



ECONOMIC OPPORTUNITIES OF OFFSHORE BANKING AND REGULATORY RESPONSES TO MONEY LAUNDERING RISKS: A COMPARATIVE STUDY

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ABSTRACT

Offshore banking offers significant opportunities for foreign investment and economic growth in developing countries, particularly for free trade zones and industrial sectors. However, it also presents potential risks related to money laundering if Anti-Money Laundering (AML) regulatory frameworks are not properly established or reinforced. This research aims to explore the potential economic benefits of developing comprehensive regulatory frameworks for offshore banking in Indonesia, while also mitigating the risks of money laundering and financial crime. To achieve this, the research adopts a qualitative approach, utilizing a comparative method to analyze the offshore banking regulations of Malaysia, Bangladesh, and Indonesia. The findings reveal that Malaysia has been utilizing offshore banking since 1990 in Labuan, while Bangladesh is currently enacting the Offshore Banking Act (OBA) 2024. Indonesia's AML framework, under Law No. 8 of 2010, has made progress, but challenges remain in its implementation, especially concerning offshore banking. The research highlights that while Malaysia and Bangladesh have established frameworks to regulate offshore banking, Indonesia still faces regulatory gaps, particularly in managing the risks of offshore financial activities. The implication is that while offshore banking holds potential, its regulation must be reinforced to prevent its use in money laundering activities, including through international cooperation.

1. Introduction

Offshore banking presents significant opportunities for foreign investment and economic growth, especially in developing countries, including those in free trade

zones and high-tech sectors.¹ For example, in 2011, the Ministry of Finance of Indonesia and Bank Indonesia considered establishing offshore banking in the Free Trade Zone (FTZ) in Batam to meet the growing demand for affordable foreign investment funding for local industrial and infrastructure development.² However, this faced challenges, such as the need for supporting regulations and alignment with the existing banking system. Batam's strategic location, being close to neighboring countries such as Singapore and Malaysia, makes it an ideal candidate for offshore banking, similar to the successful model in Labuan, Malaysia.

Labuan was designated as an International Offshore Financial Centre (IOFC) in October 1990.³ The aim of this status was to promote the Federal Territory of Labuan as an International Offshore Financial Centre, complement domestic financial market activities in Kuala Lumpur, strengthen the contribution of the financial services sector to Malaysia's Gross National Product, and develop the island and surrounding areas.⁴ The main regulatory authority, Labuan Financial Services Authority (LOFSA), oversees corporate laws in Labuan. To date, over 16,000 registered companies and more than 1,000 licensed entities are based in Labuan, spanning sectors such as banking, leasing, capital markets, insurance, reinsurance, risk management, digital financial intermediation, and wealth management.⁵ Moreover, in Bangladesh, offshore banking began in 1985 to support financing within Export Processing Zones (EPZs), fostering export-oriented industries. OBUs provide foreign currency loans to fully foreign-owned companies in EPZs, Economic Zones, and high-tech parks, promoting foreign investment and trade. However, the system has faced challenges, including financial mismanagement and misuse for money laundering, as large sums of money can be transferred between onshore and offshore accounts with minimal oversight. In response, the Offshore Banking Bill 2024 was introduced to strengthen regulation, attract foreign investment, and enhance enforcement to prevent illicit financial activities.

Offshore banking is adopted by many countries in their laws to promote economic growth and investment. However, it also presents significant concerns regarding money laundering and illegal financial activities. Often linked to tax havens, offshore banking provides benefits such as low taxes, privacy, and financial stability. The relatively less regulated environment of offshore financial centers can facilitate illicit transactions. These dual aspects—economic advantages and regulatory challenges—make offshore banking a critical area for research, particularly in terms of improving regulatory frameworks to mitigate risks while harnessing its potential to attract foreign investment and support economic development.

Moreover, in academic discourse, this area remains underdeveloped. There is a

¹ Panagiotis Delimatsis., Financial services trade in special economic zones, *Journal of International Economic Law*, Vol.24, no.2, 2021, Page.278.

² News Editor., Dipertimbangkan Pembentukan Offshore Banking, *Bisnis.com*, April 27, 2011.

³ Michael T. Skully., Malaysia's international offshore financial centre: an examination of Labuan's development and operations, *Asean Economic Bulletin*, Vol.11, no.3, 1995, page.337.

⁴ Bank Negara Malaysia., Chapter Eight: Labuan International Offshore Financial Centre, *Financial Sector Masterplan (FSMP)*, 2012. See too, Association of Labuan Banks., *Labuan International Offshore Financial Centre*, 2024.

⁵ Labuan International Business and Financial Centre. *30 Years of Intermediating Asia*. 2020.

notable lack of academic research exploring the potential of offshore banking and its use in money laundering in countries like Indonesia, Malaysia, and Bangladesh. In Indonesia, the majority of studies have primarily focused on Anti-Money Laundering (AML) laws and regulations,⁶ corruption cases,⁷ legal and criminal protection against money laundering,⁸ and money laundering investigations and enforcement.⁹ Another emerging topic is money laundering and cryptocurrency.¹⁰ However, there has been no focused research addressing AML in the context of offshore money laundering, despite the significant outflow of funds linked to corruption and illegal activities to foreign jurisdictions. In Malaysia, there are only a few articles discussing the use of offshore banking in relation to money laundering,¹¹ while others mainly focus on aspects such as AML frameworks and

⁶ Meiryani., Prevention and Control of Money Laundering Crimes on Know Your Customer Principles Application: Empirical Study of Indonesia Banking Sector, *Journal of Money Laundering Control*, Vol.27, no.5, 2024, page.877. See too, Dezie Leonarda Warganegara., Juridical review of law enforcement on money launderers: case study from Indonesia, *Journal of Money Laundering Control*, Vol.27, no.4, 2024, page.725. See too, Yanti Fadia and Muhammad Alwan Zain Nusantara., Strengthening Anti-Money Laundering Framework in Online Banking: Bank Indonesia's Initiatives and Countermeasures, *Jurnal Hukum*, Vol.39, no.2, 2023, page.255. See too, Meiryani Meiryani, Gatot Soepriyanto, and Jessica Audrelia., Effectiveness of regulatory technology implementation in Indonesian banking sector to prevent money laundering and terrorist financing, *Journal of Money Laundering Control*, Vol.26, no.4, 2023, page.895.

