

LAUNDERING

Money laundering: a global challenge

BY MUAZZIN MEHRBAN AND MARK WILLIAMS



Money laundering is a growing problem in both developed and emerging economies. Although it is difficult to measure and quantify, the IMF estimates that illegal funds total between 2-5 percent of world GDP. Globalisation and the burgeoning size of financial markets have made it easier for criminals to hide the source of their capital from government agencies. Anonymous transactions can be conducted on a cross-border basis using creative instruments and complex financial vehicles. The IMF has called for governments around the world to implement tougher rules on money laundering, partly because of its importance in funding terrorist activities. It wants checks to become standard procedure across all institutions, not just those in the banking sector.

The expectation on countries to implement harsher fraud regulations is building, according to Ellen Zimiles, co-founder and chief executive officer of Daylight Forensic & Advisory LLC. "Pressure comes from both industry and national regulators, but also, more notably, channels such as the Financial Action Task Force (FATF), whose Mutual Evaluation process assesses both the implementation of

its 'industry-standard' 40 Recommendations and the effectiveness of anti-money laundering and counter-terrorist financing systems of its member countries." She adds that recent FATF reports were produced by Canada, Finland, Singapore, the Russian Federation and China, among others. The FATF develops policies based on a combination of rules and best practices. Governments then take on board its recommendations and introduce appropriate legislation, which helps to harmonise the approach globally.

As part of the fight against money laundering, governments are placing more responsibility on financial institutions to verify the nature of transactions that pass through their systems. The 2001 USA PATRIOT Act forced many global institutions doing business in the US to adhere to US standards. Banks are expected to establish effective customer due diligence and monitoring programs, at a minimum. They need to screen activity against lists produced by the Office of Foreign Assets Control (OFAC) and report any suspicious transactions. "The most significant legal development in the US is the criminalisation of anti-money laundering

compliance, especially in terms of covered financial institutions' responsibility to monitor the suspicious activities of their customers' customers," says Marilyn Barker, counsel at Bryan Cave LLP. "In addition, from a regulatory standpoint, the imposition of enforcement actions based on zero tolerance with regard to compliance failures in the context of a purported risk-based approach, makes navigating the anti-money laundering compliance ship a very uncertain journey."

In Europe, the introduction of the EU's Third Money Laundering Directive created a risk based approach. It replaced the second directive of 2003 and requires EU member states to make changes to their existing anti-money laundering controls. The Directive describes 'simplified due diligence' as a standard check to be performed by all institutions on their clients. Any clients considered politically exposed will have to undergo 'enhanced due diligence', which consists of additional checks. Institutions will be monitored at government level to ensure their compliance.

The UK responded to the Directive by drawing up the Money Laundering Regulations 2007, which came into effect on 15 December 2007. Although the regulations appear beneficial, Ed Sautter, a partner in the Litigation & Dispute Resolution Group at Mayer Brown International LLP, believes that there are practical challenges in implementation. "The approach concerns the appropriate allocation of resources towards the areas of greatest risk, and this of course involves conducting appropriate assessments as to where the greatest risks lie. The areas which require that assessment include the geographical location of the customer or transaction, customer type, type of product, and the means by which the product is being sold," he says. Some experts have also expressed concerns that financial institutions are adhering to the regulations not for the express purpose of identifying criminals, but to avoid the finan-

cial penalties of non compliance.

Despite the challenges, anti-money laundering regulations are improving globally, according to Ms Zimiles. "Recent high profile cases, including the use of structured vehicles for alleged tax-evasion abuses by high net worth individuals, have sparked international regulatory attention and calls for tighter controls and regulation in certain jurisdictions. This is coinciding with greater demands by international organisations and agencies for countries to adopt tighter anti-bribery and corruption standards. The private sector is also stepping up to the plate in improving their internal controls in the wake of increased enforcement and financial penalties, particularly those metered by the Securities Exchange Commission and US Department of Justice," she says.

Elsewhere, regional challenges are evident. Dubai's Financial Services Authority has received praise from the IMF for its conformity to international anti-money laundering standards. Its procedures are now closely aligned with the recommendations of the FATF. However, the IMF reported specific inadequacies in the regulation of wire transfer, and the transmission of information. China's anti-money laundering policy appears constrained by a lack of internal control. The changing administrative rules and regulations coupled with poor reporting techniques have made new policies rather ineffective. The slow speed at which anti-money laundering cases are handled has created bottlenecks and backlogs of unprocessed indictments.

Recent cases highlight the importance that governments have placed on firms complying with anti-money laundering legislation. In the US in September 2007, AMEX Bank International was penalised \$65m and California's Union Bank \$31m for compliance violations. More recently, E-Trade Financial, the online share-trading broker, agreed to pay \$1m to settle civil charges that two of its brokerage firms broke anti-money laundering rules. The Securities and Exchange Commission said E-Trade had failed to follow identification procedures for over 65,000 customers. Despite internal discovery of the issue, failure to meet a compliance deadline resulted in the penalty. Trade promptly hired independent consultants

to verify its compliance program.

In another case, the National Commercial Bank of Jamaica recently wound up in court over its 2007 charge of breaking the Money Laundering Act. Investigators discovered suspicious financial transactions of \$27m in the account of a known drug trafficker. Federal agents were triggered by reports suggesting a worker at the bank had been assisting in the laundering of cash. The absence of a report lodging the transactions above the financial threshold resulted in the bank facing legal action. Under Jamaican law, transactions over \$50,000 must be reported to the authorities.

