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Taxonomies of Money Laundering: An Iranian Perspective

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Taxonomies of Money Laundering: An Iranian Perspective

Structured abstract

Purpose – To identify the sources of laundered money in Iran and the destinations to which it is transferred, independently verified by auditors. Based on such data, to develop a simple model of endogenous and exogenous factors facilitating money laundering in developing countries which can inform domestic and international legislative and regulatory responses.

Design/Methodology/Approach– Questionnaires were sent to Iranian certified public accountants who worked for auditing firms in 2019 and who have encountered suspected money laundering during their work with clients.

Findings – The government and public officials are the primary sources of money laundering activity in Iran. The main destinations of laundered funds are investments abroad, gold, foreign currencies, real estate, and purchases of luxury goods. Domestic legislation, whilst bearing similarities with that found in other jurisdictions such as the United Kingdom and the United States, is flawed in several ways, including an inability to determine beneficial ownership of funds and weak enforcement.

Originality/value – Due to international sanctions and the prevailing political situation, it is difficult to obtain data for money laundering and other financial crimes in Iran. The data obtained is of importance to international bodies in understanding the nature of money laundering in Iran, and how to negotiate in the future to address mutual concerns. Given the country's perceived high association with money laundering, the data obtained is of value in identifying the specific characteristics of the problem.

Category: Research paper.

Keywords: Money laundering. Financial Action Task Force. Iran. Terrorist financing. Golden Triangle. Palermo Convention.

1. Introduction

In advanced economies money laundering is invariably associated with sophisticated techniques intended to avoid the attention of investigators (Mitchell *et al.*, 1998; Simser, 2008; Irwin *et al.*, 2012). ‘Smurfing’, or the use of individuals to transfer high volumes of small cash payments into the financial system, goes against this perceived sophistication but is more associated with small-scale illicit drug transactions. In contrast, in developing countries the crime is associated with people smuggling, drug production and manufacture, and bribery and corruption, perhaps by politicians who take ‘back handers’ on the awarding of government contracts. For example, in Colombia the illegal narcotics industry is the main source of illicit funds (Thoumi, 2002). In Brazil, the major sources of illicit funds are smuggling, corruption, narcotics trafficking, and organised crime (Bijos, 2014). In China, the source of illicit funds is more related to corruption and insider dealing rather than drugs and violent crimes (Naheem, 2017). In India, the main sources of dirty monies are corruption, fraud, currency counterfeiting, organized crimes, human trafficking, and drug trafficking and the main tool for money laundering is *hawala* (Kar, 2011). In Pakistan, money laundering is associated with terrorist financing where drug trafficking, kidnapping and extortion generate illicit funds (Azam and Javaid, 2017). Iran shares several of these factors and has been blacklisted by the Financial Action Task Force (FATF) for its involvement with money laundering which, according to the head of the organisation, puts the international financial system at risk.

Regarding the sources of Iranian laundered funds, first impressions would suggest that this is principally derived from trade in illicit narcotics across the region: it is, after all, one of three countries making up the ‘Golden Triangle’ of the international drugs trade, the other two being Afghanistan and Pakistan (Chalk, 2010; Sabatelle, 2011). The country’s political leadership would deny any association with terrorism-related money laundering but the European Union, the United States, and the FATF, take a different view. The difference arises from a tautology: Iran does not accept the international community’s view that Lebanon’s Hizbullah is a terrorist organisation, nor Iraq’s Hashado Shabi, nor Yemen’s Ansarollah, and that as such, any payments to these groups, through charities or government financial support, cannot, by definition, constitute terrorist financing. This diametrically opposite interpretation of what constitutes a terrorist organisation is the main reason for the country’s refusal to accede to the Palermo Convention and the Terrorist

