

**Financial Institutions:  
their role in the prevention of  
money laundering**

**Presented by Martin Comley**

# Recap: what is money laundering?

*“Money laundering is the process by which criminals attempt to hide and disguise the true origin and ownership of the proceeds of their criminal activities, thereby avoiding prosecution, conviction and confiscation of the criminal funds.” From the UK-Joint Money Laundering Steering Group Guidance Notes*

- **Placement:** the initial deposit of illegally derived funds either through its introduction into the financial system; through the purchase of high value goods; or by physical cross-border transportation
- **Layering:** a series of transactions or movement of funds with the aim of distancing them from their source
- **Integration:** re-entry of funds into the legitimate economy through investment in: real estate, luxury assets or business ventures

# Which financial services are targeted?

	Placement	Layering	Integration
Banking	✓	✓	✓
Foreign exchange	✓		
Money transmission	✓		
Securities	✓	✓	✓
Insurance	✓	✓	✓

# What is the scale of the problem?

- By its very nature, money laundering occurs outside of the normal range of economic statistics so it is hard to quantify
- IMF has stated that the aggregate size of worldwide money laundering could be between 2 – 5% of the world's GDP
- Put another way, the proceeds of money laundering could total between US\$590bn – US\$1.5tr

# Economic consequences of money laundering

- **Financial institutions:** money laundering can threaten liquidity and solvency of banks when funds are transferred to another financial centre
- **Local businesses:** firms may find they cannot compete with front companies who offer services at lower rate
- **Currencies and interest rates:** can be distorted by money launderers' investment practice causing economic instability
- **Reputation:** countries linked to money laundering will suffer from reputational damage resulting in the impairment of legitimate investment opportunities

# Why are banks targeted by money launderers?

- **Global network**
- **Offer a variety of services**
- **Timely and convenient**
- **Used for any of the 3 stages of money laundering**

# Why should banks worry about money laundering (1)?

More costly



Less costly

	Voluntary/involuntary closure of bank	Management fines/risk of prosecution
Regulatory risk	✓	✓
Legal risk	x	✓
Reputational risk	✓	x
Liquidity risk	✓	x
Credit risk	✓	x

# Why should banks worry about money laundering (2)?

**Money laundering offences committed by financial institutions and/or their employees can attract prison sentences and / or unlimited fines!**

## **Examples of money laundering offences**

- **Assisting a money launderer**
- **Failing to report a suspicious transaction**
- **Tipping off a subject**
- **Failure of a financial institution to comply with local anti-money laundering legislation**

*FATF: Rec 14 Financial institutions, their directors, officers and employees should be: Prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU.*

