



**Eurasian Group on Combating Money Laundering and
Terrorism Financing
(EAG)**

WORKING GROUP ON TYPOLOGIES (WGTYP)

**«Risks of Electronic Money Misuse for Money
Laundering and Terrorism Financing »**

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Introduction

In the times of global challenges alternative payment systems carry more and more importance. One of such systems is the system of electronic payments – so called electronic money. At the present moment hundreds of thousands of people use electronic money all over the world. With its help we can buy most of those goods and services that we are used to buy for cash or with the help of a bank card, starting from bill payments online up to buying computers or cell phones.

Today we have tens of electronic payment systems online that offer the users all those services that we usually receive in banks: savings and money transfers, cash withdrawals, credit loans, etc.

In connection with the development of systems of combating money laundering or terrorism financing in different states, malefactors look for more difficult ways to legalize their criminal profits, one of which is using electronic money.

1. Annotation

The progress of high technology has unquestionable advantages, but it also brings new risks that are often quite substantial into life. One of such technologies is electronic money; it's a new way of payments, mainly based on using the Internet. Taking into consideration its fast development within the last ten years, as well as its wide-spread use, electronic money has been chosen as a joint research object by EAG and MONEYVAL to analyze the risks of its use for money laundering and terrorist financing.

The present report is meant mostly for the employees of financial intelligence services and it represents a summary of financial intelligence experience in the field of combating money laundering and terrorism financing with the use of electronic money.

There are certain recommendations that have been given, based on this experience, to mitigate the risks of using electronic money for criminal intentions.

The goals of the research performed are:

- defining the main vulnerable spots of electronic money from the point of view of money laundering and terrorism financing;
- identification of the main types of criminal acts, performed with the help of electronic money;
- development of recommendations focused on risk reduction in using electronic money for money laundering and terrorist financing.

The information basis for this research is the data, contained in open sources, as well as the information provided by the countries – research participants. At the present moment the responses of the following countries have been received (in alphabetical order): Austria, Albania, Armenia, Belorussia, Bulgaria, Germany, the Principality of Liechtenstein, China, Kyrgyzstan, Macedonia, Monaco, Poland, Russia, Slovakia, the USA, the Ukraine and Estonia.

2. Definition of electronic money and its features

The idea of having electronic money was originally developed by an American mathematician David Chaum in the 70s of the XX century. At that time the electronic money was viewed mostly as a means of having pre-paid cards with the information about the amount of transferred money stored there through various technical ways.

That way, instead of having huge packs of bills, each person would take only one card with him which he could use for money charges with the help of various special devices.

This system looks like a system of bank cards for the end consumer; however, it's not the correct way to look at it, because different mechanisms are the basis of this system. Electronic money uses the mechanism of so-called “blind signature” and they physically contain the information about the amount of money, whereas the credit cards are the tools that allow to use the bank account remotely.

With the development of the Internet the electronic money has to the large extent become a part of the virtual world, and it has stopped having a specific material embodiment.

At the present moment it is one of the most popular tools of payment for the purchases online and related fields.

Since electronic money is a fairly new notion, there are still some differences in its definition, which creates a few difficulties in terms of research performance. For example, sometimes people refer wire transfer systems (Western Union, MoneyGram and others) to electronic money.

Taking into consideration this situation, the issue of correct definition of the notion of “electronic money” carries a principal meaning for the performed research.

To depart from the technical and legal peculiarities of the electronic money we have chosen a wider interpretation of this term which, on the one hand, has

allowed to include a wide spectrum of the systems of interest, and on the other hand has allowed to exclude the systems that don't fit in the first place.

For the purposes of this research we define “electronic money” as any tool allowing to perform the exchange of demand rights for the value among the users through virtual accounts, electronic records (email, etc), as well as allowing to convert these demand rights into money or other high liquidity means.

In the context of the present research the following peculiarities of electronic money are the key ones:

- accessibility: each user can easily open up an electronic account and use it regardless of location, that means in any city or even any country;

- mobility: the location of the electronic account owner does not matter, to access the electronic wallet or account one needs only a computer or the Internet access;

- simplicity: it is not necessary to have any special knowledge or skills. The installation of “an electronic wallet” and further work with it is very simple;

- speed: the payment with the help of electronic money is instant;

- low transaction cost.

