

It is important to remark that the binding people or legal entity embrace those who or which had, until now, no obligation of recording transactions, such as non-financial institutions or people operating in Brazil as agents, officers, etc., in the service of a foreign body performing any of the binding activities.

Before the law, only financial institutions and foreign exchange trading institutions were obliged to record their transactions. This obligation was set up by Resolution 1.946 and Circular 2.207, by Central Bank. The latter one provided forms to file the records (see Attached I and II).

The Brazilian law also mandates the reporting of financial operations - according to instructions proceed from competent authority - which may consist in evidence of crime. The entities reporting shall refrain from notifying customers of such communication.

Considering that some entities and persons have no specific regulation body they shall report to the Council for the Control of Financial Activities (COAF). This Council, created by the anti-money laundering law, will have its organization and functions defined by a decree of the Executive Branch.

All considerations aforementioned show that Brazilian law dealing with money laundering is modern, meets the FATF's recommendations and overcome almost all criticisms about Brazilian anti-money laundering legislation.

Unfortunately, in spite of being very detailed, Brazilian laws have a traditional low degree of enforcement. The law n. 9.136/98 has high likelihood of not changing this behavior. The reasons are:

- a) the need for creating reports and providing means to process them, which will require a further legislation;
- b) the existent reports that until now have never been examined as routine;
- c) the fact that the existent means of recording cash transactions are not part of a computerized system, although this possibility had been considered when the respective legislation (Circular 2.207 and Resolution 1.496/92) was enacted;
- d) likely huge amount of forms that, once created and filed, will have to be analyzed;
- e) the banking secrecy legislation which makes information exchange more difficult among law enforcement authorities;
- f) the effectiveness of COAF will depend upon which functions and structure it will have to its disposal.

We should keep in mind the likelihood of uncovering a money laundering scheme is low, even in countries with broad and severe legislation, once money launders have several means to do their job and to exploit legislation flaws.

For instance, in Australia, a country which is considered an example of efficient anti-money laundering system, law enforcement authorities estimate that they are only being able to recover 1% of laundered money.

Another example is the questioning about the efficacy of U.S. reporting system. Such system might require a month or more to report to law enforcement authorities.

Thus, the Brazilian law has enormous possibilities to be as ineffective as other countries' laws, no matter how modern it is.

The great advantage that Brazil has in terms of combating money laundering lies in the fact that Real, the Brazilian currency, is not a convertible currency. This obliges the money laundering, if it is intended to be made internationally, makes use of foreign exchange transactions.

Then, the likelihood of uncovering money laundering activity is increased because all foreign exchange transactions are already recorded by computerized means.

Of course money launders might use foreign exchange black market to offset such risk but this market is not big enough. Sometimes, the proceeds of illegal activities are so huge that make money launders not use the black market. Besides this consideration it should be taken into account that money-laundering fees are higher in the black market because money launders have to share their gains with black market dealers.

Because lots of foreign exchange transactions are daily made and Central Bank inspectors, which are not many, are only able to examine some of those transactions. This fact implies lower likelihood of uncovering money laundering activity.

But if the international money laundering is conducted through foreign exchange black market it might only be uncovered by the same means a domestically money laundering is uncovered : by records of transactions and/or denunciations.

In addition, even when some transactions presents high evidences of money laundering Bank Central inspectors, many times, face huge difficulties to conclude their investigations because they would need to get information or provide information to other law enforcement authorities. However, such attitude is made difficult because of banking secrecy legislation.

Even when some information exchange is admitted - for instance, when any of the entities involved are non-financial institutions - it is done by written reports. These reports when received by the next law enforcement authority is considered one more of the several daily handled reports

All of the identified problems do not have easy solutions but there are some suggestions that once adopted might produce a greater effectiveness of the Brazilian law dealing with money laundering.

Firstly, because there are several different persons and legal entities abided by anti-money laundering law, what implies in different law enforcement authorities elaborating forms to be filed, and these forms should be unique. Of course, it will happen that some items required to be recorded will not apply for some legal entities or persons because each law enforcement authority may be interested in a particular information.

Once COAF's structure, as already mentioned, is composed by people from the several different law enforcement authorities, the best way for getting uniform recording systems is making COAF responsible for their creation.

It would be also helpful that forms were available in floppy disk or via Internet. This practice would avoid likely allegations of no reporting transactions because there was not enough forms. The floppy disk could be also used as means to send the information back to the law enforcement authority. Thus, information processing in the law enforcement authority would be easier and would make their exam more efficient.