⁷ Sani Muhamad Isa and Johan Muliadi Kerta., Money laundering in corruption cases in Indonesia, *Journal of Money Laundering Control*, Vol.27, no.1, 2024, page.131. See too, Mahrus Ali, Syarif Nurhidayat, Muhammad Shidqon Prabowo, and Rusli Muhammad., Corruption, asset origin and the criminal case of money laundering in Indonesian law, *Journal of Money Laundering Control*, Vol.25, no.2, 2022, page.457.

⁸ Arief Patramijaya., Criminal Legal Protection for Bona Fide Third Parties Over Assets in Corruption and Money Laundering Cases, *Sriwijaya Law Review*, Vol.8, no.1, 2024, page.171. See too, Artha Febriansyah, Eva Achjani Zulfa, Muhammad Yusuf, and Desia Banjarani., Reversal Burden of Proof in Process of Proving Money Laundering Cases in Indonesia, *Indonesia Law Review*, Vol.13, no.1, 2023, page.43. See too, Muhammad Ridwan Lubis., Law Enforcement Concerning the Crime of Money Laundering Based on Pancasila, *Jurnal Hukum*, Vol.38, no.1, 2022, page.34. See too, Muhtar Hadi Wibowo., Corporate Responsibility in Money Laundering Crime (Perspective Criminal Law Policy in Crime of Corruption in Indonesia), *Journal of Indonesian Legal Studies*, Vol 3, no.02, 2018, page.216.

⁹ Fauziah Lubis and Bismar Nasution., The analysis of criminal law policy on advocate reporting in preventing and assisting money laundering crime in Indonesia, *The Lawyer Quarterly*, Vol.10, no.4, 2020, page.364. See too, Rudi Sudirdja., The Prosecution in Trial in Absentia of Money Laundering Case Resulted from Conventional Case, *Padjadjaran Jurnal Ilmu Hukum*, Vol.6, no.2, 2019, page.299. See too, Adinda Putri Jade, Yaris Adhial Fajrin, Diah Nadia Putri, and Aisya Sanghra Devi Nugraha., The Reverse Burden of Proof in Indonesia's Money Laundering Crime: A Review, *Lentera Hukum*, Vol.7, 2020, page.355.

¹⁰ Meiryani., Exploration of Potential Money Laundering Crimes with Virtual Currency Facilities in Indonesia, *Journal of Money Laundering Control*, Vol.27, no.6, 2024, page.987. See too, Abdurrahman Alhakim and Tantimin, Tantimin., The Legal Status of Cryptocurrency and Its Implications for Money Laundering in Indonesia, *Padjadjaran Jurnal Ilmu Hukum*, vol.11, no.2, 2024, page.233. See too, Tiara Putri, Amiludin Amiludin, Dwi Nurfauziah Ahmad, and Hidayatulloh Hidayatulloh., Inadequate cryptocurrency and money laundering regulations in Indonesia (Comparative law of US and Germany), *Yustisia*, Vol.12, no.2, 2023, page.135. See too, Febby Mutiara Nelson, Maria Dianita Prosperiani, Choky Risda Ramadhan, and Priska Putri Andini., Cracking the Code: Investigating the Hunt for Crypto Assets in Money Laundering Cases in Indonesia, *Journal of Indonesian Legal Studies*, Vol.9, no.1, 2024, page.121.

¹¹ Bala Shanmugam, Mahendhiran Nair, and R. Suganthi., Money laundering in Malaysia, *Journal of Money Laundering Control*, Vol.6, no.4, 2003, page.377.

regulations,¹² risks and compliance in financial institutions,¹³ emerging challenges in AML and digital economy,¹⁴ cross-border legal frameworks and international cooperation.¹⁵ Furthermore, in the context of Bangladesh, previous studies have focused on various aspects of AML, such as trade-based money laundering and exports,¹⁶ anti-money laundering policies and compliance,¹⁷ virtual assets,

¹² Abdirahman Hassan Hersi., A critical analysis of Somalia's current antimoney laundering and counter financing of terrorism regime: a comparative study with Malaysia, *Journal of Money Laundering Control*, Vol.27, no.4, 2024, page.721. See too, Husameddin Alshaer, Muhamad Helmi Md. Said, and Ramalinggam Rajamanickam., Mutual legal assistance and extradition under anti-money laundering laws: a comparative analysis between Palestine and Malaysia, *Journal of Money Laundering Control*, Vol.27, no.2, 2024, page.421. See too, Fahmi Bin Adilah, Mohd Zamre Mohd Zahir, Hasani Mohd. Ali, and Muhamad Sayuti Hassan., A study of Malaysian anti-money laundering law and the impact on public and private sector, *Journal of Money Laundering Control*, Vol.26, no.4, 2023, page. 834. See too, Aspalella A. Rahman., An analysis of the forfeiture regime under the anti-money laundering law, *Journal of Money Laundering Control*, Vol.25, no.1, 2022, page.56. See too, Masetah Ahmad Tarmizi, Salwa Zolkafliil, Normah Omar, Suhaily Hasnan, and Sharifah Nazatul Faiza Syed Mustapha Nazri., Compliance determinants of anti-money laundering regime among professional accountants in Malaysia, *Journal of Money Laundering Control*, Vol.26, no.2, 2023, page.364.

¹³ Ainul Huda Jamil, Zuraidah Mohd-Sanusi, Yusarina Mat-Isa, and Najihah Marha Yaacob., Money laundering risk judgement by compliance officers at financial institutions in Malaysia: the effects of customer risk determinants and regulatory enforcement, *Journal of Money Laundering Control*, Vol.26, no.3, 2023, page.542. See too, Syed Mustapha Nazri, Sharifah Nazatul Faiza, Salwa Zolkafliil, and Normah Omar., Mitigating financial leakages through effective money laundering investigation, *Managerial Auditing Journal*, Vol.34, no.2, 2019, page.189. See too, Salwa Zolkafliil, Normah Omar, and Sharifah Nazatul Faiza Syed Mustapha Nazri., Implementation evaluation: a future direction in money laundering investigation, *Journal of Money Laundering Control*, Vol.22, no.2, 2019, 324.