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3 Financing Convention of 1999, both of which underpin the FATF's efforts to reduce terrorist-
4 related money laundering (Matsuoka, 2018). These two sources of laundered funds- drugs and
5 terrorism- come to mind in the context of Iran but as explained, there are several others which are
6 common to developing countries generally. The research questions addressed in this paper are as
7 follows. First, what are the actual as opposed to preconceived sources of money laundering in Iran?
8 Are these the same as in other developing countries, or are there nuanced differences? Second,
9 what are the destinations of Iranian laundered money? If both the sources and destinations are
10 domestic, then these should be addressed and counteracted through national legislation. However,
11 if there is an international dimension, then this raises questions about the architecture of
12 conventions and legislation which exist beyond Iranian jurisdiction. To criticise the country for
13 failings which happen outside its borders is to risk criticising the speck in its eye – its domestic
14 shortcomings which enable money laundering to take place - whilst overlooking the beam in the
15 eye of the international financial community. The next section provides a literature review of
16 money laundering in developing countries. Section 3 develops a simple theoretical model of
17 exogenous and endogenous factors contributing to money laundering in developing countries.
18 Section 4 provides empirical data regarding sources and destinations of laundered funds in Iran.
19 Section 5 applies the model to the findings and discusses the implications for domestic reform and
20 international enforcement. Section 6 concludes.
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37 **2. Literature review**

