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DISSERTATION

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NOMENCLATURE

AML	=	Anti-Money Laundering
FMU	=	Financial Monitoring Unit
CDD	=	Customer Due Diligence
CFT	=	Combating Financing of Terrorism
FATF	=	Financial Action Task Force
IMF	=	International Monetary Fund
KYC	=	Know your Customer
ML	=	Money Laundering
PEP	=	Politically Exposed Person
RBA	=	Risk Based Approach
SAR	=	Suspicious Activity Reporting
TF	=	Terrorist Financing

ABSTRACT

Financial Action Task Force (FATF) emphasises on Risk-Based Approach (RBA) so that regulated entities can respond Money Laundering (ML) and Terrorist Financing (TF) threats in ways that are proportionate to the risks involved. However, the RBA suffers from several difficulties and this has resulted in its ineffective implementation. This paper discusses practical conditions such as implementation challenges, unintentional regulatory breaches and their consequence, in carrying out RBA and agrees that 'uncertainty-based approach' is effective to the extent of Suspicious Activity Report (SAR).

Moreover, this paper suggests that the FATF needs to work together with regulators and regulated entities to address RBA's implementation challenges and provide technical assistance rather than imposing hefty penalties and sanction.¹

KEY WORDS

Anti-Money Laundering; Customer Due Diligence; Combating Financing of Terrorism; Financial Action Task Force; Know your Customer; Money Laundering; Risk Based Approach; Suspicious Activity Reporting; Terrorist Financing

¹ Lishan Ai, 'Rule-based but risk-oriented' approach for combating money laundering in Chinese financial sectors' (2012) 15 (2) Journal of Money Laundering Control 198

CHAPTER I

INTRODUCTION

1.1 BACKGROUND AND ISSUE

In 1990, an inexperienced, one-year task force published 40 vague and voluntary recommendations for building an international Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) regime.² However, during the thirty years of its formation³, FATF has become the focal institution of a powerful financial governance regime. Now countries rely on FATF's tools to counter crimes of all kinds, including but not limited to transnational organised crime for example money laundering, terrorism, and weapons proliferation.⁴ FATF's Recommendations cover the criminal justice system and law enforcement, international co-operation, and the financial system and its regulation.⁵

In its beginning, the AML framework was static, obliging regulated entities to report transactions according to fixed parameters or thresholds specified (rule-based) by the law.⁶ However, the rule-based system was soon perceived as too costly, inflexible and ineffective⁷ in the fast-moving and complex sectors.⁸ Therefore, the prescriptive nature of the rule-based approach to AML compliance and the exponential growth of Suspicious Transaction Report (STR) and Suspicious Activity Report (SAR) resulting from the use of 'tick-box' method led to the adoption of RBA to prevent Money Laundering and combat Terrorist Financing.⁹

² Susan Strange, *Mad money When markets outgrow governments* (The University of Michigan Press 1998)

³ FATF, 'Remarks by FATF President Marshall Billingslea' < <https://www.fatf-gafi.org/publications/fatfgeneral/documents/speech-fatf-ministerial.html> > accessed 30 June 2019

⁴ Mark T Nane, 'Re-thinking FATF an experimentalist interpretation of the Financial Action Task Force' (2018) 69 (2) *Crime, Law and Social Change* 131

⁵ Jackie Johnson, 'Third round FATF mutual evaluations indicate declining compliance (2008) 11 (1) *Journal of Money Laundering Control* 47

⁶ Carsten Ullrich, 'A risk-based approach towards infringements prevention on the internet adopting the anti-money laundering framework to online platforms' (2018) 26 (3) *International Journal of Law and Information Technology* 226

⁷ Lishan Ai and Jun Tang, 'Risk-based Approach for Designing Enterprise-wide AML Information System Solution' (2011) 18 *Journal of Financial Crime* 268

⁸ Carsten Ullrich, 'A risk-based approach towards infringements prevention on the internet adopting the anti-money laundering framework to online platforms' (2018) 26 (3) *International Journal of Law and Information Technology* 226

