

M-Payment: A Threat to Anti-Money Laundering

" ... there are already indications that money launderers and those that finance terrorism will avail themselves of the new m-payment systems."

-INCSR, March, 2008¹



NEW YORK, NY—Brittany has never filed an income tax return to report her \$200,000.00+ income as a high-class call girl. To continue to hide her illegal profits from the IRS and law enforcement, Brittany added an m-payment function to her mobile phones and PDA. With the m-payment feature in place, she now lives virtually cash-free. For example, Brittany asks her clients for the “e,” (street slang for electronic mobile payment, or e-pay).² “E” is a text message-like transfer of funds from a client’s mobile phone m-account to the m-account contained in Brittany’s phone. After hours, Brittany’s Blackberry now functions as a debit card for all of her spending needs: shopping at Nordstrom’s to buy that designer purse, sending a car payment for her new Mercedes-Benz via text message, and clubbing all night with her friends.

Today, Brittany earned \$800 for her services. Before m-payment technology, she had no other choice but to make suspicious daily cash deposits into her bank accounts. With the advent of m-payment, she no longer worries about anyone tracing her bank activity. As a safety precaution, Brittany destroys the SIM memory cards from her phones and PDA devices at the end of each week and replaces them with new ones. As a result, if she ever gets arrested for her activities, no digital evidence of her occupation, income, or lifestyle remains.

LOGAN SQUARE, CHICAGO, IL—Alex, an accountant by day and drug user by night, uses his PC to transfer \$400 from his personal checking account to his mobile phone’s m-payment account. Alex is in need of Ecstasy from his dealer. Per their standing arrangement, buyer and supplier meet at the local café on the corner of California Avenue and Logan Square Boulevard. As usual, the dealer has cleverly hidden the Ecstasy

in an empty cup of coffee, and Alex transfers the “e” via text message to the supplier’s mobile phone. When the transaction is complete, Alex slips away to plan his evening.

As the dealer enjoys his latte, he uses his mobile phone to text the funds to a bank in the Cayman Islands, where the deposit will easily get lost in the multitude of other small value transfers. Once the transaction is complete, the supplier gasps a sigh of relief because he knows he is safe. If a rival gang member tries to steal the cash, he will find no trace of the money. Similarly, if the police tried to apprehend him, by pressing the “Delete Transaction History” function on his cell phone—evidence-erasing software that he downloaded from the net—all incriminating evidence is gone. With no evidence of his crime, the authorities would be forced to let the dealer go.³

NAIROBI, KENYA—International Press: August 7th. On the anniversary of the suicide bomb that killed more than two hundred people at the U.S. Embassy in Nairobi, yet another suicide bomber kills fifty-eight people near the rebuilt U.S. Embassy in Kenya.⁴ At this point, the authorities are unable to determine the identity of the terrorist or group responsible for this attack, but many believe it to be the work of Al Qaeda. The FBI officer-in-charge and top Kenyan Security officials admit that they found the remains of a pre-paid m-payment mobile phone within the wreckage; however, since these devices are unregistered,

the phone could have been purchased anywhere and by anyone. In Kenya as well as in many other parts of Africa, the use of mobile phones and m-payment technology as miniature banking devices is commonplace. Critics have reiterated that m-payment technology makes it easier for terrorists to send and receive transfers of funds via text message transmission.

These scenarios exemplify the warnings issued in the March 2008 International Narcotics Control Strategy Report (INCSR) entitled “Mobile Payments: A Growing Threat,” which describes the potential exploitation of m-payment technology by money launderers, criminals, and terrorists.

What is m-payment? How does it work? Does it already exist in other countries? How can money launderers, criminals, and terrorists exploit this technology to hide their illicit activities? Most importantly, what steps can the United States and other countries take to curtail the potential abuses of m-payment?

I.

“Some of the most innovative are electronic payment products which include mobile payments or m-payments ... Driven by a remarkable convergence of the financial and telecommunications sectors, the rapid global growth of m-payments

demands particular attention. M-payments can take many forms but are commonly point of sale payments made through a mobile device such as a cellular phone, a smart phone, or a personal digital assistant (PDA)."