# Money laundering legislation: the UK example

## Primary Legislation

- Proceeds of Crime Act (covering all crimes)
- Terrorism Act

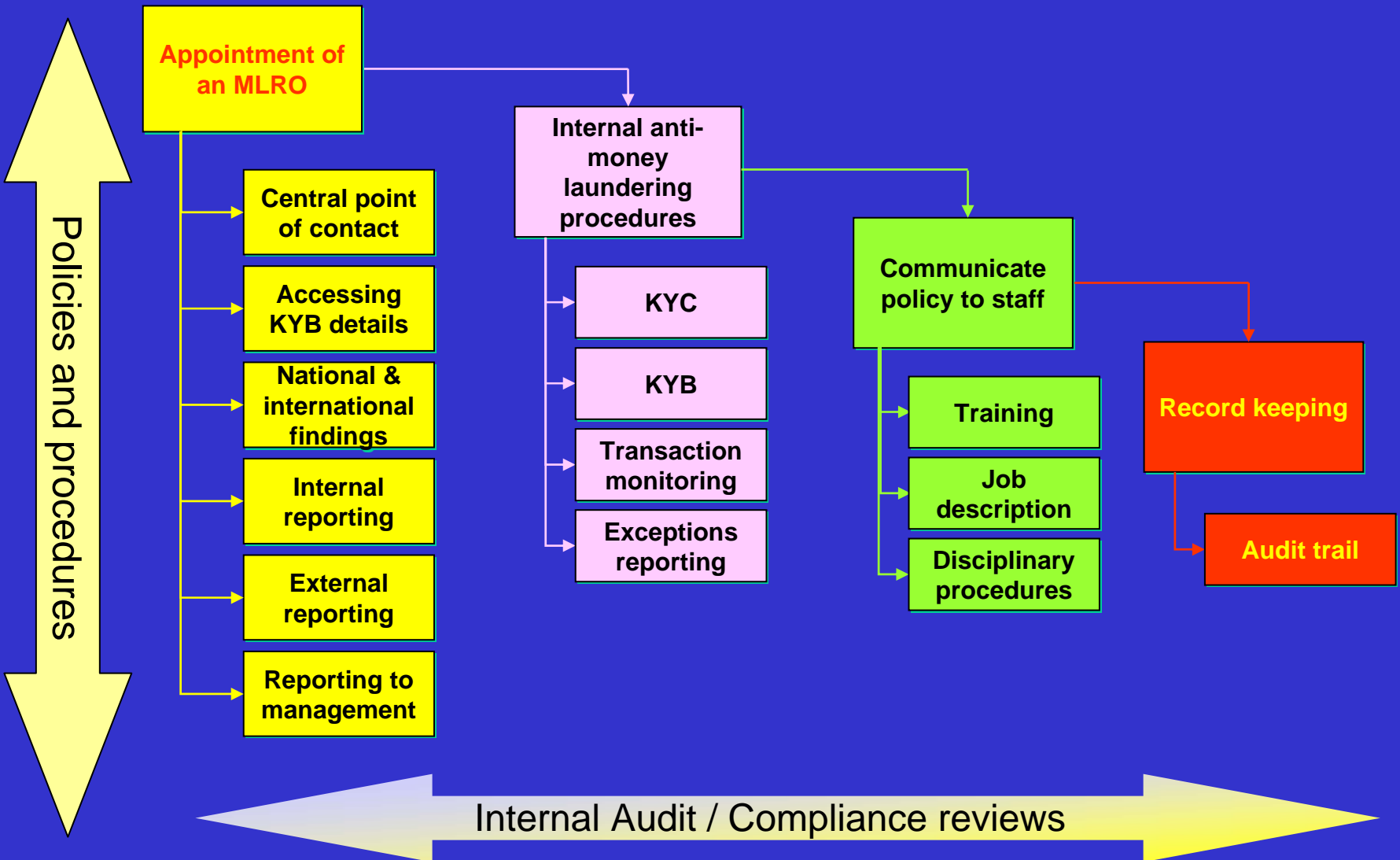
**EVERYONE HAS A DUTY  
TO REPORT SUSPICIONS**

## Secondary Legislation

- Money Laundering Regulations (including industry guidance notes)
- Regulator's rules

**ADDITIONAL PROVISIONS FOR  
FINANCIAL INSTITUTIONS**

# How do banks detect, monitor and report money laundering?



# Policies and procedures

- Policies outline the high level anti-money laundering approach of the firm
- Incorporate local legislative and regulatory requirements
- Policy is ratified annually by the Senior Management of the firm
- Procedures outline the detailed day to day anti-money laundering operations of the firm

*FATF Rec15: Financial institutions should develop programmes against money laundering and terrorist financing. These programmes should include:*

- (a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.*

# Internal anti-money laundering procedures

- Know Your Customer (KYC)
- Know Your Customer's Business (KYB)
- Transaction monitoring
- Exceptions reporting

# Know your customer procedures

- *Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.*
- *Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when:*
  - *establishing business relations;*
  - *carrying out occasional transactions:*
    - *above the applicable designated threshold; or*
    - *that are wire transfers in the circumstances covered by the Interpretative Note to Special Recommendation VII;*
  - *there is a suspicion of money laundering or terrorist financing; or*
  - *the financial institution has doubts about the veracity or adequacy of previously obtained customer identification data.*
- *The customer due diligence (CDD) measures to be taken are as follows:*
- *Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information.*
- *Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.*
- *Obtaining information on the purpose and intended nature of the business relationship.*
- *Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.*