⁹ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) *Security Journal* 24

Hence, today a central element in contemporary AML/ CFT strategies is the idea that regulatory efforts should be risk-based.¹⁰ In order to comply with FATF standards, most of jurisdictions has established FATF compliant legislation and incorporated risk-based concept in statutory definition and mechanisms. However, the reality is that RBA's implementation suffers from several challenges.¹¹ Such as excessive human intervention, expensive name screening systems, arbitrary risk categorisation, inappropriate Customer Due Diligence (CDD), lacking well skilled and trained personnel¹², particularly in the absence of definition of 'Risk' and 'suspicion' in AML/CFT regime has resulted in its ineffective implementation.

In order to address aforesaid challenges some scholars articulate that merely RBA is not enough and therefore, suggests that AML/CFT regime need to adopt risk-based but risk-oriented¹³ approach. Another school of thought argue that an "uncertainty- based approach" will provide a better representation of the decision-making process followed by regulated entities.¹⁴ Ultimately, both schools of thought propose firstly, implement AML/CFT regulation keeping in mind countries own conditions', improve better concept of AML/CFT risk and align the interest of the regulated entities' with the regulators without the need for fines and other pressures.¹⁵

1.2 METHODOLOGY

This paper is based on the doctrinal and theoretical method to examine the characteristics of risk as it applies to AML/CFT strategy.¹⁶ However, in order to highlight implementation

¹⁰ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) *Journal of Money Laundering Control* 106

¹¹ Anna Simonova, 'The risk-based approach to anti-money laundering problems and solutions' (2011) 14 (4) *Journal of Money Laundering Control* 346

¹² Lishan Ai, John Broome and Hao Yan, 'Carrying out a risk-based approach to AML in China partial or full implementation?' (2010) 13(4) *Journal of Money Laundering Control* 394

¹³ Lishan Ai, 'Rule-based but risk-oriented" approach for combating money laundering in Chinese financial sectors' (2012) 15 (2) *Journal of Money Laundering Control* 198

¹⁴ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) *Security Journal* 24

¹⁵ *Ibid*

¹⁶ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) *Security Journal* 24

challenges, this paper illustrates incidents and cases to highlight the vulnerabilities of the regulated entities which cause ineffective AML/CFT regime.

1.3 STRUCTURE

This paper comprises of six chapters (including introduction and conclusion). **Chapter 2** is introduction and gives an overview of Financial Action Task Force (FATF) (international organization) along with its history, background and standards to build the arguments, 'why FATF consider that Risk-Based Approach (RBA) is a better approach to respond ML/TF' risk. **Chapter 3** discusses potential risks and impact of Money Laundering (ML) and Terrorist Financing (TF) on the international financial system and economy. It further discusses that, in order to prevent financial system, the regulated entities are obligate to comply with AML/CFT regulations otherwise breach may bring sever consequences such as civil penalties and criminal prosecutions. **Chapter 4** analyses the doctrine namely; uncertainty-based approach¹⁷ and derives that traditional theories of risk are not easily transferable to the arena of AML and CFT,¹⁸ especially when RBA based on decision making process and outcome of decision is uncertain. **Chapter 5** examines the attributes of CDD and particularly challenges faces by regulated entities to identify a prospective customer and suggest how different way of thinking to the problem of detecting and controlling money laundering and terrorist financing successfully adopted.¹⁹ And finally **Chapter 6** concludes and outlines a possible alternative proposition for example; (1) place coordination and collaboration requirement for the supervisors in FATF recommendation and (2) Penalty and sanction should not be imposed on the out-come of decision but on the weak AML/CFT framework.