-INCSR, March, 2008

The Virtual Wallet

M-payment (mobile payment) is synonymous with the terms m-commerce, m-accounts, m-wallet, m-banking, e-money, or digital cash. For the sake of this article, the more widely accepted term "m-payment" will be used. The best way to envision this relatively exciting technology is to imagine a time in which your mobile phone or PDA will act like a wallet.⁵ Furthermore, it will be a wallet that not only allows you to withdraw money from it to pay for goods and services, but also enables you to deposit money into it—thus making this monetary device even more flexible and useful than a credit card. The widespread adoption of m-payment could eliminate the need to carry cash, visit an ATM machine, send wire transfers, or even use a credit card.⁶

Currently there are two platforms that facilitate the use of m-payment. The first enables your mobile phone to link to m-accounts, such as your bank account, credit card, internet payment service, or other financial institution. The second makes it possible for mobile phone companies to act as banks and allows customers to deposit and withdraw funds using their mobile accounts. Although this service is not yet available in the United States, m-payment has already enjoyed acceptance and success in countries such as Japan, Korea, and the Philippines. M-payment technology is also beginning to thrive in South Africa, the Democratic Republic of the Congo, and Kenya.

At present no special hardware is required to utilize m-payment. A subscriber can surf the Web for an internet-based m-payment service and then download the necessary software onto almost any existing mobile phone. M-payment software uses existing text-messaging technology to send and receive funds, confirm payments and credits, and check balances (see FIGURE 1).

The Virtual ATM

Imagine going to a McDonalds (or nearly any retailer) to buy lunch and then asking the cashier for an extra \$50

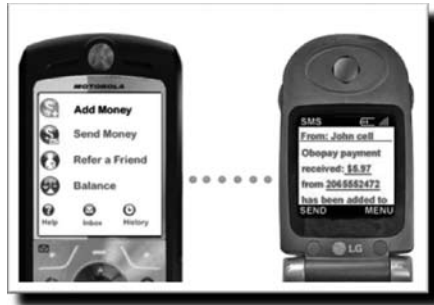


Figure 1. Source: obopay.com

(or more) in cash. For a small fee, the McDonalds cashier will not only charge a customer's m-account for the hamburger, soda, and fries, but will also ring up the \$50 in cash that he or she requested.⁷ Similar to debit cards, there is no need to locate an ATM Machine or pay high banking fees.

Person to Person (PTP) Transfers

Person to person (PTP) transfers are also possible.⁸ For example, friends, family, and private parties involved in business transactions can transfer funds to each other via their mobile phones.⁹ A mother can send her teenage daughter's allowance via text message. Employers can text message wages to their employees' mobile phones.¹⁰ After winning an auction on EBay, a buyer can text the payment to the seller.¹¹ Or, an individual wanders into a garage sale only to find that beautiful antique he has been seeking, but he has no cash. Moreover, the seller does not accept credit cards. The solution is simple: the buyer text messages the payment directly to the seller's mobile phone. The possibilities are endless.

Wire Transfers via Mobile Phone

The World Bank estimates that global remittances (i.e. international wire transfers) exceed one quarter of a trillion dollars annually.¹² Increasingly, in many areas, m-payments provide a new option to expatriates and "guest workers" that wish to send part of their wages home to support their families.¹³

In the United States, many migrant workers from Mexico and Central and South America use wire transfer services such as Western Union and Money Gram to send money to their relatives abroad. In 2005 alone, funds transferred to Mexico from the United States totaled more than \$20 billion.¹⁴ Unfortunately these wire services come with high fees, and some of the recipient banks also charge fees for the transaction as well.

Furthermore, in rural areas abroad many people do not have access to banks. With m-payment technology, a migrant worker can literally text message the payment to his relative's mobile phone, thus circumventing the exorbitant fees charged by wire transfer services and receiving banks.

Virtual Traveler's Check

Another amazing feature of m-payment technology is that it allows a mobile phone to act as a virtual traveler's check. Before leaving on a family vacation, a subscriber can deposit money into his mobile phone's m-payment account then withdraw the funds as needed during the trip. Consumers will no longer need to purchase travelers checks or travel with significant amounts of cash.¹⁵

Contract-Less, or Touch and Go, Mobile Phones

Beyond their use for text messaging to send and receive funds, mobile phones can also be placed in "contract-less" mode. To activate this feature, a special chip can be attached to or inserted into the phone.¹⁶ It is likely that future cell phones will come with this feature already built into it. When a consumer wishes to make a purchase, he or she can simply "swipe" a mobile phone over a cashier's scanning device and complete the transaction. With the "swipe" or "touch and go" feature, no signature or additional data entry is necessary at the cash register.¹⁷

Pre-Paid Mobile Phones and M-Payment

Low-income consumers or those with poor credit who would not be eligible for monthly phone contracts or credit cards can use pre-paid mobile phones to conduct m-payments. These individuals can load pre-paid cards holding various monetary denominations (\$50, \$100, \$250, or more) onto a mobile phone to enable the device to be used as a virtual wallet. As in previous examples, friends and family can also transfer funds to the pre-paid phone via text message as well.

