



# Natural disasters and money laundering risks

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## Abstract

**Purpose** – Sets out to examine the dangers of money laundering as a consequence of natural disasters.

**Design/methodology/approach** – Lists the potential abuses and scans to which unscrupulous manipulators will resort in order to profit from natural disasters.

**Findings** – Finds that criminal groups have established networks and sophisticated technology to effectively carry out their activities.

**Originality/value** – This is a detailed and eye-opening revelation of the various criminal opportunities for money laundering spawned by natural disasters.

**Keywords** Money laundering, Natural disasters

**Paper type** Viewpoint

Hurricanes Charley, Frances and Ivan left a trail of death and destruction across the Caribbean and Florida in 2004. The tsunami on December 26, 2004 devastated Asia. Hurricane Katrina destroyed New Orleans and Hurricane Rita has caused extensive damage in Texas. In all of these cases many people have been displaced from their homes and jobs. The damage and devastation to infrastructure including roads and bridges, communication, health and education are indescribable. The long-term economic impact caused by these natural disasters will be significant.

There are several private relief efforts to collect much-needed supplies to assist the people displaced by these natural disasters. Many international agencies and other charitable organizations have stepped forward to collaborate with a range of community-based organizations to begin the process of renovating and rebuilding in the affected regions. In the aftermath of such disasters, financial institutions are usually encouraged to consider all reasonable and prudent steps to assist displaced customers' cash and financial needs in the affected areas. Financial institutions may have to adjust or alter their know your customer/customer due diligence (KYC/CDD) policies in the areas affected by the disasters. However, as the reconstruction and recovery work get underway, policymakers and financial institutions in the affected areas should remain vigilant in the fight against money laundering and terrorist financing. There is no empirical evidence supporting this proposition. However, intuition suggests that the risk of money laundering and terrorist financing may increase in the aftermath of any natural disaster. Organized crime groups wishing to launder criminal proceeds and those wishing to finance terrorism may seek to take advantage of the chaos caused by natural disasters.



Intuitively, there are a number of opportunities that can be exploited for the purposes of laundering criminal proceeds and the financing of terrorism in the disaster affected areas. Criminal groups have established networks and sophisticated technology to effectively carry out their activities which may heighten in the aftermath of a natural disaster. They are generally well-equipped, flexible and ready to exploit any opportunity presented for laundering their proceeds of crime. Organized criminal groups may increasingly transport and launder bulk quantities of currency through disaster affected areas to other safe havens in order to avoid financial institutions' reporting requirements and law enforcement actions.

The laundering of proceeds of crime through money service businesses may also be a significant threat during the aftermath of a natural disaster. Various other methods may be used including structuring bank deposits and money order purchases (smurfing), commingling drug proceeds with proceeds from legitimate businesses, using parallel banking systems and trade-based schemes (precious metals and gems), and exploiting the securities and gaming industries. Organized crime groups may exploit the fact that financial institutions may find it difficult to carry out extensive customer identification procedures (CIPs) as many persons displaced or affected by natural disasters may not have access to their normal identification and personal records. In fact, in order to contribute to the restoration of economic health and recovery in the disaster affect areas, financial institutions may be forced to rely solely on non-documentary methods, or to a greater extent on a combination of documentary or non-documentary methods to verify customers' identity. A much more benign method of customers' identification verification in the disaster affected area may therefore be exploited by organized crime groups wishing to launder their proceeds of crime.

While financial institutions may open accounts prior to the verification of a customer's identity, verification of the customer's identity is generally expected to take place within a reasonable period of time after an account has been opened. However, it is reasonable to expect that in the aftermath of natural disasters, the verification of customers' identification may take much longer than normal due to the loss of standard identification documents. In fact, even the customers' records at financial institutions located in the affected areas may also be adversely affected or even, totally loss or destroyed. The risk of identity theft may also increase due to damages to buildings housing individuals' public documents, and this may compound the risk of money laundering and other crimes. Identity thieves know that financial institutions are likely to put systems in place to provide services to victims of natural disasters. Identity thieves are well prepared to exploit the situation for the purposes of money laundering and other crimes.

There are a number of measures financial institutions can take to reduce any risk when dealing with customers in areas affected by natural disasters. Financial institutions should educate themselves as to the type and availability of replacement identification for the purposes of authenticating the identification documents. Further, whenever the receipt of formal documentation is delayed, the institution should give a reasonably extended grace period for the production of identification and account opening documentation. The institution should also ensure that in all cases a formal review of the file is conducted after the deadline date for production is passed. Careful attention should be paid as to whether the customer was forthcoming with the

requested documentation or whether the customer may merely intend never to produce such documentation.

Financial institutions should also heavily implement the use of various verification methods, negative, positive, and logical, when scrutinizing risks associated with customers potentially associated with natural disaster areas. Particular attention should be paid to fraud databases to determine whether the customer is associated with known incidents of fraudulent behavior (negative verification). Financial institutions should compare the identifying information with information available from a trusted third party database source, such as a credit report from a consumer reporting agency (positive verification). Financial institutions should also analyze whether there is a positive match with someone previously reported as living in the disaster affected area and whether there is a logical consistency between the identifying information provided, such as the customer's name, street address, ZIP code, telephone number, date of birth, and social security number (logical verification).

If the affected area is traditionally a cash-based economy, financial institutions should carefully scrutinize not only the source of funds but also the source of wealth (e.g. consistent with means, resources and occupation) for any large cash sums deposited in the aftermath of a natural disaster. If customer identification and source of funds/wealth issues are not carefully controlled by financial institutions when dealing with affected customers, identifying and tracking the proceeds of crime and financing of terrorism during the aftermath of a natural disaster may therefore be a staggering challenge for law enforcement.