¹⁷ Ibid

¹⁸ ibid

¹⁹ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

CHAPTER 2

FINANCIAL ACTION TASK FORCE (FATF) AND RISK-BASED REGIMES

2.1 ANTI-MONEY LAUNDERING (AML) AND COMBATING FINANCING OF TERRORISM (CFT) REGIMES

The international community, including the United Nations and other international organisations such as the World Bank (WB), the International Monetary Fund (IMF), and regional development banks, together with the FATF and FATF-Style Regional Bodies (FSRBs), plays a key role in combating money laundering and in developing strategies and guidelines for monitoring national compliance.²⁰ Coupled with private sector expert groups such as the Wolfsberg and Egmont Groups and national institutions including financial regulators, and legislative and judicial bodies, international efforts to prevent financial and predicated crimes require a complex and coordinated commitment from multiple actors.²¹

2.2 THE FINANCIAL ACTION TASK FORCE (FATF)

FATF is an intergovernmental organization founded in 1989 on the initiative of the G7 (Canada, France, Germany, Italy, Japan, United Kingdom and the United States) to develop policies to combat money laundering.²²

2.3 FATF'S RESPONSIBILITIES TOWARDS PREVENTION OF FINANCIAL CRIME

Initially, FATF had the responsibility of examining money laundering techniques and trends, reviewing the actions which had already been undertaken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering.²³

However, after passage of time its responsibilities has expended and now FATF is responsible for setting standards and promoting effective implementation of legal, regulatory and

²⁰ Willy Zapata Sagastume, Juan Carlos Moreno-Brid and Stefanie Garry, 'Money Laundering and Financial Risk Management in Latin America, with Special Reference to Mexico' (2016) 44 < <http://economiatyp.uam.mx/index.php/ETYP/article/view/238/343>> accessed 30 August 2019

²¹ Ibid

²² Usman W Chohan, 'The FATF in the Global Financial Architecture Challenges and Implications' (2019) Centre for Aerospace & Security Studies (CASS) Paper EC001UC < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3362167&download=yes> accessed 29 June 2019

²³ Ibid

operational measures to prevent ML, combat TF and other related threats to the integrity of the international financial system.²⁴ It also monitors countries and reviews ML and TF techniques (typologies), counter-measures and promotes the adoption and implementation of the FATF Recommendations globally.²⁵

2.4 RISK-BASED APPROACH: HISTORY AND BACK GROUND

In April 1990 the FATF issued a report containing a set of Forty Recommendations, which were intended to provide a comprehensive plan of action needed to fight against money laundering.²⁶ However, following the 9/11 terror attacks, in 2001 FATF issued eight special standards²⁷ on CFT in addition to the forty Recommendations,²⁸ which are subsequently comprehensively revised in 2003.²⁹

Thereafter, in October 2004 the FATF published a Ninth Special Recommendation, further strengthening the agreed international standards for combating terrorist financing and together called 40+9 recommendations.³⁰ By virtue of 40+9 recommendations countries were obliged to (i) ratify and implement UN instruments; (ii) freeze and confiscate terrorist assets; (iii) report suspicious transactions related to terrorism; (iv) have international co-operation to implement AML and CFT measures; (v) have measure to mitigate risk of remittance, wire transfer, non-profit organizations and cash courier.³¹

The continued evolution of ML/TF techniques led the FATF to revise the standards comprehensively in 2012; and they have been expanded to deal with new threats such as the financing of proliferation of weapons of mass destruction, and to be clearer on transparency and tougher on corruption.³² The FATF also made nine Special Recommendations of CFT, part

²⁴ FATF, 'Who we are' < <https://www.fatf-gafi.org/about/> > accessed 29 June 2019

²⁵ FATF, 'What we do' < <https://www.fatf-gafi.org/about/whatwedo/>> accessed 29 June 2019

²⁶ FATF, 'History of FATF' < <https://www.fatf-gafi.org/about/historyofthefatf/>> accessed 29 June 2019

²⁷ FATF, 'IX special recommendation' < <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/ixspecialrecommendations.html>> accessed August 30, 2019

²⁸ David Lewis, 'Counter-Terrorism Financing Summit' (Bangkok, 8 November 2018) < <https://www.fatf-gafi.org/publications/fatfgeneral/documents/speech-cft-conference-nov-2018.html> > accessed 29 June 2019

²⁹ FATF, 'History of FATF' < <https://www.fatf-gafi.org/about/historyofthefatf/>> accessed 29 June 2019