Of course, it would be easier and cheaper for the persons or legal entities to send the written filed reports instead of having to insert data in the floppy disk. But this must only be taken into account whether the person or legal entity is able to demonstrate such costs are so significant.

Secondly, the proposal aforementioned will not work if the reporting and recording requirements are not obeyed. The best way to compel to obedience is to apply penalties that demotivate disobedience. The Brazilian anti-money laundering has these penalties.

The problem is to detect the no-discipline, for instance, in a commercial bank. As it was seen before, money launders sometimes has teller's complicity.

This problem can be diminished through Hot Line system and anti-money laundering training program. Law enforcement authorities should incentive the training through providing lectures and booklets. The training program interests directly the legal entities and persons responsible for the recording and reporting once they could be punished even when any employee fail, with no intention to deceit, to report due transaction.

Thirdly, the Brazilian banking secrecy legislation should be reexamined to provide exchange information between law enforcement authorities in order to make their job more efficient. This re-exam has already begun. The Brazilian Senate unanimously approved, on 02/03/98, a bill making banking secrecy legislation more flexible.

The bill grants to Brazilian Federal revenue Service periodical access to banking data without having to appeal to Justice Branch. The bill also grants to Brazilian Central Bank and CVM (the Brazilian "SEC") access to data of foreign subsidiaries of Brazilian financial institutions. The bill was sent to the Chamber of Representatives.

Ultimately, the COAF's role and structure should be as broader as possible to achieve effectiveness and efficiency. COAF has great conditions to achieve these goals. Once it will comprised of public servants from the several law enforcement authorities it is the ideal place to these authorities to exchange information and, if so agreed, to act together.

COAF also should receive the same reporting data each law enforcement is sent and thus to be able to provide a consolidated database. COAF also could determine the constitution of Task Force when necessary.

So, it seems that even without a more flexible banking secrecy legislation some good results can be achieved depending on how COAF will be structured and which functions it will have.

The efficiency and effectiveness of the Brazilian law will also depend on how efficient and effective is or will be the supervision of the financial institution and non-financial institutions.

Brazilian Central Bank has been considered an inefficient supervisor of financial institutions. The interventions in Banco Nacional and Banco Economico are shown by Central Bank critics as the most significant examples of Central Bank supervision

failure. Lots of articles were written defending Central Bank supervision and how the institution dealt with the situation without harming the soundness of Brazilian financial market.

This paper does not intend to estimate how efficient Brazilian Central Bank supervision is or to discuss whether it failed in both cases aforementioned or not. But, no matter how efficient its supervision is, it is consensus that the efficiency and effectiveness of the supervision of financial institutions performed by Central Bank can and should be improved.

Brazilian Central Bank has already been making efforts to achieve better performance of its supervision activity. Brazilian Central Bank has enacted several legislation since the interventions aforementioned and adopted new internal policy both aimed at improving banking supervision.

Resolution 2.302/97 which demand banks to inform about its assets in offshore agencies; new contests to hire employees for banking supervision activity; training policy for banking supervision; and the recent decision of creating a new Division with the specific attribution of investigating money laundering; are examples of the Central Bank efforts to be more efficient and to combat money laundering.

The Brazilian IRS is also addressing similar concerns. It has created a special Division to supervise banks and has already trained its inspectors to perform their new activity.

Once Central Bank and IRS are the main Brazilian Supervision agencies and they have their action limited, the concern about the role of COAF is stressed. COAF has high likelihood to improve the efficiency of supervision activity of Central Bank and IRS.

## **CONCLUSION**

In spite of having met FATF's recommendations and having included the laundering of money in addition to offenses other than drug money laundering, the Brazilian anti-money laundering law, considered to have a traditionally low-degree of enforcement in Brazilian legislation, must have complementary legislation that would improve efficiency and as a consequence enforcement.

Special attention should be given to the conception of reporting forms and the routine of sending them back to the respective law enforcement authority.

The COAF's function and structure should be carefully considered when it is defined by decree from the Executive Branch because COAF has a high likelihood of performing a very significant role in combating money laundering and providing room for other enforcement authorities to exchange information and also to act together.

Nevertheless, the simple fact that money laundering was criminalized is significant and provided the very important means of making money laundering riskier. The law is modern and makes Brazil more respectable abroad.

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