All these features of electronic money give them advantages to compete with such widely spread products as credit cards and Internet banking.

At the same time it is important to understand that all these features of electronic money make it a convenient tool in the hands of a criminal to use it as means of money laundering and terrorism financing, since they allow performing an easy and fast large sum transfer from any place to any place in the world with the Internet access.

At the present moment electronic money takes up its own place in the world economics, where its use is economically effective:

- payments for a comparatively small sum of money. The exact borderline is difficult to define because it depends on the standard of people's well-being in each of these countries;

- payments between physical persons;
- making purchases online, in other words buying various goods in the Internet stores, as well as payments for various services;
- payments in various social networks or in computer games.

3. Types of electronic money.

The existing systems of electronic money are generally divided into two groups at the present moment:

- electronic money based on cards;
- electronic money based on the Internet.

The systems of electronic money that refer to the first group represent a subtype of electronic money, circulation tool of which is a card with an installed chip in it that has all the information about electronic money.

Buying this sort of card from the issuer the client can pay with it at special trade spots, equipped in the corresponding way.

At the present moment this type of electronic money is fairly less common, because it is often replicated by a usual bank card of international payment systems (Visa, Mastercard, etc.).

The second type of electronic money is electronic money based on the Internet system. The key aspect of such electronic money is the absence of the physical object that could help to perform the transaction. All payments are done online without any transfer of physical objects.

Unlike bank payments with use of remote account management system through Internet banking, these systems of electronic money do not have electronic “cash” which would be taken by all the participants of the system as an equivalent.

It's important to note that some of these systems have pre-paid cards that carry a fixed amount sum of electronic money on them (5, 10, 100 points, etc). With the help of such cards it is possible, consequently, to add the necessary sum to the account in the electronic money system.

It is not completely correct to consider these cards as analogues of cash.

In reality these cards can theoretically be used as payment tools (if the contract partner agrees to take these cards as payment). Since there are cards with different nominal amounts, it is possible to give back the change if it is necessary.

Properties that allow to define a bank note as a unit of real money deal with the physical aspect of the matter – the corresponding size of the bank note, paper type, the presence of water marks, etc. The properties that define a pre-paid card as a unit of electronic money are the amount of information which is written on it (the card number, and other details).

In other words, when buying a pre-paid card, the client gets it to receive the information, written on it, and not for the sake of the physical object itself.

We should separately note the payment systems based on the mobile phones. In these systems electronic money is attached to a mobile phone account which is used to pay for the communication services. Charging money from the account of the subscriber can be done through different ways: SMS messages, special software, etc.

It is interesting to note the fact that a modern mobile phone can be used for payments with real money (through Internet banking) or electronic money (either through the Internet browser, or with special software).

Another common classification is dividing electronic money into fiat and non-fiat electronic money.

Electronic fiat money is nominated in the currency of a state and is a type of a currency unit for that state. Correspondingly, the issue, turnover and repayments of electronic fiat money are regulated by the legislation of the state in currency of which the money has been issued. By accepting electronic money to have fiat status the state provides its safety and value.

Electronic non-fiat money is not expressed in any state currency; it is issued by non-governmental organizations. Performance of obligations based on this money is correspondingly guaranteed by the organization that issued it. This type of electronic money is often connected with the currency of one of the world currencies.

4. Weak points of «electronic money».

Taking into consideration the above described features of the electronic money we can note the following points that make electronic money vulnerable to use in the purposes of money laundering and terrorism financing.

The first weak point that is important to note is the fact that electronic money provides a faster transfer of money in large amounts.

If a person decides to transfer his illegal profits using cash, then to transfer this cash from, for example, Asia to North America he will have to spend quite a lot of time for a flight, tickets purchase and similar activity. This type of transfer is dangerous, because any person transferring large sums of cash will be considered suspicious and taken for questioning by the customs offices of the arrival country.

Using the banking system does not always provide the necessary speed of transfers, because some countries have strict currency legislation and it requires obligatory documents to the bank performing the transaction.

