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# Virtue and Reality: An introductory tale of two cities

*Petrus C. van Duyne*

## The cities of Virtue and Entrepreneurship

Morality and money are usually considered as opposites like the idea of the Augustian two cities: the godly city of Virtue and the worldly city of Sin. The first one is pure and does not know any compromise; the second one is doomed unless pure virtue reigns again. Nevertheless history knows episodes in which (corrupted) holiness and dirty monies appeared to enjoy a happy alliance, as happened during the reign of the Medici popes in the beginning of the 16th Century (Hibbert, 1979). The enlargement of St Peter's proved to be very expensive and the papal licensed brothels in the Holy City were therefore charged extra. This was not enough, and the Pope started to issue letters of indulgence which assumedly shortened the time in purgatory. This proved to be a successful scam, particularly in Germany where the letters were enthusiastically sold by the monk Johann Tetzler, in close cooperation with the Fugger bank. Another German monk, Martin Luther, felt deeply offended by this after-life insurance scam and in October 1517, legend has it, nailed 95 statements on the door of the castle church in Wittenberg. This unleashed the reformation which –among others– aimed to sever this corrupt relationship (Diwald, 1982: 102-103). Whether they succeeded is for historians to judge.[1]

At present morality and (dirty) money are the focus of attention again – although this time less cosily connected. Since the Financial Action Task Force on money-laundering (FATF) sounded the alarm about the extent and threat of crime-money and the laundering thereof in 1990, a serious worldwide programme to clean the global 'financial city' of this evil has set in (Stessens, 2002; Reuter and Truman, 2004). Starting with drug money –an easy target no one could disagree with– the financial moral crusaders, united in the above mentioned FATF, developed recommendation after recommendation, gradually tightening the screws. No potential actor or financial temptation was omitted: a system of reporting was designed encompassing bankers and antique dealers, real estate agents and car dealers alike. This is no surprise: as with the anti-drug policy fanned by the US since the beginning of the last Century, a moral campaign against an evil is not a half-way enterprise (Van Duyne and Levi, 2005;

[1] At any rate this relationship had some longevity, as demonstrated by the story of the Banco Ambrosiano which ended with the demise of 'God's banker', Roberto Calvi, hanging under one of the bridges in London (Cornwell, 1983).

Courtwright, 1982).[2] The ideal 'financial city' has to be pure, like the Augustinian Godly City.

So what is the outcome after 17 years of purification, three FATF recommendations and an equal number of EU guidelines? What was the effect on the earthly city, the place of trade and industry, of real money (of whatever colour), the city of potential sinners as well as those who have to report potential sinful transactions? How does this place –with the laundered linen hanging around– relate to the constructed ideal city of legislators and policy makers? In this contraposition we are confronted with the usual strain between a 'should-be' world and the confusing state of reality. This is not only a matter of reality usually lagging behind in complying with the demands of rule makers. That has always been the case. The confusion concerns rather the ambiguous state of the threatening (and threatened) financial reality. On the one hand, the flow of threat assessment reports concerning 'organised crime' presents us an array of pictures full of 'transnational' crime-for-profit (Van Duyne, 2007). It conveys the image of a 'global city' (instead of a cosy 'village') of crime, crime-money and the laundering thereof. On the other hand, some critical researchers are still looking for the 'True Threat'. The fact that the real threatening examples must be scraped together sheds doubt on the validity of the claimed ubiquity of the dirty money threat. (Maybe it represents no more threat than the dirty money with which St. Peter –still admired today– has been built.) If it is so big, why does a simple hedge fund or a policy of bad mortgages have more capacity to create havoc on the financial and investment market than all the alleged trillions of crime-money? Consequently, if the moral 'financial city' and the related threat image of the FATF does not match with the 'earthly commercial city' of daily life, what about all the measures to stem the depicted threats? Are they really commensurate to reality or do they just follow from the orthodox purist legal principle of 100 % law coverage? This volume may provide some insights into this issue.

## The conditioned loophole reflex and enlightenment

From the elaboration above as well as from the extensive literature (for example Reuter and Blum, 2004), the reader may already surmise that the international legal experts represented in the FATF have taken the money-laundering threat anything but light-heartedly. Whether one reads the first list of recommendations or the last one, they reflect a constant search to plug any hole through which even the smallest financial fish may try to swim. This drive has certainly been intensified by the terrorist attack of 11 September 2001, in the

2 That was also the lesson of the reformation: Luther's righteousness was soon surpassed by the severe Calvin, who was himself surpassed by Scottish reformer John Knox.

aftermath of which the reach of the anti-laundering regime has been extended to the financing of terrorist activities (Levi, 2003). After the FATF issued new recommendations, the EU-commission was bound to follow suit with corresponding directives.