¹⁴ Mohamed, Norazida, Khee En Tan, Nasir Sultan, Akbar Sattar, and Hafizah Latiff., Customer protection and money laundering in the era of digital currencies: are Malaysian regulations enough to combat?, *Management & Accounting Review (MAR)*, Vol.22, no.3, 2023, page.59. See too, Ainul Huda Jamil, Zuraidah Mohd Sanusi, Najihah Marha Yaacob, Yusarina Mat Isa, and Tarjo Tarjo., The Covid-19 impact on financial crime and regulatory compliance in Malaysia, *Journal of Financial Crime*, Vol.29, no.2, 2022, page.496.

¹⁵ Husameddin Alshaer, Muhamad Helmi Md. Said, and Ramalinggam Rajamanickam., Mutual legal assistance and extradition under anti-money laundering laws: a comparative analysis between Palestine and Malaysia, *Journal of Money Laundering Control*, Vol.27, no.2, 2024, page.421. See too, Abdirahman Hassan Hersi., A critical analysis of Somalia's current anti-money laundering and counter financing of terrorism regime: a comparative study with Malaysia, *Journal of Money Laundering Control*, Vol.27, no.4, 2024, page.721.

¹⁶ Md Noor Uddin Milon, and Habib Zafarullah., Uncovering the depths of trade-based money laundering: evidence from a seaport in Bangladesh, *Journal of Money Laundering Control*, Vol.27, no.3, 2024, page.611. See too, Md Noor Uddin Milon, Habib Zafarullah, and Tahmina Akter Poli., Navigating the shadows: exports and money laundering dynamics in Bangladesh, *Journal of Money Laundering Control*, Vol.27, no.1, 2024, page.132. See too, Mofijul Hoq Masum, Amit Banik, Mohammad Tariq Hasan, Salwa Zolkafliil, Sharifah Nazatul Faiza Syed Mustapha Naz, Fazlida Mohd Razali, and Masetah Ahmad Tarmizi., Anti-money laundering and emerging economy—Evidence from Bangladesh, *Journal of Infrastructure, Policy and Development*, Vol.8, no.6, 2024, page.3720.

¹⁷ Habib Zafarullah, and Halima Haque., Policies, instrumentalities, compliance and control: combatting money laundering in Bangladesh, *Journal of Money Laundering Control*, Vol.26, no.1, 2021, page.191. See too, Md Zahurul Haq., Is Bangladesh's policy response to the growing e-commerce sector compatible with its commitment to fight predicate offences for money laundering?, *Journal of Money Laundering Control*, Vol.27, no. 3, 2024, page.525. See too, Shirin Sultana., Role of Financial Intelligence Unit (FIU) in anti-money laundering quest: Comparison

cryptocurrencies, and regulatory challenges,¹⁸ and corruption, black money, and tax issues.¹⁹

Moreover, Indonesia is currently focusing on achieving high economic growth by attracting substantial investments, particularly in the technology sector and the development of Special Economic Zones (SEZs). While the country possesses considerable potential, it has yet to implement specific regulatory frameworks for offshore units that would facilitate international transactions and optimize investment flows. This gap in regulation is particularly significant in the context of the ongoing “servicification” of the manufacturing and financial sectors—two interconnected industries that are critical for the successful development of SEZs, a trend observed in other nations such as China.²⁰ The lack of a clear regulatory framework for offshore banking and the absence of robust mechanisms to AML may hinder Indonesia's ability to fully harness the benefits of Foreign Direct Investment (FDI) and integrate its economy into global financial markets. Therefore, there is a pressing need to develop comprehensive regulations that address offshore financial activities, strengthen AML enforcement, and create a more transparent and secure investment ecosystem. This research aims to explore the potential economic benefits of such regulatory frameworks, with a focus on enhancing Indonesia's capacity to attract and retain international investments while mitigating financial crime risks.

2. Research Methods

This research adopts a qualitative research design, focusing on a comparative approach to explore and analyze the regulatory frameworks governing offshore financial activities in Indonesia and other countries, particularly Malaysia and Bangladesh. The aim is to identify gaps in Indonesia's current regulations, specifically Law Number 8 of 2010, which is the Law of the Republic of Indonesia concerning the Prevention and Eradication of the Crime of Money Laundering, particularly in relation to offshore banking units, and to compare them with successful regulatory models from other jurisdictions. Data were gathered through document analysis, including official regulations, policy reports, and academic

between FIUs of Bangladesh and India, *Journal of Money Laundering Control*, Vol.23, no.4, 2020, page.935. See too, Syed Alamin Ahmed., Practical application of anti-money laundering requirements in Bangladesh: an insight into the disparity between anti-money laundering methods and their effectiveness based on resources and infrastructure, *Journal of Money Laundering Control*, Vol.20, no.4, 2017, page.437.

¹⁸ Md Zahurul Haq, Kazi Fahmida Farzana, and Moniruzzaman Md., Could banning virtual assets be a breach of the doctrine of legitimate expectation?, *Journal of Money Laundering Control*, Vol.25, no.4, 2022, page.726. See too, Md Zahurul Haq, Zainal Amin Ayub, Zuryati Mohamed Yusoff, and Md Abdul Awal Khan., Factors influencing anti-money laundering regulatory approaches towards casinos and cryptocurrencies in Bangladesh, *Journal of Money Laundering Control*, Vol.25, no.2, 2021, page.449.

¹⁹ S. M. Solaiman., “Captured by evils”—combating black money, corruption and money laundering in Bangladesh: The dog must bark to keep predators away, *Journal of Money Laundering Control*, Vol.21, no.3, 2018, page.276. See too, Attiya Waris, and Laila Abdul Latif., The effect of tax amnesty on anti-money laundering in Bangladesh, *Journal of Money Laundering Control*, Vol.17, no.2, 2014, page.247.

²⁰ Panagiotis Delimatsis., Financial services trade in special economic zones, *Journal of International Economic Law*, Vol.24, no.2, 2021, Page.278. See too, Yuan Yiming, and He Lei., The Poverty Reduction Effect of China's Special Economic Zones—Case Study of Shenzhen, *Studies on China's Special Economic Zones*, Vol.3, 2020, page.12.

literature. This method allows for a comprehensive exploration of the legal and economic environments in different countries, identifying best practices that Indonesia could adopt. The research also incorporates insights from relevant case studies, drawing on examples of offshore financial centers in countries such as Malaysia and Bangladesh, to inform the development of recommendations for strengthening Indonesia's regulatory framework. The research utilizes a descriptive analysis technique to systematically examine and compare the legal frameworks, highlighting the strengths and weaknesses of each country's approach. By examining relevant laws, regulations, and policies, the study aims to provide an in-depth understanding of how Indonesia's existing framework can be improved to foster international investment while mitigating the risks of money laundering and other illicit financial activities.