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42 In a speech in Chatham House, London, in January 2010, introducing the United Kingdom
43 government's new anti-bribery strategy, the Lord Chancellor stated that the World Bank estimated
44 that a trillion dollars a year are paid in bribes. Politicians and public officials in developing and
45 transition economies are estimated to receive between twenty and forty billion dollars in bribes
46 each year despite ostensibly robust anti-corrupt payments legislation found in most advanced
47 economies. For example, the United Kingdom's Bribery Act 2010, based on the Organisation for
48 Economic Cooperation and Development's 1997 Anti-Bribery Convention, makes it a strict
49 liability offence for partnerships and companies to fail to prevent bribery, principally through the
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3 making of payments to foreign public officials to obtain a business advantage. The sources of
4 dirty money in developing countries have been investigated by Vaithilingham and Nair (2007).
5 They focused on technology (information and communication technology infrastructure), the
6 quality of human capital, effectiveness of legal frameworks, and corporate governance and ethics
7 within firms. They found that an efficient legal framework combined with good corporate
8 governance lower the pervasiveness of money laundering. In a report produced by the World Bank
9 in 2012 on controlling the flow of illicit funds from developing countries, edited by Peter Reuter,
10 several factors were identified as drivers of money laundering. First, tax evasion resulting from
11 failure to create social consensus and political ambition to build a legitimate and effective state.
12 This political economy aspect of money laundering can be described thus: if there is a lack of
13 consensus on the need to pay taxes to fund political stability and economic growth, combined with
14 a lack of administrative capacity to collect taxes, and if regime leaders and elites are unwilling to
15 tax themselves, then money laundering and an outflow of dirty money will persist (Petanlar *et al.*,
16 2011). Tax evasion is perceived as dissatisfaction with government, political interference in the
17 economy, and weak governance (Lewis, 1982; Kim 2008).
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21 In Columbia geography has been a significant obstacle to economic integration and an obstacle to
22 effective central state presence throughout the country. The country has a large informal economy;
23 financial services cover only a minority of the population, illegal economic activities are
24 widespread, and violence, sometimes allegedly conducted by government proxies, is frequently
25 used to achieve economic goals. Law enforcement is problematic, undermined by political and
26 societal corruption. Iran has a similar large informal economy but in contrast to Columbia, state
27 control is highly centralised and the government's writ runs throughout the entire country and is
28 not excluded from regions or provinces (Khandan and Nili, 2014). Money laundering is also
29 associated in developing countries with human trafficking: most profits made by petty traffickers
30 are retained in the country in which they are derived, but it is the core businesses of criminal
31 organisations such as prostitution, illegal drugs, counterfeiting, corruption, where the high profits
32 are made. In the World Bank Report of 2012, Maton and Daniel considered 'The kleptocrat's
33 portfolio decisions', showing how politically exposed persons (PEPs) involved in corrupt activities
34 in Kenya, Indonesia, Uganda, and Zambia, including two former heads of state, were able to amass
35 fortunes offshore in tax havens, and were also able to evade civil asset recovery powers. They
36 noted that those charged with offences are invariably more able to hire lawyers able to oppose
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3 prosecutions than the persons pursuing them. The situation is exacerbated by an unwillingness of
4 politicians who subsequently come to power to pursue those who came before them and have
5 looted the country.
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9 Otusanya (2011) linked money laundering to political corruption in developing countries, and the
10 extent to which it significantly damages economic development. Sharman and Chaikin (2009)
11 considered how systems of laws, regulations and institutions developed to counter money
12 laundering provide powerful tools for fighting corruption. They questioned why such tools are not
13 used in developing countries in combatting corruption, given that they can easily and at low cost
14 be deployed in this additional context. They proposed that anti-money laundering (AML) systems
15 can be used to fight corruption because of the focus on the importance of financial intelligence,
16 asset confiscation, and international cooperation. However, such systems as proposed by outside
17 powerful actors, for example the FATF, suffer from a lack of ownership in developing countries,
18 leading to their adoption in a tokenistic fashion to enhance international legitimacy and
19 reputations. Sharman (2008) noted that in 1988 not a single country had a policy against money
20 laundering, but twenty years later over 170 countries had broadly similar AML policies in place.
21 This extensive diffusion was puzzling because it had not been conclusively proven that such
22 policies work. Sharman argued that this process of diffusion was much more power-based than
23 voluntary. The mechanisms driving policy diffusion including direct coercion, mimicry, and
24 competition, were all discursively mediated exercises of power, rather than reflecting rational
25 learning or brute material forces.
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39 Genuine compliance by developing countries with FATF requirements, and with obligations
40 prescribed in Conventions such as Palermo and the Terrorist Financing Convention, has been
41 questioned in the literature (Johnson, 2002). Masciandaro (2005) considered the policy
42 consequences of the pros and cons of the blacklisting procedure, finding that lax financial
43 regulations combined with the high cost of compliance can undermine a country's aspiration to
44 meet its FATF obligations. Eggenberger (2018) has questioned the legitimacy of the process of
45 blacklisting, identifying three prerequisites for effectiveness: the stigma of being blacklisted, the
46 nature of sanctions imposed in support, and the blacklist's legitimacy. Mugarura (2013) observed
47 that global anti-money laundering laws are often emasculated by the fact that they are implemented
48 in the realm of international law which manifests itself within independent member states' vested
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3 strategic self-interests. In the event of conflicts, national self-interests will prevail. But money
4 laundering is an opportunistic crime because it generates both synergies and externalities and the
5 response of an individual state often depends on how it is affected by it. In not acceding to the
6 required international conventions as stipulated by the FATF, Iran has experienced significant
7 reputational damage, being one of only two countries on the blacklist (Rahmdel, 2018). Force has
8 also been applied to encourage compliance (as well as in response to the international community's
9 concern about nuclear proliferation in the region), in the form of sanctions which have had a
10 profound economic impact. The country has also been placed at a competitive disadvantage vis a
11 vis its neighbours in failing to attract foreign direct investment. However, the legitimacy of the
12 blacklisting process as explained by Eggenberger (2018) has been questioned by the Iranian
13 government because of differing interpretations as to what constitutes a terrorist organisation,
14 averred to earlier. Paradoxically, when the country does eventually comply with the Conventions,
15 this may be less tokenistic than has been the case with other developing countries as criticised by
16 Sharman and Chaikin (2009). The next section develops a model of factors facilitating money
17 laundering in developing countries which will be applied later in the context of Iran.
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32 **3. A simple endogenous and exogenous modelling for money laundering in developing** 33 **countries** 34 35 36 37 38