Potential Displacement of ATMs, Wire Transfer Companies, and Credit Cards?

As with m-payment accounts holders in other parts of the world, Americans will undoubtedly also embrace the convenience and cost savings of this virtual wallet. With the continued proliferation of m-payment technology, it

may be argued that m-payment services could actually result in the death of ATM machines, wire transfer companies, and high interest rate credit card fees. This prediction is well-founded when one considers that the United States contains approximately 250 million mobile phone subscribers—a number equal to 82 percent of the population¹⁸—and over three billion mobile phones are currently in use worldwide.¹⁹ In addition to these facts, The Wireless Association reported in its 2007 Wireless Industry Survey that consumers send almost one billion text messages each day worldwide.²⁰

Even more compelling is the convenience offered by this service. Given this technology, customers no longer have to locate an ATM machine in order to withdraw money. Using a PC, they can transfer funds from their bank accounts directly to their mobile phone accounts. When a migrant worker needs to send money to his family abroad, he or she can merely speed-dial the funds directly from his mobile phone to a relative's phone. An individual will no longer need to drive to the local Western Union outlet to complete the transaction. In contrast to high interest credit cards, m-payment service providers will offer competitive rates, discounts, or other incentives to attract new customers.²¹ Finally, another cause for concern on the part of banks and wire transfer companies is the fact that mobile phones have already contributed to the demise of pay phones, cameras, and retail music stores.²²

PayPal Facilitates a Fundamental Shift in M-Payment

In a report published by Juniper Research, a respected consultancy group that provides analytical services to the global hi-tech communications sector, Senior Analyst Alan Goode concluded that the entry of PayPal into the micro m-payment and m-retail sector, "will only serve to facilitate a fundamental shift in global consumer payment services now and into the future."²³ Moreover, Goode predicts that "mobile payments are set to rise to \$10 billion in total revenue by 2010."²⁴

Other players that have already entered the m-payment market include Google's G-Pay, Firehorn Holdings, LLC, mFoundry Inc, and Obopay, Inc.²⁵ The largest provider is PayPal with more than 100 million Internet accounts worldwide.²⁶

II.

"There are numerous money laundering and terrorism financing implications [of m-payments], but digital value smurfing represents a very clear threat."²⁷

-INCSR, March, 2008

Smurfing

The dark side of m-payment, if the service remains unregulated, will enable money launderers, criminals, and terrorists to exploit this new technology. In specific, this new technology will undoubtedly facilitate smurfing.

It is generally known that astute money launderers, criminals, and terrorists have always been willing to keep their financial transactions under \$1,000 per day²⁸ to avoid financial reporting requirements.²⁹ One way to hide money is by using multiple "smurfs" or "runners" to make deposits, purchase money orders, traveler's checks, or other transactions involving illicit or "dirty" money.³⁰ Smurfing can be accomplished by spreading small denomination drug payments, or contributions to terrorist causes, across various remittance centers or multiple bank accounts. In essence, smurfing breaks down illegal proceeds into small amounts that can be moved with less risk of attracting the authorities' attention.³¹

For instance, a drug dealer or terrorist can order ten *different* soldiers, or "smurfs," to open ten *different* bank accounts, or conduct ten *different* financial transactions per day. After the accounts are open, the drug dealer or terrorist orders his smurfs to deposit amounts less than \$999 per day—for example, \$756 one day, \$922 another day, and so on. By ensuring that the bank deposits, or other financial transactions, fall below the \$1,000 threshold, they can avoid suspicion and prevent the triggering of financial reporting requirements. In this example, ten *different* smurfs with ten *different* bank accounts who deposit an average of \$850 per day can launder \$2.21 million annually.

Although more sophisticated detection systems, increased government oversight, and heavier penalties have slowed down the practice of "smurfing" in recent years, this system remains a fundamental method for moving cash and cash equivalents.³²

Digital Value Smurfing (DVS)³³

M-payment with digital value removes the fundamental element of money

laundering: cash. In the future, money launderers, drug dealers, and other criminals will no longer demand cash for their products or services; instead, they will demand digital payment sent via text message. With digital value, multiple smurfs will no longer be needed to make suspicious cash deposits. Criminals will be able to bypass regulated banks and their financial reporting requirements and exchange dirty money for digital value in the form of stored value cards or mobile payment credits.³⁴ Moreover, with digital value instead of cash, they can instantly send—with a touch of a cell phone keypad—their digital value across the country, around the world, or to secret offshore bank accounts.