3. Results and Discussion

3.1. Offshore Financial Centers: Between Investment, Regulation, and Money Laundering Risks

Offshore financial centers (OFCs) are defined by the IMF as jurisdictions offering financial services to non-residents through banks and other financial agents.²¹ States establish OFCs to attract foreign investment by offering favorable regulations, such as lower taxes, banking secrecy, and minimal oversight. These centers help facilitate international capital flows, particularly for major industrial countries and emerging markets. They enable these economies to manage financial risks, including currency fluctuations and short-term debt accumulation. By understanding OFC activities, financial institutions can better detect potential risks, improving surveillance and early intervention to protect financial systems.

The emergence of OFCs plays a crucial role in attracting investment and fostering the growth of SEZs. OFCs contribute significantly to the expansion of global financial services trade, which in turn drives the development of SEZs.²² These zones are often part of broader government strategies designed to stimulate economic growth through favorable regulatory frameworks that create specialized jurisdictions offering preferential treatment to businesses. As financial services trade continues to grow, Offshore Financial Centers have rapidly spread, with some SEZs integrating an OFC as a key component, positioning themselves as strategic trading hubs for financial investment. In this context, financial services are not only a vital infrastructure within SEZs but, in some cases, the core focus of an SEZ, facilitating growth and attracting international financial investors.

However, OFCs and offshore banks are often criticized for their role in facilitating money laundering, as they provide an environment conducive to hiding illicit

²¹ International Monetary Fund., Offshore Financial Centers. Background Paper Prepared by the Monetary and Exchange Affairs Department, June 23, 2000.

²² Panagiotis Delimatsis., Financial services trade in special economic zones, *Journal of International Economic Law*, Vol.24, no.2, 2021, Page.278. See too, Yuan Yiming and He Lei., The Poverty Reduction Effect of China's Special Economic Zones—Case Study of Shenzhen, *Studies on China's Special Economic Zones*, Vol.3, 2020, page.12. See too, Julien Chaisse and Georgios Dimitropoulos., Special economic zones in international economic law: towards unilateral economic law, *Journal of International Economic Law*, Vol.24, no.2, 2021, page.236.

financial flows.²³ These institutions, operating in jurisdictions with lax regulatory oversight, banking secrecy laws, and complex financial structures, make it difficult to trace the origin and movement of illegal funds. Many OFCs are located in small island nations or microstates, such as those in the Caribbean, and attract significant non-resident financial activity, including funds from political elites and large corporations engaged in illicit practices. The secrecy provided by OFCs has been linked to money laundering, as they enable individuals to hide the origin of their wealth through anonymous accounts, shell companies, and cross-border transactions. Despite international efforts such as United Nations conventions and AML standards, enforcement remains inconsistent.

The rise of OFCs since the 1960s can be attributed to the concept of “four spaces”: secrecy, regulation, politics, and economics. These jurisdictions have thrived due to their ability to facilitate unethical financial practices through flexible legal frameworks and sovereignty, offering a safe space for capital mobility.²⁴ OFCs have been used by corrupt political figures to move illicit wealth, further exacerbating corruption in developing nations. However, Western countries also contribute to money laundering, utilizing these centers for illicit transactions. Global regulatory bodies, such as the Financial Action Task Force (FATF) and regional groups like the Caribbean Financial Action Task Force (CFATF), have introduced policies to combat money laundering, yet the issue persists. The challenge lies in the interaction between banking secrecy and anti-money laundering regulations, which often create legal obstacles for law enforcement, particularly in seizing criminal assets.

As illicit financial flows continue to grow, there is increasing pressure on major economies to enhance cooperation with offshore jurisdictions and close loopholes that enable money laundering. The definition of “offshore” has evolved, with international bodies like the OECD, G7, and the EU pushing for stronger regulations and transparency in these jurisdictions.²⁵ However, private sector actors remain largely unaccountable under international law, despite the introduction of international sanctions for non-compliance by governments. In developing countries, challenges persist in combating money laundering, particularly related to offshore banking. While many countries have made efforts to implement AML measures, these systems often lack effectiveness. The motivations for enforcing AML regulations in developing countries are typically driven by external international pressures and internal political considerations rather than a genuine commitment to fighting financial crime.²⁶ As a result, while legal frameworks have been established, they may not always be adequately enforced, and gaps in the regulatory environment can allow illicit activities to persist.

²³ Fabian Teichmann, Sonia Ruxandra Boticiu, and Bruno S. Sergi., Compliance issues in arbitration proceedings—bribery, money laundering and other abuses, *Journal of Financial Crime*, Vol.31, no.3, 2024, page.761.

²⁴ Mark P. Hampton and Michael Levi., Fast spinning into oblivion? Recent developments in money-laundering policies and offshore finance centres, *Third World Quarterly*, Vol.20, no.3, 1999, page.649.

²⁵ Pierre M. Picard and Patrice Pieretti., Bank secrecy, illicit money and offshore financial centers, *Journal of public economics*, Vol.95, no.7, 2011, page.945.

²⁶ Jun Tang, and Lishan Ai., Combating money laundering in transition countries: the inherent limitations and practical issues, *Journal of Money Laundering Control*, Vol.13, no.3, 2010, page.219.

On the other hand, the need for foreign investment to drive economic growth is increasingly pressing. In response, many countries have established SEZs, offering various incentives to attract foreign investors.²⁷ One of the key factors driving this trend is what Delimatsis refers to as the “servicification” of manufacturing and the finance sector, where services, particularly financial services, play a central role in attracting investments to SEZs.²⁸ This includes access to offshore banking, which allows businesses and individuals to benefit from favorable financial regulations and tax advantages, further enhancing the appeal of SEZs as investment hubs.

For instance, Malaysia established Labuan as an Offshore Financial Center (OFC) in 1990 to attract international investment and bolster its financial services sector. The designation of Labuan as an IOFC was formalized through the passage of five acts by the Malaysian Parliament in the same year. In 1994, the Association of Labuan Banks and the Association of Labuan Trust Companies were founded. Since then, Labuan IBFC has attracted over 16,000 registered companies and more than 1,000 licensed entities across sectors.²⁹ Labuan currently hosts 59 offshore banks, 112 insurance-related companies, 68 leasing operations, 37 fund management firms, and 20 trust companies. Many of these entities are Japanese firms serving Japanese companies in Malaysia.³⁰ The jurisdiction provides a range of financial services including banking, insurance, leasing, and wealth management. However, Malaysia bans offshore casinos and Internet gaming sites, ensuring that Labuan’s financial services remain focused on legitimate business operations.