# Examples of know your customer procedures

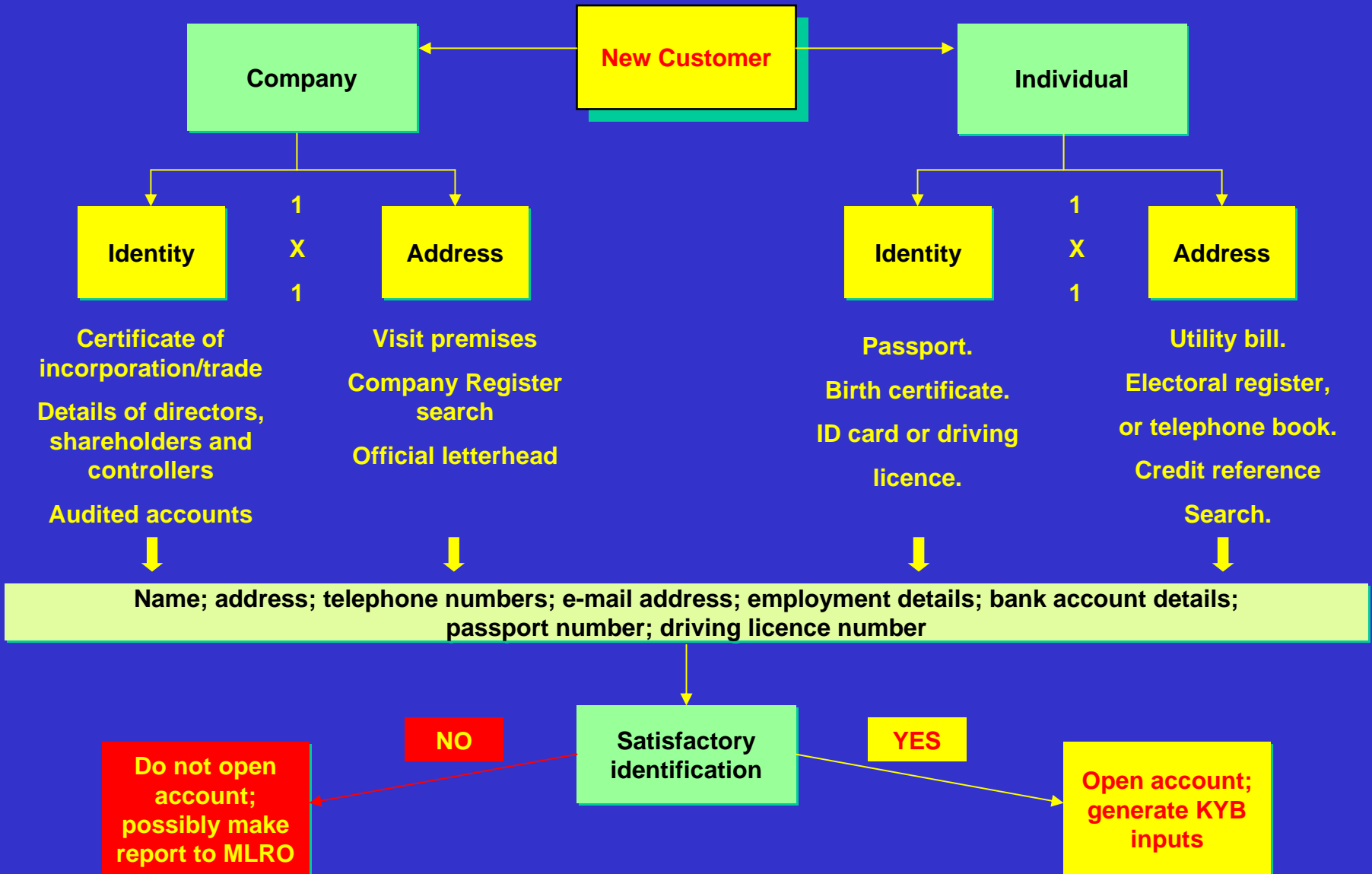
Type of customer	Proof of identity	Proof of address
Private individual	Passport; identity card; driving licence; birth certificate	Bank statement; utility bill; credit agency search; electoral/government register
Publicly listed company	Check listing status on relevant stock exchange; confirmation of authority to act	Not applicable
Private company	Certificate of incorporation/ certificate to trade; proof of identity of directors/controllers/ major shareholders/beneficial owners; search at Companies Registrar	Evidence of registered address eg official letter-head or visit to premises