39 It can be seen from the literature that causes of money laundering are both endogenous and
40 exogenous. Regarding the former, factors would include the lack of will and the resources to
41 enforce domestic legislation, absence of accountability of politicians, and the ineffectiveness of
42 anti-corruption laws and procedures (Markovska and Adams, 2015; Sharman and Chaikin, 2009).
43 Sharman (2008) indicates that corruption and money laundering often go hand in hand; corrupt
44 politicians who have looted the state need to find effective ways to launder their illegal gains.
45 Other endogenous factors include the extent of the informal economy; the greater this is, the greater
46 the opportunity for money laundering (Ponsaers *et al.*, 2008). In August 2016 the Iranian English
47 Economic Daily, the *Financial Tribune*, noted that Iran's informal economy (the part of the
48 economy which does not pay taxes and is not monitored by state agencies, for example regarding
49 labour rights or safety in the workplace) employs a third of the workforce, and generates a fifth of
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3 economic output. The Minister of Cooperatives, Labour and Social Affairs, Ali Rabiei, stated in a
4 conference in May 2016 that of 22.5 million people presently employed in the country, sixteen
5 million are formally employed, leaving 6.5 million in the informal sector. According to the former
6 head of the National Tax Administration, Ali Askari, and reported in the *Financial Tribune* article,
7 tax revenues are below 7% of GDP, in contrast to 25-30% in most developed countries. According
8 to the Ministry of Economic Affairs and Finance, in the fiscal year 2015-16, the informal economy
9 accounted for 36.5% of GDP compared with 7% in 1974-75. Accountants who fail to report
10 clients' undeclared earnings to the appropriate authorities, or assist them in evading taxation,
11 perpetuate and exacerbate the informal economy and in so doing make money laundering more
12 likely (and even socially acceptable). The same is true of financial institutions which receive or
13 pay out to payers or beneficiaries suspected of concealing their identity. The remainder of this
14 section will examine these endogenous and exogenous factors in detail.
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27 **3.1. Endogenous factors facilitating money laundering**

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31 A significant endogenous factor contributing to money laundering pertains to the political
32 economy of a country and the extent to which elites understand the obligation to pay taxes for
33 economic and social advancement (Hassan and Prichard, 2016). This in turn is a product of social
34 cohesiveness; if a society is atomised and individualistic, or if evasion of taxes is regarded as
35 socially or morally acceptable, then the size of the illegal economy and with it money laundering
36 as a corollary, will increase (Storm, 2013). The size of Iran's informal economy has resulted in an
37 increase in tax evasion and money laundering in recent decades. A connected endogenous factor
38 is the ability of central government to impose its will and to ensure compliance with AML laws
39 across the country, for example in individual provinces. A highly decentralised state with
40 significant levels of regional autonomy such as Columbia has resulted in limited central
41 government fiat and a proliferation of tax evasion, money laundering and an illicit trade in
42 narcotics as a result. In contrast Iran is, governmentally, a highly centralised state which would
43 suggest an ability to enforce AML rules across the country (Higgins, 1984). However, the
44 existence of multiple authorities in Iran has increased the level of corruption (Hen-Tov, 2007) ;
45 bribery, embezzlement, abuse of power, and other forms of corruption in Iranian governmental
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3 agencies is significant. This coincides with findings by Alamdari (2005) who observed that, from
4 a political economy perspective, instead of horizontal layers of classes the power structures in both
5 Shi'ism and clientelism are based on vertical columns of rival and autonomous groups. The
6 traditional Shi'ah institution of *Marja'iyat* (source of emulation which provides religious
7 interpretation on matters of law), has come into conflict with an elected government. A reformist
8 government elected in 1997 failed to deliver on its democratic promises and to end the role of
9 autonomous groups; for Alamdari, disenchanted with state-sponsored reforms, Iranian society
10 seemed to be moving towards pragmatism and utilitarianism, while the political power structure
11 leans towards militarism. Central government is therefore principally concerned with 'holding the
12 ring' between competing groups within the political architecture (Atabaki, 2005), rather than in
13 designing and enforcing effective AML rules from the centre.
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25 **3.2. Exogenous factors facilitating money laundering**