This OFC was established to attract international investment and boost its financial services sector, contributing to the country's Gross National Product (GNP) and fostering regional development. Supervised by the LOFSA, Labuan offers several advantages, including a 3% tax on net audited results or a flat MYR 20,000 for trading companies, low operational costs, liberal exchange controls, and access to a skilled workforce.³¹ With its status as an OFCs, Labuan was included in the list of recognized OFCs by the IMF in its June 2007 background paper, which used a qualitative approach to identify 46 such centers. This list also incorporated the April 2000 FSF list of 42 OFCs. Labuan was placed in Group II by the IMF, which includes jurisdictions with procedures for supervision and cooperation in place, but where performance still falls below international standards, with room for improvement.³² In response to global pressure on tax havens, Labuan removed the term “offshore” from its statutes in 2010.

According to a report by the U.S. Department of State, Malaysia has made

²⁷ Frick, Susanne A., and Andrés Rodríguez-Pose., What draws investment to special economic zones? Lessons from developing countries, *Regional Studies*, Vol.57, no.11, 2023, page.2136. <https://doi.org/10.1080/00343404.2023.2185218>;

²⁸ Panagiotis Delimatsis., Financial services trade in special economic zones, *Journal of International Economic Law*, Vol.24, no.2, 2021, Page.279.

²⁹ Labuan International Business and Financial Centre. *30 Years of Intermediating Asia*. 2020.

³⁰ U.S. Department of State. Money Laundering and Financial Crimes: Malaysia. 2018, page. 263.

³¹ The jurisdiction became formalized as an International Offshore Financial Center (IOFC) through five acts passed by the Malaysian Parliament in 1990. However, in 2010, due to global pressures on tax havens, Labuan removed the term “offshore” from its statutes, marking a shift in its regulatory framework while maintaining its appeal as a financial hub, IFLR, Labuan’s Legal Revamp, IFLR, July 19, 2010. See too, Deloitte., Taxation and Investment in Malaysia 2018.

³² Financial Stability Forum., Report from the Working Group on Offshore Centres, April 5, 2000.

significant strides in combating money laundering, particularly with the establishment of the Anti-Money Laundering Act (AMLA) in 2001. The National Coordination Committee to Counter Money Laundering (NCC), which consists of 13 government agencies, oversees and coordinates national AML initiatives. Additionally, Malaysia's Financial Intelligence Unit (FIU) has been a member of the Egmont Group of financial intelligence units since 2003, reflecting its commitment to international cooperation in fighting financial crimes. Malaysia also adheres to the FATF forty recommendations and the nine special recommendations on terrorist financing.³³

Moreover, in terms of Labuan's role in combating money laundering, LOFSA, under the authority of Malaysia's Central Bank, regulates offshore banking, insurance, and trust companies. While the offshore sector is vulnerable to illicit activities, LOFSA ensures that the same AML regulations that apply to domestic financial service providers also govern Labuan's offshore businesses. Offshore banks, trusts, and insurance companies are required to submit suspicious transaction reports, and LOFSA enforces stringent background checks before granting licenses. Additionally, the use of nominee directors and bearer instruments is prohibited in Labuan.³⁴

In Bangladesh, as another example of comparison, offshore banking in Bangladesh was introduced in 1985 through a circular issued by the Bangladesh Bank. Initially, its purpose was to support financing within the EPZs, which were designed to promote export-oriented industries.³⁵ Over the years, offshore banking has become a crucial part of the country's financial ecosystem, facilitating international trade and attracting foreign capital. OBUs allow businesses within designated zones—such as EPZs, Economic Zones (EZs), and high-tech parks—to access financing in foreign currencies, particularly in an environment where the domestic currency's exchange rates can be volatile. This structure enables local businesses to engage in international finance without the complexities associated with fluctuating local currency values.

The core function of OBUs is to provide loans in foreign currencies to businesses, particularly fully foreign-owned companies, operating in these zones. The loans are offered at competitive rates, such as LIBOR + 3.5%, and can be used to meet both short-term and long-term financing needs. This arrangement provides critical financial support, especially to Multinational Corporations (MNCs), helping them to operate with fewer restrictions on currency conversions and allowing for smoother international transactions. As a result, OBUs have significantly contributed to the inflow of FDI and the overall growth of Bangladesh's export trade and industrial sector.

However, offshore banking in Bangladesh has faced a series of challenges. One significant issue is the potential for financial mismanagement. The ease with which foreign currency is obtained and extended as loans has led some banks to exceed borrowing limits or divert funds from onshore units to offshore divisions. This has

³³ U.S. Department of State. Money Laundering and Financial Crimes: Malaysia. 2018, page.264.

³⁴ U.S. Department of State. Money Laundering and Financial Crimes: Malaysia. 2018, page.266.

³⁵ The Business Standard, *The History of Offshore Banking in Bangladesh*, The Business Standard, July 31, 2024.

resulted in liquidity problems within the local banking system, causing delays in fulfilling crucial financial obligations such as Letters of Credit (LCs). These delays hinder the ability of businesses to import necessary goods and materials, creating disruptions in the economy. Moreover, offshore banking units have become susceptible to misuse, particularly in the form of money laundering. The ability to transfer large sums of money between onshore and offshore accounts without strict oversight has raised concerns about illegal financial activities. Reports have surfaced indicating that some individuals, including influential figures and criminal actors, have used offshore banking services to launder money or evade taxes. These activities have raised alarms among regulators, prompting calls for stricter oversight and more robust mechanisms to prevent financial crimes.

In response to these concerns, the Offshore Banking Bill 2024 was introduced in the Bangladesh Parliament on March 2, 2024, by Finance Minister Abul Hasan Mahmood Ali. The bill was passed on March 5, 2024, with the primary aim of strengthening Bangladesh's foreign currency reserves and attracting further foreign investment. Under the new law, offshore banking units are required to operate with licenses from Bangladesh Bank. They are allowed to provide a range of services, including short-term loans, letters of credit, guarantees, and bill discounting, but can only accept deposits from 100% foreign-owned companies based in EPZs, EZs, and hi-tech parks. Notably, OBUs are exempt from income tax and any direct or indirect charges on profits or deposits.