# Examples of know your customer procedures (2)

## Additional points to consider

- For joint accounts, proof of identity is required for both parties
- Proof of identity and address also required for powers of attorney and third party mandates
- Verify address for non-domestic customers through official means
- Accounts opened for non face-to-face customers eg internet accounts, require a third document to prove identity (fraud prevention)
- Original documents should be sought; if not, they should be certified registered as seen by an official body
- Consider visiting the premises of private companies to verify address details
- Where a company is owned by another company, ensure verification is sought of ultimate beneficial owner

# Know your customer (KYC)



# Know your customer (KYC)

## - Politically Exposed Persons (PEPs) -

Financial institutions should, in relation to politically exposed persons, in addition to performing normal due diligence measures:

- Have appropriate risk management systems to determine whether the customer is a politically exposed person.
- Obtain senior management approval for establishing business relationships with such customers.
- Take reasonable measures to establish the source of wealth and source of funds.
- Conduct enhanced ongoing monitoring of the business relationship.

### FATF Rec 6

**PEPs:** are individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.

# **Know your customers business (KYB)**

- **Important to obtain a profile of a customer's expected level of business**
- **Financial institutions can assess the validity of actual financial transactions against expected financial transactions**
- **Financial institutions can make a judgement as to what may constitute a suspicious transaction**
- **KYB should be regularly reviewed to incorporate any confirmed changes to a customer's business**

# Examples of know your customers business information

## Private Customer

- Purpose of account
- Annual income
- Source of income
- Source of wealth
- Estimated account activity
- Estimated turnover
- Typical counterparties
- Type of services used
- International connections

## Corporate Customer

- Purpose of account
- Type of business
- Group structure
- Estimated turnover
- Source of net worth
- Estimated account activity
- Net worth
- Type of services used
- International connections

# Transaction monitoring

*Financial institutions should develop programmes against money laundering and terrorist financing.*

*These programmes should include:*

- *The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.*
- *An ongoing employee training programme.*
- *An audit function to test the system.” – FATF Recommendation 15*

**Firm's should have automated or manual systems in place to:**


- **Identify unusual account balances out of line with salary or expected profitability of a company**
- **Identify unusual cash transactions**
- **Identify unusual turnover**
- **Identify unusual payment transactions**
- **Identify unusual beneficiaries including those on national / international sanction lists**
- **Identify reactivation of dormant accounts**

# Transaction monitoring - example A (1)

John Smith opened a cheque account with Big Bank Group on 1 January 2002. He provided adequate documentation verifying his identity and address. Big Bank Group has compiled the following information about John Smith's business:

<b>Purpose of account</b>	<b>Cheque account; day to day transactions</b>
<b>Annual income</b>	<b>US\$80,000</b>
<b>Source of income</b>	<b>Employed by Microsoft Corporation</b>
<b>Source of wealth</b>	<b>Monthly salary payments</b>
<b>Estimated account activity</b>	<b>US\$4000 per month</b>
<b>Typical counterparties</b>	<b>Utility companies; high street firms</b>
<b>Type of services used</b>	<b>Cheques; ATM; domestic payments</b>
<b>International connections</b>	<b>Limited. Some international payments made for internet purchases</b>

# Transaction monitoring - example A (2)

John Smith 1045 56TH STREET SEATTLE WA 38472 USA		BIG BANK GROUP 4587 10TH AVENUE NEW YORK USA				
2002	Sheet 2	Account No	12345678	Debit	Credit	Balance
Jan 01	OPENING CREDIT				\$2,000.00	\$2,000.00
Sep 10	ELEC TRSF PACIFIC HEIGHTS EXPORTS				\$87,345.00	\$89,345.00
Sep 11	CASH				\$3,500.00	\$92,845.00
Sep 14	CASH				\$2,500.00	\$95,345.00
Sep 20	TIMBER MERCHANTS OF PERU	\$80,000.00				\$15,345.00
Sep 26	ELEC TRSF N WEST MINING CO, ANGOLA				\$35,489.00	\$50,834.00
Sep 27	FX 25,000 TL @ US\$1.5				\$16,667.00	\$67,501.00
Sep 27	FX CHARGE	\$40.00				\$67,461.00
Sep 30	ROBERT MUGABE	\$52,000.00				\$15,461.00