³⁰ Ibid

³¹ FATF, 'IX special recommendation' < <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/ixspecialrecommendations.html>> accessed August 30, 2019

³² FATF, 'History of FATF' < <https://www.fatf-gafi.org/about/historyofthefatf/>> accessed 29 June 2019

of the forty.³³ After the aforesaid revision FATF's 40 recommendations set out the essential measures that countries should have in place to:³⁴

- i. identify the risks, and develop policies and domestic coordination;³⁵
- ii. pursue money laundering, terrorist financing and the financing of proliferation;³⁶
- iii. apply preventive measures for the financial sector and other designated sectors;³⁷
- iv. establish powers and responsibilities for the competent authorities (e.g., investigative, law enforcement and supervisory authorities) and other institutional measures;³⁸
- v. enhance the transparency and availability of beneficial ownership information of legal persons and arrangements;³⁹ and
- vi. facilitate international cooperation.⁴⁰

Widely, FATF's 40 recommendations can be divided into seven Groups⁴¹, the following are table is comparison between old⁴² and new FATF's recommendations.

GROUP	TOPICS	Old Recommendation Number (2003)	New Recommendation Number (2012)
I	AML/CFT Policies and Coordination		
	Assessing risks and applying a risk-based approach	-	1

³³ David Lewis, 'Counter-Terrorism Financing Summit' (Bangkok, 8 November 2018) < <https://www.fatf-gafi.org/publications/fatfgeneral/documents/speech-cft-conference-nov-2018.html> > accessed 29 June 2019

³⁴ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated October 2018 < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 30 June 2019

³⁵ Ibid

³⁶ Ibid

³⁷ Ibid

³⁸ Ibid

³⁹ Ibid

⁴⁰ Ibid

⁴¹ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated October 2018 < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 30 June 2019

⁴² "R" denotes to 'recommendation' and SR is symbolised as 'special recommendation for CFT column of old recommendation.

	National cooperation and coordination	R. 33	2
II	Money Laundering and Confiscation		
	Money laundering offences	R.1 and R. 2	3
	Confiscation and provisional measures	R. 3	4
III	Terrorist Financing and Financing of Proliferation		
	Terrorist financing offences	SR. II	5
	Targeted financial sanctions related to terrorism and terrorist financing	SR. III	6
	Targeted financial sanctions related to proliferation	-	7
	Non-profit organizations	SR. VIII	8
IV	Financial and Non-Financial Institution Preventative Measures		
	Financial institution secrecy laws	R.4	9
	Customer due diligence and Record Keeping	R. 5 and 10	10 and 11
	Additional measures for specific customers and activities		
	Politically exposed persons	R. 6	12
	Correspondent banking	R. 7	13
	Money or value transfer services	SR. VI	14
	New technologies	R. 8	15

	Wire transfers	SR. VII	16
	Reliance, controls and financial groups		
	Reliance on third parties	R. 9	17
	Internal controls and foreign branches and subsidiaries	R. 15 and R. 22	18
	Higher-risk countries	R. 21	19
	Reporting of suspicious transactions		
	Reporting of suspicious transactions	R. 13 and SR. IV	20
	Tipping-off and confidentiality	R. 14	21
	Designated non-financial businesses and professions (DNFBPs)		
	DNFBPs: Customer due diligence	R. 12	22
	DNFBPs: Other measures	R. 16	23
	Transparency and Beneficial Ownership of Legal Persons and Arrangements		
V	Transparency and beneficial ownership of legal persons	R. 33	24
	Transparency and beneficial ownership of legal arrangements	R. 34	25
	Powers and Responsibilities of Competent Authorities and Other Institutional Measures		
VI	Regulation and supervision of financial institutions	R. 23	26