Despite its intentions to enhance financial stability, the new law has generated concerns regarding its potential to facilitate illicit financial activities, particularly money laundering. Opposition leaders have voiced their apprehension, pointing to previous instances where offshore banking was used to launder money, including high-profile cases like that of casino magnate Salim Prodhan.³⁶ Although the law aims to address these issues, experts argue that its success hinges on effective regulatory enforcement. Muhammad A. Rume Ali, former Deputy Governor of Bangladesh Bank, emphasized that internal monitoring systems and stringent penalties for non-compliance are essential to prevent misuse.³⁷ He believes the law addresses gaps in previous regulations and can enhance investor confidence, but only if it is accompanied by robust enforcement mechanisms against money laundering. A similar argument also exists in the literature, where some argue that export-import activities in Bangladesh, including those in EPZs, are vulnerable to trade-based money laundering due to the ease with which illicit funds can be moved across borders. These zones, designed for economic growth, can inadvertently facilitate money laundering activities by masking the true nature of transactions.³⁸

³⁶ The Financial Express., Court Sentences Salim Prodhan to Jail Over Illegal Assets, Money Laundering, *The Financial Express*, April 30, 2023.

³⁷ TBS Report., What Does the Offshore Banking Act Bring to the Table?, *The Business Standard*, July 31, 2024.

³⁸ Md Noor Uddin Milon and Habib Zafarullah., Uncovering the depths of trade-based money laundering: evidence from a seaport in Bangladesh, *Journal of Money Laundering Control*, Vol.27, no.3, 2024, page.611. See too, Md Noor Uddin Milon, Habib Zafarullah, and Tahmina Akter Poli., Navigating the shadows: exports and money laundering dynamics in Bangladesh, *Journal of Money Laundering Control*, Vol.27, no.1, 2024, page.132. See too, Mofijul Hoq Masum, Amit Banik, Mohammad Tariq Hasan, Salwa Zolkaflii, Sharifah Nazatul Faiza Syed Mustapha Naz, Fazlida Mohd Razali, and Masetah Ahmad Tarmizi., Anti-money laundering and emerging

3.2. Regulatory Framework of Money Laundering Crimes in Indonesia

Money laundering is the process of concealing the origin of money obtained through illegal or criminal activities by using a series of investment or transfer activities that are repeatedly carried out. The aim is to give the money invested or transferred a legal status within the financial system. The purpose of money laundering is to disguise funds derived from illegal activities so that they can be integrated into formal economic activities. The crime of money laundering occurs in three stages: placement, layering, and integration.³⁹ Money laundering is essentially an effort to hide or disguise funds generated from a crime or the proceeds of a crime, as stated in Article 2 of Law Number 8 of 2010 concerning the Crime of Money Laundering.⁴⁰ The intent is to conceal or obscure the origin of assets so that they appear to be legitimate.

Article 3 of Law No. 8 of 2010 of the Republic of Indonesia, concerning the Prevention and Eradication of Money Laundering Crimes (hereinafter referred to as the Anti-Money Laundering Law), states that any person who places, transfers, diverts, spends, pays, grants, deposits, takes abroad, changes the form of, exchanges with currency or securities, or engages in any other actions involving assets that are known or reasonably suspected to be the proceeds of a crime, with the intention of hiding or disguising the origin of the assets, shall be punished with a maximum imprisonment of 20 (twenty) years and a maximum fine of Rp 10,000,000,000 (ten billion rupiah). Article 4 further states that anyone who hides or disguises the origin, source, location, designation, transfer of rights, or actual ownership of assets that they know or should suspect are proceeds of money laundering shall be subject to a maximum imprisonment of 20 (twenty) years and a maximum fine of Rp 5,000,000,000 (five billion rupiah).

Moreover, Article 4 of the Anti-Money Laundering Law also applies to those who benefit from the proceeds of money laundering. The article specifies that the crime of money laundering can be imposed on anyone who hides or disguises the origin, source, location, designation, transfer of rights, or actual ownership of assets that they know, or should suspect, are the proceeds of a crime as referred to in Article 2, paragraph (1). This is considered equivalent to committing money laundering itself. Based on Article 2 of the Law, the following crimes are categorized as predicate offenses for money laundering: corruption, bribery, narcotics trafficking, psychotropic drugs, labor smuggling, migrant smuggling, crimes in the banking sector, the capital market, the insurance sector, customs, excise, human trafficking, illegal arms trade, terrorism, kidnapping, theft, embezzlement, fraud,

economy—Evidence from Bangladesh, *Journal of Infrastructure, Policy and Development*, Vol.8, no.6, 2024, page.3720.

³⁹ Meiryani., Prevention and Control of Money Laundering Crimes on Know Your Customer Principles Application: Empirical Study of Indonesia Banking Sector, *Journal of Money Laundering Control*, Vol.27, no.5, 2024, page.877; See too, Warganegara., Dezie Leonarda., Juridical review of law enforcement on money launderers: case study from Indonesia, *Journal of Money Laundering Control*, Vol.27, no.4, 2024, page.727.

⁴⁰ Muhammad Ridwan Lubis., Law Enforcement Concerning the Crime of Money Laundering Based on Pancasila, *Jurnal Hukum*, Vol.38, no.1, 2022, page.33. See too, Mahrus Ali, Syarif Nurhidayat, Muhammad Shidqon Prabowo, and Rusli Muhammad., Corruption, asset origin and the criminal case of money laundering in Indonesian law, *Journal of Money Laundering Control*, Vol.25, no.2, 2022, page.457.

forgery, gambling, prostitution, crimes in the taxation sector, forestry sector, environmental sector, maritime and fisheries sector, or any other crimes that carry a prison sentence of 4 years or more. Article 2 also contains provisions regarding the *locus delicti* (the location of the crime) in two contexts: first, using the territorial principle, where the predicate crime occurs within the territory of the Unitary State of the Republic of Indonesia; and second, using the principle of double criminality, where if the act is committed in another country and is considered a crime there, it must also be a crime under Indonesian law for it to be prosecuted.