# Exceptions reporting (1)

## Exceptions Report generated by Big Bank Group

<u>Customer name</u>	<u>Reason for exception</u>	<u>Comments</u>
John Smith	Dormant account reactivated	Account last used on 1/1/02
John Smith	Unusual turnover	Expected turnover \$4000 per month Vs actual of \$135,000
John Smith	Unusual cash transactions	Cash payments of \$6000 credited to account, including foreign currency exchange
John Smith	International counterparties	Counterparties unknown; questionable locations eg Angola and Peru
John Smith	Unusual services	Frequent use of international electronic transfers

## **Exceptions reporting (2)**

- **Bank staff manually review exception reports to assess whether or not a transaction is suspicious**
- **Use internal information and/or contact the customer BUT avoid tipping off**
- **If staff are still suspicious, an internal report should be generated**
- **Where a transaction is found to be legitimate, staff should update KYB inputs with new information**

# Transaction monitoring - example B (1)

Timber Electronics, a private company responsible for the manufacture of computers, opened a cheque account with Tower Bank on 1 January 2002. Adequate documentation was provided verifying the legal identity and address of the company including the identification of the directors. The following information has been compiled regarding Timber Electronics' business:

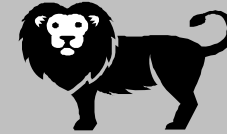
<b>Purpose of account</b>	<b>Managing cash flow; paying overheads etc</b>
<b>Annual profitability</b>	<b>US\$900,000</b>
<b>Source of wealth</b>	<b>Monthly salary payments</b>
<b>Estimated account activity</b>	<b>US\$80,000 per month</b>
<b>Typical counterparties</b>	<b>Utility companies; high street firms</b>
<b>Type of services used</b>	<b>Cheques, electronic transfers</b>
<b>International connections</b>	<b>Suppliers from Germany, Italy; purchasers from Egypt, Saudi Arabia, UAE</b>