	Powers of supervisors	R. 29	27
	Regulation and supervision of DNFBPs	R. 24	28
	Financial intelligence units	R. 26	29
	Responsibilities of law enforcement and investigative authorities	R. 27	30
	Powers of law enforcement and investigative authorities	R. 28	31
	Cash couriers	SR. IX	32
	Statistics	R. 32	33
	Guidance and feedback	R. 25	34
	Sanctions	R. 17	35
VII	International Cooperation		
	International instruments	R. 35 and SRI	36
	Mutual legal assistance	R. 36 & SRV	37
	Mutual legal assistance regarding freezing and confiscation	R. 38	38
	Extradition	R. 39	39
	Other forms of international cooperation	R. 39	40

The FATF Standards have been revised to strengthen the requirements for higher risk situations, and to allow countries to take a more focused approach in areas where high risks remain, or implementation could be enhanced.⁴³ Therefore, countries are required; first identify, assess and understand ML/TF risks that they face, and then adopt appropriate measures to mitigate the risk.⁴⁴ The risk-based approach allows countries, within the framework of the FATF requirements, to adopt a more flexible set of measures, in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risk, in order to focus their effort in the most effective manner.⁴⁵

2.5 FATF's RISK-BASED GUIDANCE

FATF has so far issued four rounds of updated and adjusted RBA guidance⁴⁶, which are subsequently being introduced into national laws by its member countries and beyond.⁴⁷ These RBA guidance, not only are traditional credit and financial institutions, but it also applies to Designated Non-Financial Businesses and Professions (DNFBPs) for example securities companies, casinos, real estate agents, legal professionals, accounting professionals, trust and company service providers, virtual assets and virtual asset services providers, life insurance, money and value transfer services, prepaid cards, mobile payments and internet-based payment services, dealers in precious metal and stones⁴⁸ (here-in-after called 'regulated entities'). Hence, as per FATF's standards the regulated entities were given obligations and so-called flexibility to perform their own risk assessment according to their product mix, customer base and geographic exposure.⁴⁹

2.6 LEGAL MECHANISM OF RISK-BASED APPROACH

⁴³ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019

⁴⁴ Ibid

⁴⁵ Ibid

⁴⁶ FATF Risk Based Approach Guidance , 'The Rational of Risk Based Approach' (FATF 2019) < [https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 30 July 2019

⁴⁷ FATF, 'FATF Countries' < <http://www.fatf-gafi.org/countries/>> accessed 30 June 2019

⁴⁸ Ibid

⁴⁹ Stravros Gadinis and Colby Mangels, 'Collaborative Gatekeepers' (2016) 73 (2) Washington & Lee Law Review 797

FATF has set up afore-stated international standards and subsequently these recommendations are being adopted and merged into national laws by its members and beyond.⁵⁰ Hence, by virtue of national and international legislations, regulated entities are responsible to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.⁵¹

Interestingly, on one hand RBA entitles the countries to set standards according to their own situation⁵² and recognise that countries have differences in their legal, operation and financial system and unable to set identical standards. Whereas, on the other hand forces to adopt FATF's recommendation without any amendment.⁵³ Consequently, 205 jurisdictions adopted FATF's RBA standards without keeping in mind their own situation and made them part of legislation (for example, UK, China, Pakistan and United states whose AML/ CFT regulations are replica of each other). This is the reason that more than 60% of the countries failed to meet the FATF standards and considered as 'non-compliant' and 'High risk'.⁵⁴

2.7 CONCLUSION

FATF and FSRBs along with other international organization are making effort to craft standards and recommendations to prevent the international financial system and society from predicated/ designated crimes and ultimately lead to RBA. Interestingly, RBA to allows countries, to adopt a flexible set of measures, to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, to focus their efforts in the most effective way.⁵⁵ Whereas, contrary to RBA objective (flexibility), FATF has universal

⁵⁰ FATF, 'FATF Countries' < <http://www.fatf-gafi.org/countries/>> accessed 30 June 2019

⁵¹ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated October 2018 < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>> accessed 30 June 2019

⁵² Ibid

⁵³ Ibid

⁵⁴ Basel Institute on Governance, *A country ranking and review of money laundering and terrorist financing risks around the world* (Basel AML Index, 2019) International Centre for Asset Recovery 6 < <https://www.baselgovernance.org/sites/default/files/2019-08/Basel%20AML%20Index%202019.pdf>> accessed 11 September 2019

⁵⁵ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated October 2018 < <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>> accessed 30 June 2019

procedure⁵⁶ to assess the countries' compliance levels of implementation of its recommendations⁵⁷ rather assess them according to their own situation.