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29 Exogenous factors include the effectiveness of enforcement of asset recovery processes in foreign
30 courts. This in turn depends on recognition of Iranian domestic court rulings in foreign courts, and
31 of orders regarding the freezing of bank accounts held in foreign jurisdictions. There are two
32 international conventions covering enforcement of court rulings in the region: the Riyadh Arab
33 Agreement for Judicial Cooperation 1983, and the 1996 Gulf Cooperation Council Convention for
34 the Execution of Judgments, Delegations and Judicial Notifications (the GCC Convention). The
35 former has 18 signatories across the Arab world, while the latter is limited to the six members of
36 the GCC. Both Conventions cover matters including the recognition and enforcement of civil
37 judgements, including the freezing of bank accounts suspected to be linked to looting of the state
38 by politicians or public officials, money laundering and corruption, rogatory assistance by
39 domestic courts in support of foreign proceedings, and the service and recognition of legal
40 documents such as orders freezing assets. Iran is not a signatory to either Convention: this is a
41 significant exogenous weakness in any attempt to pursue the proceeds of money laundered by, for
42 example, bureaucrats or corrupt officials if these have been moved outside the jurisdiction to
43 neighbouring states (Askin and Collins, 1993; Chamberlain, 2002). Other exogenous factors will
44 include the availability of offshore financial centres to Iranian launderers, and their ease of
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3 accessibility (Otusanya and Lauwo, 2012). Launderers also need to invest in overseas assets such
4 as high value property, with the collusion of local advisors such as estate agents and lawyers (He,
5 2006). Foreign banks which assist capital flows to offshore accounts, or provide informal and
6 unlicensed conversion of currencies, or fail to properly record or report the identity of
7 beneficiaries, also assist in the money laundering process (Peterson, 2013). Having developed this
8 simple model of endogenous and exogenous factors facilitating money laundering in developing
9 countries, the next section will provide the results of field research in Iran regarding the balance
10 between the two.
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20 **4. Research findings**

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26 A questionnaire was e-mailed to Iranian audit firms and then followed up with phone calls in which
27 the objectives of the research were explained. This method of investigation is widely accepted in
28 academic research of this nature (Babbie, 2012). Accounting professionals, particularly auditors,
29 are expected as part of their professional duties to be aware of signs of money laundering and then
30 to report these to the appropriate authorities, principally through the filing of Suspicious Activity
31 Reports (Melnik, 2003; Mitchell *et al.*, 1998;; Norton, 2018). Accordingly auditors have an
32 important role to play in counteracting money laundering (Salrhi et al., 2019; Cox, 2014; Standing
33 and Van Vuuren, 2003). In 2019, 253 audit firms with 1,008 CPAs were operating in Iran
34 (available at <http://en.iacpa.ir/Membership>): these provided the statistical population for this
35 research. We received 148 responses (14.7% of our research sample). The opinions expressed in
36 the questionnaire were well informed on the issue of money laundering: when asked about
37 awareness of domestic laws regarding money laundering and FATF requirements, 17.6% said they
38 had average knowledge of the former, 63.5% good, and 14.7% excellent. For awareness of the
39 latter, the corresponding percentages were 37.9%, 27.7%, and 8.1%.
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4.1. Sources of laundered funds

The main sources of dirty funds in Iran as deduced from the questionnaires are presented in Table 1. The principal sources comprise bribery in government, smuggling of goods, undeclared earnings, and the illicit narcotics trade (Farzanegan, 2009). These results are consistent with prior academic research noted earlier. Although respondents also believed that bribery involving company contracts and criminality by the military are also significant sources of dirty funds, their importance is less than the five others. Some respondents also considered human trafficking and sanctions evasion as two other sources of dirty funds in the country, but the activity was statistically insignificant. The results are presented in Table 1.

Table 1
Main statistics of sources of dirty funds in Iran

	N	Mean	Mdn	Std	Sk	Kurtosis	Min	Max
Bribery in government and contracts	148	4.35	5.00	0.92	-1.40	4.36	1.00	5.00
Bribery in companies and contracts	148	3.76	4.00	1.03	-0.49	2.49	1.00	5.00
Drugs money	148	4.06	4.00	1.13	-1.01	2.99	1.00	5.00
Undeclared earnings	148	4.35	5.00	0.86	-1.38	4.56	1.00	5.00
Military	148	3.51	4.00	1.40	-0.41	1.84	1.00	5.00
Smuggling of goods	148	4.43	5.00	0.83	-1.86	7.24	1.00	5.00
Terrorism	148	3.61	4.00	1.27	-0.49	2.16	1.00	5.00
Petty or small crime, for example by taxi drivers, shop keepers	148	2.34	2.00	1.26	0.64	2.39	1.00	5.00

Mdn is the abbreviation of median, Std is the abbreviation of standard deviation, and Sk is the abbreviation for Skewness.