Designing directives for the EU is a meticulous legal labour, as can be admired in the contribution of *Joeb Rietrae*, economist and previous financial markets and AML/CTF expert at the Dutch Ministry of Finance. The author carefully discusses the third EU anti-money laundering Directive of December 2005. The Directive represents a tightly woven and broadly designed net covering a broad sample sheet of financial activities as well as commercial institutions and persons in the EU. As far as the scope of criminal activities are concerned, it covers all 'serious' offences which are defined as being those: '*punishable by deprivation of liberty or a detention order for a maximum of more than one year*'. This represents a very low threshold, though still a bit higher than those in jurisdictions like the Netherlands, which applies the anti-laundering clause to *all* criminal offences. As there are hardly crimes for profit which have a maximal prison term of less than one year, the practical coverage is virtually 100 %, though one may wonder what the qualification 'serious' still means. In this context it is just a formal threshold without any criminological meaning, stretching from petty shoplifting to ENRON-like fraud schemes.

Also in other aspects the coverage is broad as well as dense. This follows from the strict application of the transparency requirement and know-your-customer requirement: no entity or commercial market player which is engaged in activities likely to be used for money laundering or terrorist financing is allowed to remain out of reach. And no institution or obliged person is allowed *not* to know his customer. It is irrelevant whether such activities take place on internet or in real, 'bricks and mortar' enterprises. In all cases the know-your-customer principle applies and there is no slackening of the requirement of the customer due diligence (CDD). This entails that one is obliged to find out who the –thus far ephemeral– potential *beneficial owners* of any legal person really are. These are defined as those persons or entities which control 25 % plus one of the shares, votes or property of whatever entity. Given that it may sometimes be difficult to establish the identity of a customer, the obliged entity must proceed on a risk based approach or take every reasonable measure. If the identity cannot be determined, no business relation must be established or an occasional transaction be carried out. Predictably, anonymous bank accounts and bearer passbooks are prohibited, as well as (indirect) relationships with shell banks.

Leaving aside the multitude of other requirements imposed on the financial system or recommendations to the Member States, I would like to point at one particular pious wish: money-laundering statistics. Member states "shall . . . maintain comprehensive statistics". If the financial system must be a perfect transparent city, the same standard should apply to the organs of the Member

States. However, here we arrive again at the 'earthly city', this time of real people staffing the agencies who have to do something themselves, other than interfering in someone else's financial job. I must defer the tale of that part of city. First comes an interesting description of a special group: lawyers, civil-law notaries and tax advisors.

For good reasons the author *André Tilleman* working at the Dutch Bureau of Financial Supervision devotes ample space to the legal professional groups. Indeed, its members are at great risk of being exposed to various aspects of criminal or at least hidden funds while having a statutory duty to professional secrecy. What their clients convey to them must remain as confidential as the confessions to a father confessor. Nevertheless, since 2003 also these professionals are obliged to report suspicious transactions related to money-laundering or terrorism. How to deal with this obvious tension?

The involvement of legal professionals did not come as a surprise. Since the mid 1990s there were already guidelines for civil-law notaries and lawyers to prevent their involvement in criminal activities by receiving illegally obtained money. Cash payments of more than € 10.000 were prohibited for civil-law notaries (€ 11.345 for lawyers). Now these professionals are within the orbit of the anti-laundering legislation, with the exception of 'typical' activities pertaining to their core business. These relate to "determining the legal position of a client, his representation at law, giving advice prior to, during or after legal proceedings, or giving advice about instituting or avoiding legal proceedings". They have to determine the identity of their clients too before rendering services which are subject to the Identification Act and they must not accept cash payments above the specified threshold (which would have to be reported). Unusual transactions which may relate to money-laundering and/or terrorist activities have to be reported as well.

Though these professional's secrecy is no longer sacrosanct, when lawyers and notaries perform their 'core function' of determining the legal position of their clients, client confidentiality and the right of non-disclosure are not waved. However, invoking these rights is no longer taken for granted and has been challenged in court, though not always successfully. The legal profession is aware now that their work is under supervision too.

The author provides an elaborate description of the supervisory bodies: the Dutch Central Bank, the Authority Financial Markets, the Fiscal Police and the Bureau Financial Supervision. The latter deals particularly with the legal and financial professions (e.g. accountants and tax advisors) and has extensive powers, such as inspecting also confidential client documents.