In the first half of 2008, the People's Bank of China punished 12 institutions involved in money laundering activity. The Anti-money Laundering Bureau checked 1084 financial organisations and discovered a growing trend of private banks with questionable dealings. Head of the Bureau Tang Xu suggested that illegal fundraising and laundering was disturbing the country's economic stability. Central Bank branches and foreign exchange regulators have uncovered 42 money laundering cases involving approximately \$12.2bn since September 2007. Tang has insisted the country will further strengthen its checks.

But as governments tighten their anti-money laundering laws, criminals find ways to adapt. Some have relocated their activities to states with less regulation. Trade financing has become a common way of disguising money movement. The inaccurate invoicing of goods and services as well as inaccuracies in shipping papers are two of the ways of covering up laundering activity. Front companies are a common way of shrouding the movement of funds, along with false descriptions of goods that are used to launder money. In addition, traditional smuggling of bulk cash over international borders remains a popular method.

Financial institutions are the main focus of the anti-money laundering regimes because governments see them as the frontline of prevention. "They play a key role in identifying and responding to money laundering," notes Ms Zimiles. "Given their position in customer acceptance and identification, international currency transmittal, and resources invested in

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compliance and monitoring, financial institutions are uniquely placed to identify and report suspicious activities to local authorities."

Perhaps the biggest challenge in controlling the flow of money is identity theft. Since the internet easily facilitates payment transactions, it has become the main tool of money launderers due to the anonymity it provides. But regulations are making life harder. "Money launderers have been challenged by customer identification and verification rules that certain financial institutions employ as part of their anti-money laundering compliance programs," explains Ms Barker. "The systems now in place make it difficult for money launderers to do business as usual. As a consequence, money launderers must gain access to the system by forging their true identities."

In India, the banking association has joined with 10 banks to improve customer verification and transaction monitoring. It has produced revised guidance notes on customer knowledge and anti-money laundering practices, along with software to detect suspicious transactions. The Reserve Bank of India has also issued guidelines on wire transfers and transaction monitoring. Additional areas of

focus include categorising customer risk and training personnel. The State Bank of India, ICICI Bank and HSBC are all part of the improvement process. India's example demonstrates how financial services are taking the lead in anti-money laundering processes.

But not all financial institutions are content acting as first line of defence. In the US, the American Bankers Association (ABA) recently called for a federal 'gatekeeper' to tackle suspicious activity. It believes reforms are needed to penalise criminals and not banks. It suggested that banks had difficulty complying with complicated federal reporting obligations, and also that the costs associated with compliance were rising. For now, banks need to walk carefully through an anti-money laundering minefield. "Financial institutions should endeavour to comply not only with respect to explicit regulations but the guidance

or soft regulations that FinCEN or the supervisory agencies promulgate," suggests Ms Barker. "They should carefully consider and interpret published enforcement actions and deferred prosecutions agreements as examples of 'backdoor' anti-money laundering compliance expectations and correspondingly adjust their anti-money laundering compliance programs."

It is also important that anti-money laundering regulation is overseen at the top level of the organisation, believes Ms Zimiles "Anti-money laundering practices should be supported by senior management with sufficient resources, including a dedicated person with AML compliance responsibilities, adequate firm-wide training, well documented policies and procedures a continual program of compliance and internal audit testing, to ensure that the organisation is fulfilling its obligations or

risk enforcement action by its local regulator or, often worse, exposure to reputational and financial damage."

New measures making it harder for criminals to launder money will evolve over time. For financial institutions, compliance programs are challenging and complex. They are not cheap, although the penalties for not meeting requirements tend to outweigh the costs, both in financial and reputational terms. Adequate anti-money laundering diligence is an obligation that banks must fulfil. As Mr Sauter points out "A very strong onus remains on financial services firms; they continue to be regarded as gatekeepers in the battle against international crime and money laundering." But establishing effective standards is fraught with problems, and these may only intensify as criminals find new ways to infiltrate and manipulate financial systems. ■



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Ellen Zimiles, Daylight's co-founder and CEO, has more than 23 years of litigation and investigation experience, including 10 years as a federal prosecutor. Before forming Daylight, Ellen was a principal at a "Big Four" accounting firm, where she coordinated the forensic practice across all industry segments and was practice leader for the financial services industry. She is a leading authority on anti-money laundering programs, fraud control and public corruption matters. Ellen speaks frequently on these matters before banking, legal,

compliance and academic audiences. She served as the independent financial auditor for the International Brotherhood of Teamsters as part of a federal court consent agreement.

Before her Big Four experience, Ellen was an assistant United States attorney in the Southern District of New York for more than 10 years. She served in the civil and criminal divisions and was chief of the forfeiture unit for more than six years. Ellen was responsible for many high-profile

money laundering, fraud and forfeiture cases. In recognition for her contributions as a federal prosecutor, Ellen received the United States Department of Justice's John Marshall Award for Outstanding Service and the United States Department of Health and Human Services' Integrity Award. Ellen earned a bachelor's degree at Brooklyn College and a law degree at Syracuse University College of Law, where she served as an editor of the law review.