Table 1 comprises mainly endogenous factors relating to the sources of money laundering. For example, receipt of bribes by government officials, undeclared earnings, petty crime, and corrupt payments made for company contracts (so-called 'back handers'). Of these, bribery in government and undeclared earnings are the most significant sources, according to auditors who completed the

questionnaire. However, smuggling of goods was deemed more significant at a mean of 4.43 compared to 4.35 for these other two factors. Terrorism is a significant source and has a mean of 3.61. The military as a source of money laundering has a mean of 3.51, whilst drugs money is at 4.06. The military, by virtue of its presence in other countries, is also able to channel illegal funds beyond the reach of domestic courts (Tangri and Mwenda, 2003). These latter four factors are exogenous in nature: they take place at the interface between Iran's domestic jurisdiction and the outside world. For example, drugs flow across the 'Golden Triangle'; money is taken by Iranian parties as intermediaries as the drugs pass through from the producer regions of Afghanistan and Pakistan to the consumer markets of the West (Sen, 1992; Sabatelle, 2011). Similarly terrorist funding flows out from Iran to recipients or proxies in neighbouring states (subject to the observation that, should these payments be made to organisations not recognised as terrorist by the Iranian government, then tautologically these do not represent terrorist flows), constituting a further externality (Rudner, 2010).

4.2. Destinations for laundered funds

Table 2
Main statistics of the destination of laundered monies in Iran

	N	Mean	Mdn	Std	Sk	Kurtosis	Min	Max
Investing in securities	148	2.92	3.00	1.30	0.11	1.94	1.00	5.00
Purchasing shares in companies.	148	3.18	3.00	1.26	-0.06	2.01	1.00	5.00
Purchasing real estate	148	4.25	5.00	0.90	-0.85	2.54	2.00	5.00
Purchasing luxury goods	148	4.13	4.00	1.02	-0.88	2.71	1.00	5.00
Transferring outside national borders	148	4.51	5.00	0.88	-1.86	5.76	1.00	5.00
Payments to family or to friends	148	3.08	3.00	1.21	0.00	2.05	1.00	5.00
Purchasing gold and foreign currencies	148	4.30	5.00	0.82	-0.83	2.63	2.00	5.00

Mdn is the abbreviation of median, Std is the abbreviation of standard deviation, and Sk is the abbreviation of Skewness.

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6 Table 2 identifies the destinations for Iranian laundered funds as ranked by auditors who completed
7 the questionnaire. These comprise both endogenous and exogenous considerations. Regarding the
8 former, there are investments in government and corporate bonds, ranked with a mean of 2.92.
9 There are also payments to family and associates, with a mean of 3.08. Both these factors should
10 be dealt with domestically. For example, the Iranian Stock Exchange imposes rules by which
11 investors in securities must be named and their names appear on share certificates and registers of
12 members. Transfers to family should be within the competence of the tax authorities to deal with,
13 although it is accepted that present practice is unsatisfactory as evidenced by the low tax take
14 achieved. However, exogenous factors are considerably more significant in terms of how they
15 were ranked by respondents. Transfers outside national borders had a mean of 4.51, whilst
16 purchases of gold and foreign currencies had a mean of 4.3. Both activities require the collusion
17 of foreign intermediaries, whether this be passive ('looking the other way' and not filing a SAR),
18 or active (for example, deliberately bidding for high value art at an auction sale on behalf of a
19 known PEP, or buying real estate on his or her behalf).
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30 Transfers of funds out of Iranian jurisdiction require foreign banks to process these (unless the
31 physical cash is loaded into boats or lorries and transported across borders), and for foreign third
32 parties such as lawyers or estate agents to invest the proceeds on behalf of, and to the instruction
33 of, the launderer. This is the integration stage of money laundering: illegal funds become part of
34 the financial system and difficult to trace. Failure of the country to accede to conventions which
35 would enable such funds to be pursued represents a significant exogenous weakness. However,
36 failure of foreign financial intelligence units and prosecutorial authorities to detect or intercept
37 such illegal flows from Iran represents a weakness for which the government cannot be held
38 responsible. For example, in January 2018 the United Kingdom introduced Unexplained Wealth
39 Orders under the Criminal Finances Act 2017 to seize assets unless and until the owner can explain
40 the origin of funding. Failure to utilise such orders and comparable orders in other developed
41 countries, reflects two failures: first, that of the Iranian government to prevent the initial crime
42 (endogenous weakness), and second, that of the UK or other overseas authorities to make use of
43 the appropriate legislative instrument to seize it (an exogenous failure for which the former cannot
44 be held to blame). Most respondents considered Canada, Turkey, the UAE, the USA, the UK,
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3 Panama, Russia, Georgia, China, and tax havens, as the main destinations for laundered money
4 from Iran. Of this list, the US, UK, and Canada have exceptional investigative powers and asset
5 seizure legislation, and yet are identified by auditors as being preferred destinations for dirty
6 money. This suggests that, despite the present sanctions regime, flaws in the system are still
7 enabling launderers to move money out of the country. Hence, before the international community
8 condemns the speck in Iran's eye, which is of course of a considerable size, it should first recognise
9 the beam in its own eye which makes the flows of funds out of the country possible. The next
10 section critiques the extent to which endogenous and exogenous factors are addressed in current
11 Iranian legislation.
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22 **5. AML legislative provisions in Iran: a critique**