# Transaction monitoring - example (2)

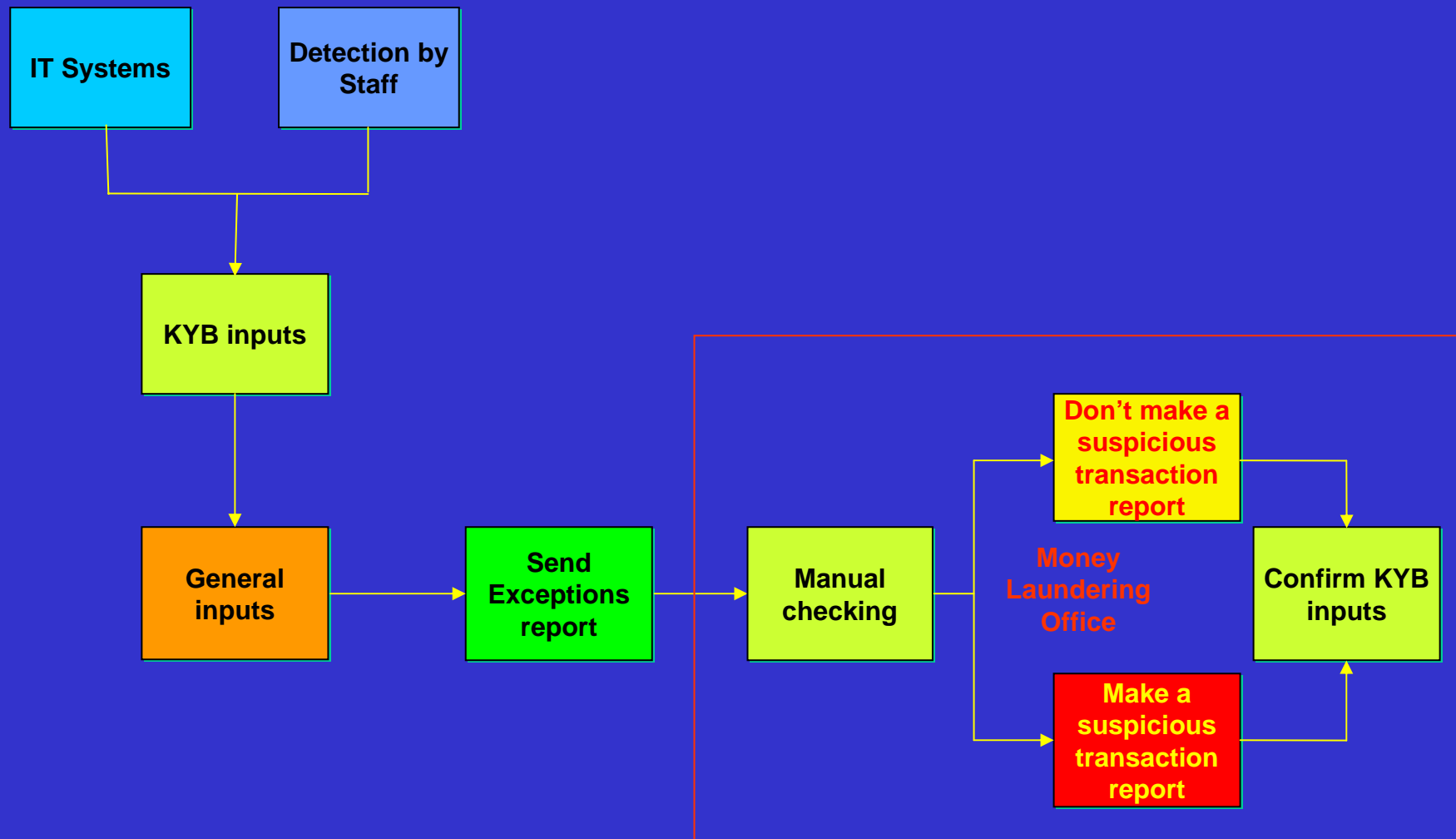
2002		Sheet 10	Account No	83483638	Debit	Credit	Balance
Jul 01	BALANCE B/F						£43,000.00
Sep 10	ELEC TRSF UNITED BANANAS CO, GUATEMALA			£236,345.00			£279,345.00
Sep 11	CASH			£10,000.00			£289,345.00
Sep 14	CASH			£8,000.00			£297,345.00
Sep 20	ELEC TRSF NEWLANDS IMPORT/EXPORT CO			£136,000.00			£433,345.00
Sep 26	CASH			£2,800.00			£436,145.00
Sep 27	CASH			£4,000.00			£440,145.00
Sep 27	FLEC TRSF WALLACE ESTATES, SPAIN			£43,890.00			£484,035.00
Sep 30	ELEC TRSF PROP DEVELOPERS, CHINA			£413,780.00			£70,255.00