Of course, the brief sections above are only intended to give an initial impression of the thorough efforts of the authorities to fight money-laundering and to impose an impressive supervisory network. This is all about the regulation of various actors to safeguard the ideal of financial transparency to keep dirty money out. It is a legislators' reflex to mend the loopholes, not to balance

legal interests against the real threat posed by financial actors (Van Duyne *et al.*, 2005). But these actors (and their potentially murky clients) are not the only citizens. There is also the district of law enforcing agencies and agents, either supervising others or chasing the crime-monies and suppressing the laundering. What does it look like?

In his contribution *Petrus C. van Duyne*, professor of Penal Law at Tilburg University, makes an attempt to obtain material for this side of the story. His approach is simple: if the gruesome story about crime-money and laundering the authorities want us to believe is true, then they should have properly documented all statistical evidence about perpetrators and their deeds. All in all, this should represent the authorities' part of the transparency play.

Van Duyne's search through the available public data bases of four European Member States (Netherlands, Germany, Belgium and the UK) makes it clear that irrespective of the seriousness of the problem, the authorities do little more than shedding some flickering lights on a few stretches of their law enforcement tasks. The data are fragmentary, badly kept and from proper methodological standards shallowly justified (if at all) making it impossible to determine their reliability and validity. Above all, despite the repeatedly stated and generally recognized 'transnational' nature of the dirty money flows, the national statistics are actually incomparable. This is the more poignant as there are German and Dutch statistics concerning suspicious money flows going out of and into these countries, differentiated by country of origin and destination. However, in no way do they match: neither in format nor in content. It yields to all extent comparisons of apples and oranges. The lofty recommendation about 'comprehensive statistics' in the Member States, mentioned above, is telling for the lack of statistical expertise of the authors of the third EU directive. It is a pious wish from an alien legalistic city.

Despite the flickering lights of the law enforcement documentation (FIUs, police and Public Prosecution Office), some glimmering evidence can be gleaned. In the first place, there is the traditional fear about the drug money. The Belgian statistics, allowing a breakdown of the reported suspicious money volume and the predicate crime, shows that compared to (tax) fraud and (organised) economic crime drug money is just a fraction of the whole at 5 %. This is somewhat in line with the findings of Levi and Reuter (2006) and the German annual money laundering reports in which drug offences rank well below commercial crimes like deceit and swindling. Despite the weakness of the data it can be taken as a serious refutation of the drug money scare, even if no one would deny that there is a lot of drug money around.

A more detailed analysis of the Dutch money-laundering database reveals in the first place how careful one must be in interpreting the laundering data. This was the case with a few mega-transactions with (Russian) oil money, which distorted the picture of 2003 or the 'revolving door launderers' who carry out a large number of suspicious transactions (particularly money transfers). The

analysis also demonstrates patterns of money flows into and out of the country which should have caused the authorities to raise questions. For example: the traditional 'criminal payment deficit' of the UK (particularly Scotland) with the Netherlands, paying either for dope or cigarettes; and the large incoming flow of suspicious money from Italy. No such questions were raised, however.

The same can be said about the outcome of the fight against crime-money: the confiscated assets or the 'fruits of crime', which are also the 'fruits' of enforcement. No questions were asked about what the composition of the confiscated assets actually meant in terms of criminal economy. Or whether the conviction success rate of a mere 6 % is not a bit meagre. The information management of the law enforcement agencies proved to defy almost any question, if raised in the first place. The author concludes that the present anti-laundering approach is rather based on a firmly established belief system than on a sober statistical analysis of what happens in the 'real city'. It is a tale of a city whose policy makers still live in the intellectual stage of the 'pre-Enlightenment' era, formulating its policies in an empirical *camera obscura* without feeling uneasy about it.

## The criminal inhabitants

The contribution of Van Duyne demonstrates that attempts to get a view on the (finances of the) criminal inhabitants of the city –for whom all the regulations have been drafted– foundered on the information mismanagement of the law enforcement agencies. Fortunately the contributions following this sad conclusion do show light on who we meet in the 'criminal down town'.

### *Human traders*

In their contribution *Kauko Aromaa*, director of HEUNI and *Martii Lehti*, director of National Research Institute of Legal Policy, give an account of the market of human beings. Granted, they too have to start with a warning about the 'data full of gaps', particularly concerning non-sex related human trafficking. For example, victims of trafficking may be counted every time she/he has been observed in various countries: each country counting one but the same victim. Briefly and critically they scanned a few sources (with a probable common but unknown source), reaching a total of 500.000 trafficked persons to the 'old' EU, with spooky turnovers of 100 million to 'several billions of Euros'. Equally indeterminate are the number of purportedly identified victims of prostitution related trafficking, sometimes with estimated ranges of more than 500 %.

Despite decades of policy making, implementing, defining and redefining human trafficking, the authors make clear that there is still little clarity in this