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26 In a Public Statement issued in October 2019 the FATF provided the following explanation of its
27 policy towards Iran:
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30 'Until Iran implements the measures required to address the deficiencies identified with respect to
31 countering terrorism-financing in the Action Plan, the FATF will remain concerned with the
32 terrorist financing risk emanating from Iran and the threat this poses to the international financial
33 system. The FATF, therefore, calls on its members and urges all jurisdictions to continue to advise
34 their financial institutions to apply enhanced due diligence with respect to business relationships
35 and transactions with natural and legal persons from Iran, consistent with FATF Recommendation
36 19, including: (1) obtaining information on the reasons for intended transactions; and (2)
37 conducting enhanced monitoring of business relationships, by increasing the number and timing
38 of controls applied, and selecting patterns of transactions that need further examination'.
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46 FATF concerns, and those endogenous and exogenous factors identified in the previous section,
47 should already be capable of addressed by the appropriate domestic authorities using legislative
48 provisions which already exist in Iran. According to Article 49 of the Constitution of the Islamic
49 Republic of Iran:
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54 The government has responsibility for confiscating all wealth accumulated through usury,
55 usurpation, bribery, embezzlement, theft, gambling, misuse of endowments, misuse of government
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3 contracts and transactions, the sale of uncultivated lands and other resources subject to public
4 ownership, the operation of centres of corruption, and other illicit means and sources, and restoring
5 it to its legitimate owner. If no such owner can be identified, it must be entrusted to the public
6 treasury’.

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10 This Article predates provisions in the UK Proceeds of Crime Act 2002 and the US Patriot Act
11 2001 by a couple of decades (the Constitution was introduced in 1979), and shares both the means
12 and the objectives of these later statutes. Subsequently Article 662 of the Islamic Penal Code was
13 ratified in 1996, criminalising dealing with the proceeds of theft; Note 2 of Article 119 of the Penal
14 Code of the Armed Forces further criminalised obtaining the proceeds of embezzlement. It is
15 apparent from these provisions that Iran already has in place the statutory mechanisms allowing
16 for the seizure of illegally obtained earnings, notwithstanding that they do not specifically refer to
17 money laundering *per se*. The first major legislative attempt by the Iranian authorities to combat
18 money laundering as a distinct crime was in 2002. In the Regulations Concerning Prevention of
19 Money Laundering through Financial Institutions and its 24 articles, money laundering and
20 suspicious transactions were formally defined. The Regulations require banks and other financial
21 institutions to fully implement know your customer protocols, to effectively supervise the activities
22 and operations of their customers, and not to render any type of banking service to ‘prohibited
23 persons’, which would include organisations deemed terrorist by the government (Salehi and
24 Imeny, 2019). However, in the FATF Statement of February 2019, weakness in customer
25 verification was identified as a continuing failing in banks’ AML procedures.

