The Money Laundering and Fraud Issue of the Decade?

We recently wrote that "transaction laundering" could be the money laundering and fraud issue of 2019 and beyond. The *Financial Times* says transaction laundering is a $200 billion per year scheme in the United States alone and that number is expected to increase (perhaps exponentially) over the next few years.

Briefly, what is transaction laundering (a/k/a "credit card laundering," "undisclosed aggregation," or "factoring")?

> **Transaction Laundering is the criminal/money launderer's use of the legitimate merchant payment infrastructure through "front companies" "pass though companies" and "funnel accounts" to process illicit transactions.**

Transaction laundering is very difficult to detect primarily because it mixes legitimate and illicit transactions, typically in low dollar amounts. The "processor" of the "transaction laundering" transaction has a legitimate credit card merchant account and, in most cases (especially in pass-through and funnel account schemes), most of the transactions processed through the account are legitimate.

Now, from the *Wall Street Journal* (subscription required) comes this happy headline:

The New ID Theft: Millions of Credit Applicants Who Don't Exist

Synthetic Identity Fraud is one of the fastest growing forms of identity theft—and the hardest to spot and combat.

Criminals have used synthetic identity fraud to perpetrate mortgage fraud for years. "Synthetic" borrowers purchased billions of dollars in overvalued real estate in the mortgage market in the early 2000s. Why is this scary? The Wall Street Journal says:

> Because the person taking out cards or loans isn't real, there are no consumer victims to alert lenders…Synthetic-identity fraud exploits a vulnerability in America's consumer-credit system. Lenders often consider a loan applicant legitimate if the applicant has a credit report at Equifax Inc., TransUnion or Experian PLC. But a new "credit file"—essentially a precursor to a credit report—often gets created when someone simply applies, even if the loan doesn't come through.

Equifax says synthetic identity fraud accounts for a whopping 80% of all credit card fraud losses and estimates it was an $8 billion problem in 2018.

What does this have to do with money laundering in general and transaction laundering in specific? Transaction laundering is a $200 billion per year problem now and it involves inflated or non-existent transactions processed through credit card companies. If you combine these inflated or non-existent transactions with synthetic (a/k/a fake) credit accounts, the sky might be the limit on money laundering opportunities. Imagine if the criminal money launderer had a virtually unlimited number of false credit identities ("synthetic debtors") who could obtain credit and perhaps bank accounts, make cash deposits, move money, and become customers in transaction laundering schemes. This is not a "worst case" scenario, it is a growing reality. Here's an example from *Thomson Reuters*.

So, is all lost? Well, no, but it's far from found. Credit card and big data companies as well as the credit bureaus are attacking the problem with math. The effectiveness of these methods remains to be seen. KYC systems are, we believe, behind the power curve, but as the problem gets more press, they will (we hope) catch up. The challenges of verifying the legitimacy of the potentially illicit business (remember that the effective transaction laundering methodology processes good transactions with bad ones) is substantial. The first step in this process is to recognize and publicize these problems so the smart, diligent, creative professionals in the financial services and RegTech industries (that's you) continue to create solutions. The criminals and money launderers are smart, creative, and diligent, but so are we.

About the Author

Mark Stetler is CEO of RegSmart. He has a degree in Finance from Baylor University (*cum laude*, 1985) and a law degree from the University of Texas (with honors, 1988). Mark has worked in the financial services industry for 30 years as an attorney and entrepreneur. Mark previously co-owned one of the nation's largest firms specializing in forensic financial audits. He is a Certified Anti-Money Laundering Specialist and a chief architect of RegSmart's anti-money laundering risk assessment and audit SaaS.

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