Electronic money is largely free of these types of disadvantages. The transfers inside electronic money systems happen practically instantly, some of the systems have maximum transfer limits.

The second weak point is the fact that the systems of electronic money do not need a personal contact of the system with the client. This way the use of cash is clearly based on the personal contact of the payer and the recipient, since the money has to be transferred by somebody.

Using non-cash based money transfers also has large degree of client's contact with the system. To perform the payment the client has to come to the bank and fill out the corresponding payment documents which allow the bank to physically identify the client.

The bank client can use remote account management system, however, many banks attach a certain attribute of the user (an IP-address, a phone number) to the

used account, the keys to the account management also have physical nature (for example, flash card, a disc, etc), which reduces the user's mobility.

Electronic money has been originally oriented for remote use since it doesn't have physical nature. While using electronic money the clients do not have to leave any useful information either about themselves or about the deals they make. In addition to this, criminals can continue their activity using special technical devices that impede the process of installing it.

The third vulnerability that the criminals might use is using electronic money for international transfers which greatly complicates investigations of economic crimes.

Since electronic money has been originally oriented on being used online, its use takes on a truly international character. This way, the victim of a crime can be located in one jurisdiction, and the criminal in the other, while the used system of electronic money can be registered in the third one.

That is why, in the case of having a financial investigation of this fact, a financial intelligence agency from the country where the victim is from has to send a request to the financial intelligence agency from the country where the system of electronic money is registered, and this process is going to slow down the investigation quite a bit.

The fourth vulnerable point that has to be noted is the fact that the system of electronic money could be located in the country with a weak legal base in the field of combating money laundering and terrorism financing. Consequently, an insufficient volume of procedures, held in this field in one country can lower the effectiveness of combating illegal financial operations in other countries.

5. Ways to withdraw and deposit money in the system of electronic money.

Since at the present moment electronic money has somewhat lower liquidity than real money (for example, electronic money cannot be used in a regular retail grocery store, car purchase, money exchange in a standard currency exchange, etc.), we are greatly interested in the ways to deposit and withdraw money in and out of the system.

If we look at the electronic money in the context of its use for money laundering and terrorism financing, this money is not the final goal of the criminals, but rather a tool to commit a crime. In other words, having received a fixed amount of criminal electronic money, especially if this sum is great enough, the criminals will most likely convert it into actual money. For that reason the issue of ways of depositing and withdrawing money in and out of the system is extremely important.

At the present moment the following ways to deposit money into the electronic money systems exist:

- through deposit terminals. The client finds the closest terminal, inputs his “electronic wallet” number, probably also his mobile phone number and other identification data, inputs the amount of money in cash, after that “the electronic wallet” is appended;

- with a bank card. Having entered the system of electronic money through a special program or Internet browser the client gives his login data, as well as the data of his bank card, and then notes down the amount of money he needs to withdraw from the bank card.

- through a bank transfer. The client of the system comes to a bank branch with the electronic money system administrative details and asks to transfer a certain amount of money onto the account of that system, after that his account receives the corresponding amount of money.

- cash through a bank branch;

- using Internet banking. This way allows to withdraw money remotely from a bank account onto the account in the system of electronic money, after that the client's electronic wallet receives the corresponding amount of electronic money.

- with a money transfer through alternative money systems. The client performs a money transfer on the account of the electronic money system, at the same time this electronic wallet gets a corresponding amount of electronic money.

- with the help of a pre-paid card. The client buys a special pre-paid card in a store. While doing that he doesn't give any login data and the purchase information of these cards is not reported into any financial intelligence departments. Then he inputs the data from this card into the system of electronic money and after that he receives the corresponding amount in electronic money on his electronic wallet.

- using a special exchange branch. The client comes into a currency exchange branch and exchanges a corresponding amount of money for electronic money. For that transaction the exchange branch might not perform client identification or report a suspicious transaction into the financial intelligence office.

- with the help of other electronic money. The client can exchange one electronic currency for the other one with the help of special services (corresponding Internet sites).

These described procedures are widely accessible and allow clients of the system to perform a fast and easy deposit of a large amount of money into the system. Some of the deposit ways do not allow appropriate identification and increase the risk of using electronic money for the criminal purposes.