A *single* Digital Value Smurf (DVS) could open multiple m-payment accounts with multiple service providers, such as m-payment bank accounts, Internet payment accounts, and pre-paid mobile phones. Other avenues could include renting cell phones from others, or utilizing false identities to open additional accounts. The number of m-payment accounts that a *single* DVS could establish is unlimited. Thus, using the same example as above, a *single* DVS with merely ten *different* m-payment accounts could arguably launder the same amount of money that it would take ten *different* smurfs to accomplish.

Other Implications: Facilitation of Tax Evasion by Small Businesses

M-payment technology can facilitate tax evasion. Three billion people around the world own mobile phones, but only one billion possess bank accounts, according to the GSM Association.³⁵ BearingPoint, a major management and technology consulting company, estimated the unbanked marketplace in the United States alone at \$510 billion in 2006.³⁶

The fundamental rule in small business accounting is that all financial transactions are conducted through a business checking account provided by banks. For instance, when a sole proprietor, a partnership, or a corporation conducts business, it does so by using a business checking account. As required by law, banks employ the Know Your Customer (KYC) protocols by requesting identification from new customers along with evidence of the business entity (assumed names registration, business license, or articles of incorporation).

With an m-payment account, however, a small business owner can conduct business virtually under the radar. Instead

of business deposits, the company can receive e-payments. Furthermore, instead of disbursing expenses through its business checking account, the company can make payments via m-payment. With no paper trail, the unbanked small business owner could easily evade income tax filing requirements, thus depriving the U.S. Treasury of billions of dollars in tax revenue.

III.

"Much work and creative thinking will be required to maintain the advantages NPMs [new payment methods], including m-payments offer, while at the same time preventing exploitation and misuse by money launderers and terrorist financiers and simultaneously protecting user privacy and the integrity of the global financial systems."

-INCSR, March, 2008

M-payment is revolutionary—mainly due to its convenience. This technology will literally change the way consumers pay for goods and services, the way they are compensated, the way they save money, the way they spend it, and the way they send money to family and friends abroad. This service will create new industries and new opportunities. M-payment is also radical because it may represent the final piece of the financial puzzle that moves our world into a cashless society.

With the convenience that m-payment offers, however, comes the potential for criminal misuse. M-payment technology, if unchecked, can be exploited by money launderers and terrorists. Presently, the United States is ill prepared to handle the dark side of m-payment. As the INCSR acknowledged, "The United States has few safeguards against abuse of m-payments."³⁷ Moreover, the report also warns that the only applicable federal reporting requirement to providers of stored value cards is the Currency Transaction Report (CTR) rule. A CTR must be filed for all cash transactions greater than \$10,000 per day.³⁸ However, the CTR can be filed up to fifteen days after the transaction has occurred, giving terrorists and criminals enough time to disappear.³⁹ Although almost all U.S. m-payment service providers are registered as Money Services Businesses (MSB) with the Financial Crimes Enforcement Network (FinCEN), the regulations do not have specific provisions pertaining to

them.⁴⁰

New legislation is needed to regulate m-payment service providers. Legislation can include requirements that service providers monitor accounts, enhance suspicious activity reporting, require maximum transaction limits (e.g., \$1,000 per day), require the registration of pre-pay cell phones with m-payment, and development of new, m-payment specific software to detect suspicious activity.

With m-payment projected to grow to 52 percent by the year 2011,⁴¹ there is ample time to put the necessary safeguards and regulations in place to combat the threat to anti-money laundering.

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¹ International Narcotics Control Strategy Report (INCSR), March, 2008. "Mobile Payments—A Growing Threat." Bureau of Int'l Narcotics & Law Enf. Aff., available at www.state.gov/p/inl/rls/nrcrpt/2008/vol2/html/101346.htm.

² The three scenarios in the text are dramatizations. The slang term "e" (short for "e-money") is the author's invention.

³ Inspired by the scenario described in Asian Development Bank, "Effects of Mobile phones on Anti-Money Laundering/Combating Financial Terrorism (AML/CFT) Wire Remittance Operations," at p. 34, sec. 134, available at www.adb.org/Documents/Others/OGC-Toolkits/Anti-Money-Laundering/documents/Working-Paper-March2007.pdf.

⁴ William Claiborne, *Bomb Explodes at 2 U.S. Embassies in Africa; Scores Dead*, WASH. POST, Aug. 8, 1998, at A1.