Some argue that the perfect money laundering mechanism is carried out in three stages:⁴¹

- 3.2.1. Placement is the process of introducing money derived from criminal activities into the financial system or financial institutions. This is the first step in separating criminal assets from their illicit source.
- 3.2.2. Layering (or separation) involves separating the proceeds of crime from their origin through a series of financial transactions designed to hide or disguise the source of the funds. This stage typically includes transferring funds between multiple accounts or locations, often through complex transactions, to obscure and erase the traces of the funds' origin.
- 3.2.3. Integration is the final stage, where criminal assets that have been placed and/or layered are used as legitimate assets for lawful business activities or to fund further criminal endeavors. This stage completes the money laundering process by reintroducing the illicit funds into the legitimate economy. As a result, the perpetrators can freely use the proceeds of their crimes without drawing suspicion from law enforcement, which might hinder investigations or pursuit.

Of the various stages of money laundering, layering is particularly associated with the transfer of illicit wealth and the use of financial institutions or offshore banks abroad. Layering seeks to separate the proceeds of crime from their original source — the crime itself — through multiple stages of financial transactions designed to hide or disguise the origin of the funds. This often involves transferring funds from several accounts or locations, as a result of placement, to other places through complex transactions that obscure and eliminate traces of the funds' source. Examples of layering activities include transferring funds between banks or across regions and countries, using cash deposits as collateral to support legitimate transactions, and moving cash across borders through a network of legitimate business activities or shell companies.

However, this AML law does not place much emphasis on law enforcement regarding money laundering transactions abroad, or the use of shell companies and offshore banking, which are often employed as methods to disguise illicit funds from criminal activities, including corruption, terrorism, illegal mining,

⁴¹ Rider Barry & Michael Ashe., *Money Laundering Control*, Ireland, Round Hall Sweet & Maxwell, 1996, page.312. See too, Adrian, Sutedi., *Tindak Pidana Pencucian Uang*, Bandung, Citra Aditya Bakti, 2008, page.19. See too, Yustiavandana, Ivan., *Tindak Pidana Pencucian Uang di Pasar Modal*, Bogor, Ghalia Indonesia, 2010, page.10.

deforestation, banking crimes, and other offenses in Indonesia. The law only briefly addresses foreign transactions, focusing primarily on the duties of the Financial Transaction Reports and Analysis Center (*Pusat Pelaporan dan Analisis Transaksi Keuangan* or PPATK).⁴² For example, Article 23(1) requires financial service providers to report transactions to the PPATK, including those involving the transfer of funds to and from abroad. Article 23(3) specifies that the amount of such transactions that must be reported is determined by regulations issued by the Head of the PPATK. Article 25(3) mandates that these reports be submitted no later than 14 working days from the date the transaction takes place. Additionally, Article 44(1) grants the PPATK the authority to request information from the reporting party based on requests from law enforcement agencies or international partners, as part of its function to analyze or examine the reports and information outlined in Article 40(d).

The current laws and regulations governing criminal acts of corruption and money laundering have significant limitations in detecting money laundering activities, particularly those involving international transactions or the use of shell companies and offshore banking. These limitations create opportunities for perpetrators to launder the proceeds of their crimes, as the laws do not adequately address these methods. One of the key issues is the varying interpretations of certain provisions in the legislation, which results in a lack of legal certainty and undermines the effectiveness of enforcement. As a result, the existing framework fails to provide sufficient deterrence or control over cross-border money laundering activities, which often involve complex financial networks designed to disguise the origin of illicit funds.⁴³

3.3. Exploring the Potential of Offshore Banking in Indonesia and Addressing Money Laundering

Indonesia, like many countries, faces significant challenges in combatting money laundering, particularly when it comes to international financial transactions and offshore banking. While Indonesia has an established legal framework for AML, particularly through Law Number 8 of 2010 on the Prevention and Eradication of Money Laundering Crimes, it lacks robust regulations that specifically address

⁴² The AML law primarily emphasizes the role of the Financial Transaction Reports and Analysis Center (PPATK) in tracking the flow of money, particularly in relation to financial intelligence investigations. The PPATK, in collaboration with reporting parties such as banking institutions, plays a crucial role in monitoring and supervising financial transactions to combat money laundering. The law recognizes that efforts to tackle money laundering cannot be carried out by the PPATK alone; active participation from financial institutions is essential. The PPATK's function in overseeing cash transactions is critical in the fight against economic crimes, especially in the context of the anti-money laundering regime. By working with financial institutions, the PPATK aims to disrupt money laundering activities, which are often linked to other predicate crimes, and prevent the concealment of illegal funds derived from criminal activities commonly seen in Indonesia. See too, Anastasia Suhartati Lukito., Financial intelligent investigations in combating money laundering crime: An Indonesian legal perspective, *Journal of Money Laundering Control*, Vol.19, no.1, 2016, page.98.

⁴³ Arief Patramijaya., Criminal Legal Protection for Bona Fide Third Parties Over Assets in Corruption and Money Laundering Cases, *Sriwijaya Law Review*, Vol.8, no.1, 2024, page.171. See too, Yanti Fadia and Muhammad Alwan Zain Nusantara., Strengthening Anti-Money Laundering Framework in Online Banking: Bank Indonesia's Initiatives and Countermeasures, *Jurnal Hukum*, Vol.39, no.2, 2023, page.255.

offshore financial activities, particularly those that involve shell companies or complex financial transactions designed to obscure the origins of illicit funds. This presents a gap in the country's ability to effectively prevent and trace money laundering activities, especially those that cross borders. In comparison, countries like Malaysia and Bangladesh have implemented specific regulations related to offshore banking and financial units, which offer valuable lessons for Indonesia.