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39 In 2008 the Iranian Parliament ratified a further Anti-Money Laundering Law, refining the
40 definition of money laundering. The Anti-Money Laundering High Council was constituted the
41 body responsible for coordinating agencies involved in AML (the Financial Intelligence Unit, or
42 FIU). However, the FATF identified as continuing failings the lack of independence of the FIU
43 and the lack of protection afforded to whistleblowers. In 2016, Iran focused on countering terrorist
44 financing by ratifying the Combating the Financing of Terrorism Law. This law provided a further
45 refinement of the definition of terrorism. It also extended this definition to include predicate
46 offences such as handling illegal money or opening accounts through which it can be channeled,
47 prescribed applicable penalties, and laid out the reporting obligations of different entities.
48 However, the reality is that these laws continue to fall short in material respects, including
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3 identification of true beneficiary and transferor of funds through wire transfers, and dealings with
4 charities. Existing legislation fails to adequately counteract endogenous factors facilitating money
5 laundering and falls short in terms of effective enforcement. However, in contrast to other
6 developing countries which experience these endogeneities, Iran does have specific and targeted
7 legislation 'on the books': what is lacking, amongst other reasons, is the political will to enforce it
8 (Sohrabi *et al.*, 2016). Regarding the exogenous factors identified as sources in Table 1, these are
9 more serious and, possibly, beyond the remit of the Iranian state to oppose. Specifically, the
10 inability to trace laundered moneys into foreign accounts, inhibited by the country's failure to
11 accede to relevant conventions for civil recovery through foreign courts, will continue to hobble
12 efforts to recover proceeds of criminal activity by public officials, the military, and others who
13 hide their ill-gotten gains in foreign locations (Scher, 2005; Simser, 2010; Smellie, 2005).
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25 **6. Conclusion**

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30 The main reason for Iran's inclusion on the FATF blacklist is its failure to accede to the Palermo
31 and Terrorist Financing Conventions. In 2019 the FATF identified deficiencies in the country's
32 AML regime including not identifying and freezing terrorist assets in line with United Nations
33 resolutions, inadequate customer due diligence, inadequate reporting of suspicious transactions,
34 and lack of information about the originator and beneficiary of wire transfers. This paper has
35 shown that the taxonomy of money laundering in Iran is more nuanced than this general critique
36 by the FATF would suggest. We have proposed that factors facilitating money laundering, both in
37 Iran and in other developing countries, are better analysed and dealt with if seen as being either
38 endogenous or exogenous in nature. With regard to the former, these are factors within the purview
39 of the government; Iran has the domestic legislative instruments to deal with the crime of money
40 laundering but failure to do so may be attributable to a lack of political will, or to save
41 embarrassment of those presently in government or public service, or who have retired from either.
42 Exogenous factors are the responsibility of financial intelligence units in other countries. The view
43 of auditors is that weaknesses in the international financial system are the main facilitators of
44 transfers of funds relating to terrorism, drug dealing, currency purchases, and purchases of high
45 value overseas assets. Iran's failure to accede to civil recovery conventions mean that such moneys
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3 cannot be traced and recovered through foreign courts. However, other jurisdictions do have
4 mechanisms at their disposal to deal with this, and in so doing to make the flow of dirty money
5 more difficult. These include, for example, Unexplained Wealth Orders in the United Kingdom
6 which enable assets to be seized and held unless and until the owner explains the source from
7 which they were purchased. The taxonomies of money laundering in Iran are complex, comprising
8 weaknesses in the domestic legislative architecture which are exacerbated by endogenous factors-
9 weaknesses in the international domain- over which the country has no control. In negotiating with
10 Iran and encouraging the country to comply with the Palermo and Terrorist Financing Conventions
11 it is important to bear in mind that, whilst domestic factors which bring about money laundering
12 can be addressed using existing legislation, there is also a need for the international community to
13 prevent the flows of illicit funds to jurisdictions where there is already appropriate legislation in
14 place but which, according to our findings in the questionnaire administered to auditors, is
15 similarly inadequately enforced.
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