TIMBER ELECTRONICS  
 4 QUEENS ROAD TRADING ESTATE  
 GUILDFORD  
 SURREY  
 UK

TOWER BANK  
 34 LOWER THAMES STREET  
 LONDON  
 UK EC2R 8AH



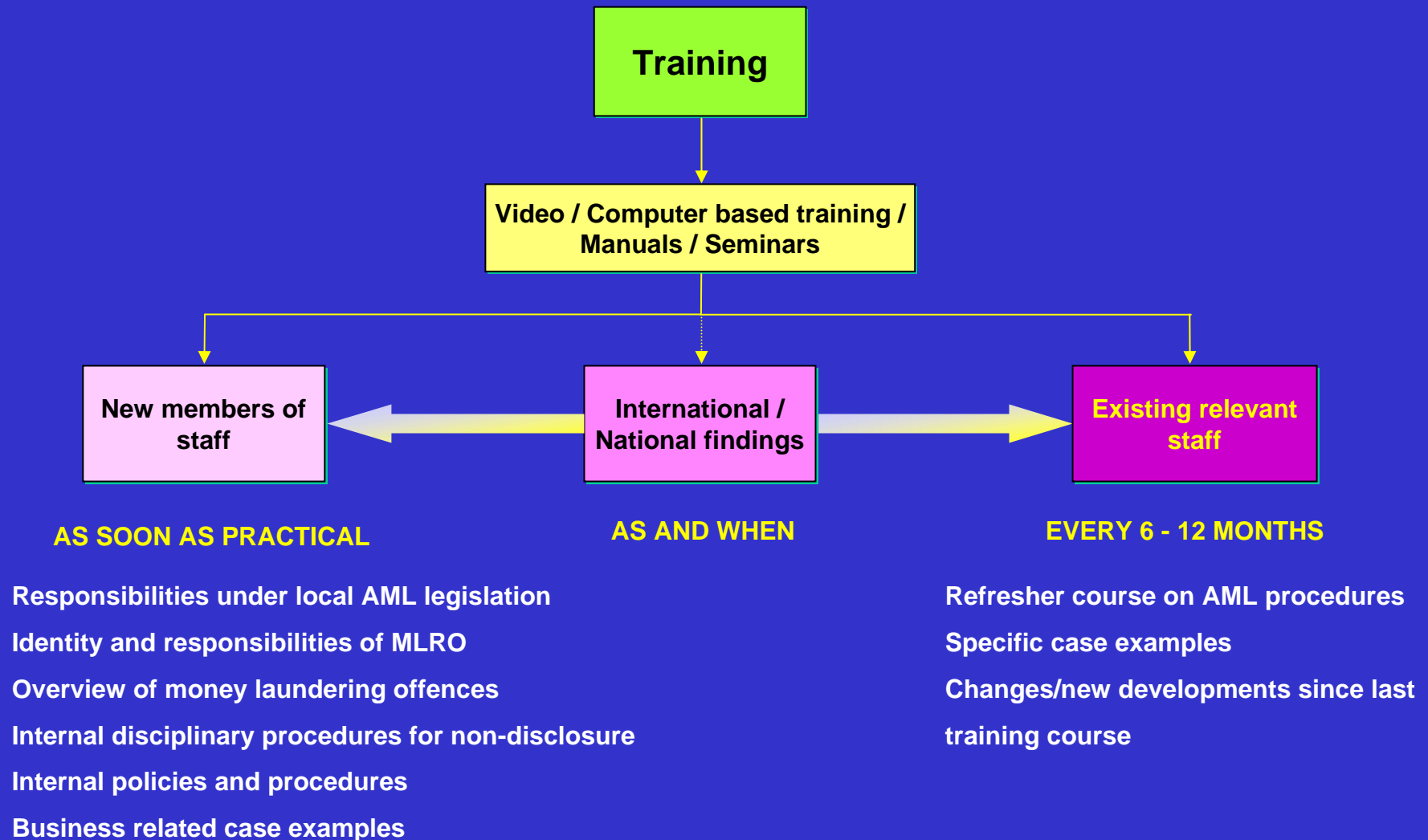
# Transaction monitoring & exceptions reporting process



# **Appointment of a Money Laundering Reporting Officer (MLRO)**

- **Central point of contact on AML issues both internally and externally with law enforcement agencies and regulatory authorities**
- **Receives and reviews suspicious transaction reports from members of staff**
- **External reporting of suspicious transactions to local Financial Intelligence Unit**
- **Obtains and uses national and international AML findings**
- **Researches and prepares AML reports for management**

# Communicate AML polices to staff (1)



***FATF Rec15: Financial institutions should develop programmes against money laundering and terrorist financing. These programmes should include: b) An ongoing employee training programme.***

# Communicate AML policies to staff (2)

- Procedure manuals
- Money laundering handbook
- Intranet
- Job descriptions
- On-the-job training
- Internal disciplinary procedures