By examining the experiences of other countries, Indonesia can enhance its legal and regulatory framework to address the growing concerns surrounding OFCs and money laundering. It needs to establish specific regulations for offshore financial units. One of the most significant gaps in Indonesia's current AML framework is the lack of regulations specifically targeting OFCs. While countries like Malaysia have created Labuan as an IOFC to attract foreign investment, Indonesia lacks a clearly defined system for regulating offshore financial activities. Labuan, for example, provides a legal framework that allows businesses to benefit from lower taxes, banking secrecy, and minimal regulatory oversight while ensuring compliance with anti-money laundering regulations. Indonesia could adopt a similar approach by establishing Offshore Financial Units (OFUs) or creating designated zones within SEZs where offshore financial activities can be more effectively regulated. These units would need to adhere to strict Know Your Customer (KYC) and AML standards, including detailed reporting requirements for international transactions, due diligence on offshore accounts, and regular audits. Such a system would help ensure that Indonesia can attract legitimate foreign investment while minimizing the risk of money laundering within its financial system.⁴⁴

The next step is to enhance cross-border transaction oversight. A key weakness in Indonesia's existing regulations is the lack of a comprehensive framework for overseeing cross-border transactions. While the PPATK is responsible for receiving reports of suspicious financial activities, including international money transfers, the current legal framework does not adequately address the use of offshore banks or shell companies involved in international money laundering schemes. In contrast, Malaysia and Bangladesh have enacted regulations that require financial institutions to report and scrutinize cross-border transactions, particularly those involving offshore banking units. For instance, Malaysia's Labuan IBFC and Bangladesh's OBUs have specific regulations that govern transactions across borders, ensuring that these transactions adhere to international standards of anti-money laundering and counter-terrorism financing. Indonesia could benefit from introducing stricter regulations that require financial institutions to report all cross-border transactions involving offshore financial centers, especially those originating from high-risk jurisdictions. Additionally, the PPATK could be granted more authority to monitor these transactions in real time, ensuring that suspicious activity is flagged and investigated promptly.⁴⁵

⁴⁴ Meiryani., Prevention and Control of Money Laundering Crimes on Know Your Customer Principles Application: Empirical Study of Indonesia Banking Sector, *Journal of Money Laundering Control*, Vol.27, no.5, 2024, page.878. See too, Bala Shanmugam, Mahendhiran Nair, and R. Suganthi., Money laundering in Malaysia, *Journal of Money Laundering Control*, Vol.6, no.4, 2003, page.375.

⁴⁵ Abdirahman Hassan Hersi., A critical analysis of Somalia's current antimoney laundering and counter financing of terrorism regime: a comparative study with Malaysia, *Journal of Money Laundering Control*, Vol.27, no.4, 2024, page.721. See too, Artha Febriansyah, Eva Achjani Zulfa,

Furthermore, strengthening international cooperation and compliance is also needed. Indonesia's current legal framework does not place enough emphasis on international cooperation regarding offshore money laundering. Both Malaysia and Bangladesh have made significant strides in improving international cooperation by becoming active members of global AML networks such as the Egmont Group and by complying with the FATF Recommendations. These efforts facilitate better information sharing and coordination between national and international authorities, thereby improving the detection and prosecution of cross-border financial crimes.⁴⁶ Indonesia could strengthen its engagement with international regulatory bodies like the FATF and regional organizations such as the Asia Pacific Group (APG). By aligning more closely with international standards, Indonesia can gain access to resources, intelligence-sharing platforms, and best practices to combat money laundering more effectively. This will also allow Indonesia to better track illicit flows of money across international borders, particularly when they involve complex financial networks or offshore accounts.⁴⁷

Lastly, what is needed is to enhance financial intelligence and enforcement mechanisms. While PPATK plays an important role in Indonesia's AML framework, the agency currently faces limitations in investigating offshore money laundering activities. In Malaysia, the LOFSA plays an active role in monitoring and enforcing AML regulations within its jurisdiction. By comparison, Indonesia could strengthen the capacity of PPATK by granting it more authority to investigate offshore financial entities and ensuring that suspicious transactions involving international banks and shell companies are flagged for further scrutiny.⁴⁸ Additionally, Indonesia could create specialized units within PPATK or collaborate with international financial intelligence units to more effectively monitor offshore financial flows.⁴⁹ This would allow the government to respond more quickly to emerging threats, particularly in cases where funds are transferred through offshore accounts or shell companies designed to obscure the source of illicit funds.

4. Conclusion

Offshore Financial Centers (OFCs) play a critical role in attracting foreign investment by offering favorable financial services, such as low taxes and minimal regulation. However, they are often criticized for enabling illicit financial activities, including money laundering, due to lax oversight and banking secrecy laws. Countries like Malaysia and Bangladesh have established OFCs to promote economic growth, but these centers also face significant challenges in regulating offshore banking and preventing misuse. To address these issues, stronger

Muhammad Yusuf, and Desia Banjarani., Reversal Burden of Proof in Process of Proving Money Laundering Cases in Indonesia, *Indonesia Law Review*, Vol.13, no.1, 2023, page.45.

⁴⁶ Bala Shanmugam, Mahendhiran Nair, and R. Suganthi., Money laundering in Malaysia, *Journal of Money Laundering Control*, Vol.6, no.4, 2003, page.379.

⁴⁷ Meiryani, Gatot Soepriyanto, and Jessica Audrelia., Effectiveness of regulatory technology implementation in Indonesian banking sector to prevent money laundering and terrorist financing, *Journal of Money Laundering Control*, Vol.26, no.4, 2023, page.899.

⁴⁸ Yanti Fadia, and Muhammad Alwan Zain Nusantara., Strengthening Anti-Money Laundering Framework in Online Banking: Bank Indonesia's Initiatives and Countermeasures, *Jurnal Hukum*, Vol.39, no.2, 2023, page.255.

⁴⁹ Mahrus Ali, Syarif Nurhidayat, Muhammad Shidqon Prabowo, and Rusli Muhammad., Corruption, asset origin and the criminal case of money laundering in Indonesian law, *Journal of Money Laundering Control*, Vol.25, no.2, 2022, page.457.

regulatory frameworks, international cooperation, and robust enforcement measures are necessary to balance economic benefits with the prevention of financial crimes.

Indonesia's current regulatory framework for combating money laundering, as outlined in Law No. 8 of 2010, defines money laundering in three stages: placement, layering, and integration, targeting those who disguise the origin of illicit funds. However, the law does not sufficiently address the challenges of monitoring and prosecuting cross-border money laundering, particularly when offshore financial institutions and shell companies are involved. While the PPATK plays a key role in overseeing financial transactions, the lack of emphasis on international transactions and inadequate enforcement mechanisms hinders the effectiveness of the legal framework in curbing complex money laundering schemes.

Thus, Indonesia's regulatory framework needs to be strengthened, particularly in relation to offshore banking. By drawing lessons from countries like Malaysia and Bangladesh, Indonesia can introduce specific regulations for OFUs and enhance oversight of cross-border transactions. Strengthening international cooperation, improving financial intelligence, and expanding the capacity of the PPATK will be essential in ensuring effective enforcement and safeguarding Indonesia's financial system from illicit activities.

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