⁵ Dan Frost, *One More Thing Mobile Phones Could Do: Replace Wallets*, USA TODAY, Nov. 20, 2007.

⁶ *Id.*

⁷ Heinz Bulos, *Filipino's Are Getting the Message*, BUS. WK./ASIAN BUS., Nov. 22, 2004, available at www.businessweek.com/magazine/content/04_47/b3909072.htm. In the Philippines, McDonalds restaurants currently offer this service.

⁸ KPMG Press Release, "Mobile Payments in Asia Pacific," at p. 8, available at www.kpmg.com.sg/publications/ICE_MobilePaymentASPAC.pdf.

⁹ Per-Johan Lundin, *Getting the Message: Mobile Payments in Asia*, TOTAL TELECOM, July 4, 2005, available at www.sicap.co.za/store/press/00008.pdf.

¹⁰ INCSR, *supra* note 1.

¹¹ On Paypal's official website, the downloadable software already exists to pay for winning bids on eBay. See www.paypal.com/mobile.

¹² INCSR, *supra* note 1.

¹³ *Id.*

¹⁴ Statement of James S. Randal,

Commissioner, Texas Dept. of Banking, Sept. 26, 2006, at http://www.banking.state.tx.us/news/test/2006/t06_10-09.pdf.

¹⁵ INCSR, *supra* note 1.

¹⁶ Lundin, *supra* note 9.

¹⁷ *Id.*

¹⁸ Jonathan Sidener, *Mobile Phones Taking on Many Roles, Transforming Market, Generation*, UNION TRIBUNE, Jan. 27, 2008, available at www.signonsandiego.com/news/metro/20080127-9999-ln27phone.html.

¹⁹ INCSR, *supra* note 1.

²⁰ One Billion Text Messages Sent a Day—CTIA Wireless Industry Survey Results, ECOUSTICS ONLINE, Oct. 23, 2007, at <http://news.ecoustics.com/bbs/messages/10381/397384.html>.

²¹ Michelle Donegan, *Google Moves in on M-payments*, WIRELESS FOR THE OUTDOOR ENTERPRISE, Sept. 4, 2007, at http://unstrung.com/document.asp?doc_id=132983.

²² Geoff William, *10 Businesses Facing Extinction in 10 Years*, ENTREPRENEUR.COM, Sept. 19, 2007, at www.entrepreneur.com/startingabusiness/article184288.html.

²³ Alan Goode, *Mobile Commerce Strategies: Ticketing, Retail, Payment & Security* (2d ed.), May 2006, at www.juniperresearch.com/shop/viewpressrelease.php?pr=14.

²⁴ *Id.*

²⁵ Donegan, *supra* note 21.

²⁶ Rachel Ehrendfeld, *Outside View: How Terrorists Send Money*, UPI, May 1, 2007, at www.upi.com/International_Intelligence/Analysis/2007/05/01/outside_view_how_terrorists_send_money.

²⁷ INCSR, *supra* note 1.

²⁸ Money Service Businesses (MSB's) are required file a Suspicious Activity Report (SAR) when "\$1,000 or more in business activity with the same person on the same day" is detected. FAQ's Regarding Suspicious Activity Reports, at www.irs.gov/businesses/small/article/0,,id=154557,00.html.

²⁹ John Forbes, *Effects of Mobile Phones on Anti-Money Laundering/Combating Financial Terrorism (AML/CFT) Wire Remittance Operations*, Asian Development Bank (March 2007), at p. 34 sec. 134, available at www.adb.org/Documents/Others/OGC-Toolkits/Anti-Money-Laundering/documents/Working-Paper-March2007.pdf.

³⁰ INCSR, *supra* note 1.

³¹ *Id.*

³² Forbes, *supra* note 31.

³³ *Id.* "Digital value smurfing" is a term coined by John Forbes, AML Specialist, with the Asian Development Bank.

³⁴ *Id.*

³⁵ Ehrendfeld, *supra* note 28.

³⁶ *Id.*

³⁷ INCSR, *supra* note 1.

³⁸ *Id.*

³⁹ Ehrendfeld, *supra* note 28.

⁴⁰ *Id.*

⁴¹ Hamilton Sekino, *Mobile Payments: Mobile Operator Market Opportunities and Business Models*, Diamond Mgt. & Tech. Consultants Rep., at 2, available at www.diamondconsultants.net/PublicSite/ideas/perspectives/downloads/INSIGHT%20-%20Mobile%20Payments%20_Diamond.pdf.