At the present moment the following ways of withdrawing the money from the system exist:

- a bank transfer. A client of the system formulates a request in a special program or through the Internet browser to withdraw the required amount of money from the system by giving his administrative details. After that the

corresponding amount is withdrawn from his electronic payments system bank account into the client's bank account.

- transfer to a bank card. This point is similar to the previous one, except that the transfer is made on the client's bank card administrative details.

- a cash transfer through the system of money transfers. The client formulates a request to withdraw money from the system of electronic money and comes to the alternative money transfers system branch, after that he receives a corresponding amount of money.

- money payments with the help of a special exchange branch. After coming to a special currency exchange branch the client exchanges his electronic money for the corresponding amount of cash.

- money order payment.

The ways to receive/withdraw the amounts of money into the system described above make electronic money clearly easily accessible and convenient for criminals.

6. Recommendations

Despite the fact that electronic money is a fairly new tool, quite a few countries have legislation, allowing to regulate electronic money conversion. Having summarized the existing experience we can identify the following recommendations in order to combat money laundering and terrorism financing.

6.1. System clients identification

Despite the simplicity of the process, the client identification for the system of electronic money has a few peculiarities, caused by the nature of it.

There is the opportunity to have a simpler identification for the system's clients. The conditions for it could be, for example, limiting the amount of transferred money through one account during a fixed amount of time. At the same time the clients of the system that are corporate entities have to go through a complete identification process.

Taking into consideration the fact that electronic money does not assume a constant personal contact of the user with the system, it is extremely important to find such an identification mechanism that would present credible information about the client on the one hand, and on the other hand would not make an electronic money user's life too complicated. One of such mechanisms is attaching electronic wallets to the user's bank card.

6.2. Restrictions introduction for transfer totals

Electronic money is a tool that provides high speed money transfers between the clients, and it assumes that there is no constant contact between the user and the system. Taking this into consideration, as well as taking into consideration the fact that electronic money is mainly set to be used as payment means in electronic

stores, it seems reasonable to set up a limit for the total amount of transferred money among different user groups.

6.3. Payments refusal without payment function

If we accept the fact that electronic money is means of payment for goods, work and services, that means that electronic money could be used to perform transactions that have to be controlled on a compulsory basis. For example, one can get a zero percent loan or buy precious metals or security papers with the help of electronic money. To reveal these transactions effectively it is important to have payment designation function.

6.4. Data direction to a competent authority

Since the systems of electronic money are used for money laundering and terrorism financing, in order to combat this situation effectively it is necessary to inform the corresponding state authorities about transactions performed with electronic money. It is also necessary to find out whether the transactions performed with electronic money are subject to compulsory control. On the one side this would allow to receive a lot of information, but on the other side this will create an additional load for the system of electronic money, that means it will make it more expensive to use.

6.5. Licensing of the activities of electronic money system

Since electronic money is directly tackling such an important field of state activity as money conversion, and with the development of the Internet the range of its activity keeps growing, it seems to be necessary to implement licensing of electronic money issue.

The types of licenses could be different. It could be a license of a credit and finance establishment, or a separate license, allowing to perform transactions only with electronic money.

Obviously, this measure will not only mitigate risks from the point of view of money laundering and terrorism financing, but will also allow to make this field more transparent and reliable.

The project participants provided the information about complex use of the noted measures to substantially mitigate risks of electronic money use for money laundering and terrorism financing.

Conclusion

Despite being fairly new electronic money is the tool used for money laundering and terrorism financing.

With the development of high technology and, first of all, the Internet, electronic money will also develop, so the risks of its use will grow.

The key features that set up the basis of such use are those features that make electronic money so attractive to the users: its wide-spread use, accessibility, mobility and ease of use. Electronic money allows to transfer large sums of money quickly for long distances without a physical contact of the user with the system.

Law enforcement agencies and financial intelligence departments of different states have many examples of electronic money use for criminal purposes, including quite complex criminal schemes.

At the same time, use the recommendations, taking into consideration the specifics of electronic money, for example, client identifications, provision of information about performed operations to financial intelligence department and others allow to substantially reduce the risks of their use for criminal purposes.