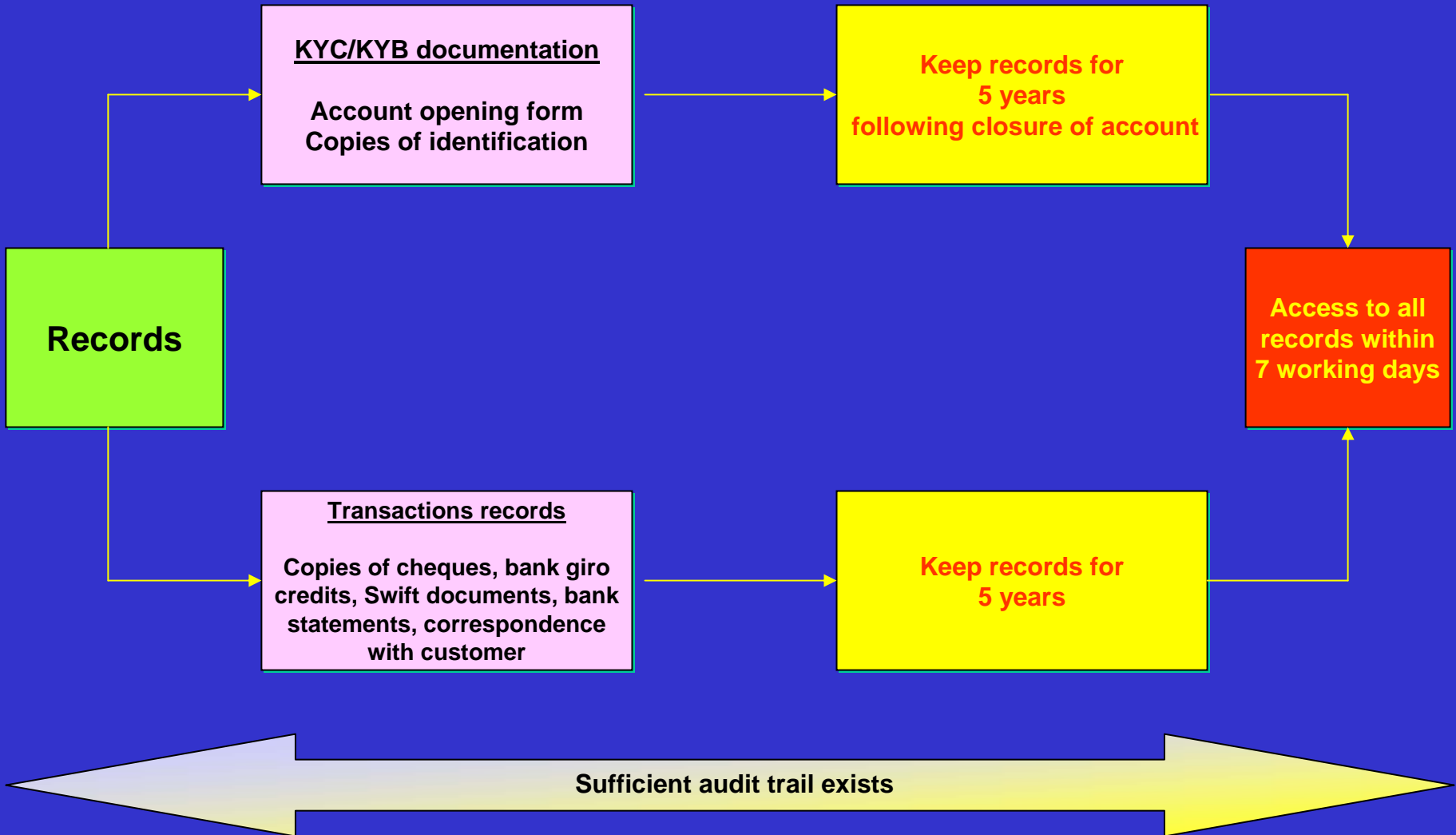
# Record keeping (1)

*“Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity.*

- Financial institutions should keep records on the identification data obtained through the customer due diligence process (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the business relationship is ended.*
- The identification data and transaction records should be available to domestic competent authorities upon appropriate authority.”*

*- FATF Recommendation 10*

# Record keeping (2)



# Know Your Customer Information – Example 1

Ali Dervis, a private individual living in Cairo, wishes to set up a bank account

What KYC information should be taken?

What information should you know about your customer's business?

## KYC

Confirm identity of the individual, for example, by obtaining a copy of a passport or an ID card. Confirm address of the individual, for example, copy of official document, home visit

## KYB

Confirm where the money is coming from which will open the account; where regular monies will be coming from; what services will be used; who are the typical counterparties

# **Know Your Customer Information – Example 2**

**A privately owned Egyptian travel agency firm wishes to open a bank account. Two directors run the company**

**What KYC information should be taken?**

**What information should you know about your customer's business?**

## **KYC**

**Confirm identity of the firm, copy of certificate of incorporation/certificate of trade; confirm identity and addresses of directors; confirm identity of shareholders/controllers of the company; evidence of registered address.**

## **KYB**

**Confirm where the money is coming from which will open the account; confirm expected level of activity on the account; confirm expected annual profits (see audited annual accounts); types of counterparties; typical countries the travel agency deals with**