Those persons or entities wishing create mayhem on civil society through terrorism and the financing terrorism are also well-equipped, flexible and ready to exploit opportunities created by natural disasters. Those wishing to finance terrorism may exploit non-bank money channels including trade, charities and remittance services during the immediate aftermath of a natural disaster.

Advances in communication and technology have dramatically expanded legitimate commercial enterprise between states, shrinking distances, rendering state frontiers porous, and opening up previously unimaginable opportunities for commercial, political and social interaction. However, in the immediate aftermath of any natural disaster there is generally a disruption in communication, business, commerce and trade which may present unprecedented openings for illegitimate activities by criminal groups and enterprises and those wishing to finance terrorism.

As the disaster affected areas descend into chaos, prior to the re-establishment of civil institutions most notably law and order and also during the period of diverting resources to the immediate task of post-disaster search and rescue, and recovery and security, certain criminal activities separate from looting, may also escalate. For example, there may be increased contraband trade around the affected areas. The affected areas could become temporary transit points for drugs and human trafficking. It is also possible that natural disasters may lead to an increased risk of integration of organized crime groups into the affected areas.

As the Financial Action Task Force (2003) (FATF) noted the voluntary or charitable sector can be described as one of the key providers of certain services to society, together with the public and private sectors. During the reconstruction and relief effort non-profit and charitable organizations will undoubtedly touch almost all aspects of peoples' lives in the affected areas. It is conceivable however, that criminals may seek

to use existing, or create new non-profit and charitable organizations fronting as aiding the recovery and relief effort as vehicles for money laundering and subsequently, diverting funds into the financial system and the wider economy of the affected areas. The risk of money laundering calls for enhanced scrutiny of donors and non-profit and charitable organizations coming forward to provide financial assistance and other relief and aid to victims of natural disasters. It also calls for stricter monitoring of compliance with anti-money laundering laws and combating the financing of terrorism regulations by financial institutions.

The potential misuse of non-profit and charitable organizations by terrorist groups has been identified by the FATF. The misuse of non-profit and charitable organizations can be extended to money laundering. As in the case of financing of terrorism, criminals may choose to infiltrate established non-profit and charitable organizations or establish new non-profit and charitable organizations with a stated purpose of providing disaster relief aid in order to launder dirty money. The thought of infiltration of legitimate humanitarian or charitable organization by criminals to take advantage of the current state of devastation and destruction in disaster affected areas is reprehensible. The proceeds of crime can be easily commingled with funds collected for ostensibly legitimate charitable purpose and then diverted to other economic sectors such as construction and disaster relief consumer financing. As the devastation and destruction is extensive the misuse of non-profit and charitable organizations associated with disaster reconstruction and recovery work could also serve as an intermediary or cover for the movement of funds regionally and internationally into the financial system.

The misuse and abuse of the sanctity of charitable giving by money launderers could have an adverse effect on donors and on those in need. In order to minimize the misuse of non-profit and charitable organizations associated with natural disaster reconstruction and recovery work, the authorities and financial institutions should put appropriate policies and systems in place. Some of the key areas of interest when conducting KYC/CDD for financial institutions should be: corporate governance (e.g. corporate instruments, board of director activities); financial transparency/disclosure (e.g. board members/key employees, distribution of funds and solicitation for funds); financial practice/accountability (e.g. budget, CFO, independent audit results, and receipt and disbursement of funds); programmatic verification (e.g. Is there transparency in the solicitation and application of funds process? Are they officially registered? Have past projects actually been carried out? Are the beneficiaries known and real? Have the intended beneficiaries received the funds that were sent for them? Are all funds, assets, and premises accounted for? Is this organization on a sanction list? Have there been direct field audits of programmes? What are the results of public research conducted on the organization?); administration (e.g. documented administration, managerial and policy control over operations); and regulatory/private sector oversight (e.g. comments from regulatory bodies – bank, tax, financial, charity commissions and private sector watchdog organizations).

In addition, there should be some element of coordination of disaster relief efforts to reduce the risk of fly-by-night charities setting up purely for criminal purposes. There should be a national coordinator or regulatory oversight agency that collects and distributes information about all relief efforts and programmes that are operating in a stricken area and provides for some sort of screening or vetting of the charitable or relief organization.

Non-profit and charitable organizations associated with disaster relief efforts should be encouraged to be transparent. The availability of information and public disclosure about charities' operations can help stimulate oversight by donors, the media, academia, and private organizations. Financial institutions in their dealings with charitable organizations at this time should encourage those organizations to disclose information on various facets of their operations to facilitate the KYC/CDD process.

The devastation and destruction caused by recent natural disasters may provide opportunities for criminals to filter their proceeds of crime into the economies of the affected areas. There are numerous potentials for money laundering risks when dealing with customers in areas affected by natural disasters. Criminal elements may seek to use the chaos created by the disaster to conceal or disguise the proceeds of crime committed prior to the disaster, during the recovery and reconstruction phase. Financial institutions will need to re-evaluate their CIP policies, KYC/CDD and verification procedures to address potential abuses by criminals trying to gain access to the financial system by exploiting weaknesses in the circumstances and suffering created by natural disasters. The disaster affected areas will have to rely on humanitarian or charitable organizations' assistance during reconstruction and recovery work. Already some highly reputable non-profit or charitable organizations and donors have stepped forward to provide natural disaster relief assistance. However, the authorities and financial institutions will have to be vigilant to ensure that existing and newly created charitable organizations are not merely sham that simply funnel proceeds of crime.

#### **Reference**

Financial Action Task Force (2003) *Report on Money Laundering Typologies 2002-2003*, February, FATF, Paris.

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