⁵⁶ Procedure for the FATF Fourth round of AML/CFT mutual Evaluation (updated June 2019) and Methodology for assessing Technical Compliance with FATF recommendation and the effectiveness of AML/CFT systems are published < [https://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 28 June 2019 and Universal consolidated process and procedure for mutual evaluation and follow-up (updated June 2019) published < <https://www.fatf-gafi.org/publications/mutualevaluations/documents/universal-procedures.html>> accessed 28 June 2019

⁵⁷ FATF, 'Mutual evaluation' < [https://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 28 June 2019

CHAPTER 3

FINANCIAL AND PREDICATED CRIME: THREAT TO ECONOMY AND HUMAN SURVIVAL

3.1 INTRODUCTION

The purpose of this chapter is to discuss the elements, with illustrations, which forced FATF and other international bodies, for example; Bank for International Settlement (BIS), European Union (EU) and International Monetary Funds (IMF) to set up standards to prevent international financial system from the predicated and designated crimes. Since, ML and TF possess high risk as they are not only capable of damaging the international financial system and economy and hence human survival. This chapter defines ML/TF and then analyses the protentional risk it carries for international financial system, which caused to craft RBA legislations. Whereas, RBA has several implementation complexities and challenges as discuss chapter 3 and 4.

3.2 MONEY LAUNDERING (ML)

ML is one of designated crimes (such as; fraud, smuggling, terrorism, corruption and bribery)⁵⁸ and encompasses of three distinct, alternative actus reas: (i) the conversion or transfer, knowing that such property is the proceed of crime (ii) the concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime; and (iii) the acquisition, possession or use of property, knowing, at the time of the receipt, that such property is the proceeds of crime.⁵⁹

Simply, ML is the criminal practice of processing ill-gotten gains and dirty money through a series of transactions, in this way the funds are “cleaned” so that they appear to be proceeds from legal activities”.⁶⁰ Ill-gotten money includes, but is not limited to, illegal arm sales, the

⁵⁸ FATF, 'Designated categories of offence' <<https://www.fatf-gafi.org/glossary/d-i/>> accessed 1 September 2019

⁵⁹ United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (adopted 20 December 1988, entered into force 11 November 1990) 1582 UNTS 95 (an informal/ shortened title) and United Nations Convention against Transnational Organized Crime Resolution (adopted by 15 November 2000, entered into force 8 January 2001) A/AES/55/25 (without reference to a Main Committee)

⁶⁰ Federal Financial Institutions Examination Council, 'Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2014) <<https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ffiec-bsa-aml-examination-manual.pdf>> accessed 17 July 2019

illegal sale of wildlife, prostitution, fraud and embezzlement, insider trading and securities fraud, bribery and corruption, tax evasion, and siphoning off of aid funds.⁶¹ ML is a crime and constantly changing in terms of modus operandi and extent of risk involved. Consequently, the individuals who are responsible for implementing an effective RBA (here-in-after called 'responsible person') within the regulated entities are required to acquire knowledge and constantly upgrade their skills to avoid lapses in decision-making process.

3.3 STAGES OF MONEY LAUNDERING CYCLE

Money trail is evidence of crime and the money itself is vulnerable to seizure and must be protected. Therefore, in order to protect the laundered money, criminals plot diverse and complex process⁶² and amazingly currency is not involved at every stage of the laundering process.⁶³

The process of ML involves dynamic three-stage, namely placement, layering and structuring.⁶⁴

⁶¹ Jackie Johnson, 'In Pursuit of Dirty Money Identifying Weaknesses in the Global Financial System' (2001) 5(2) Journal of Money Laundering Control 122

⁶² UNODC, 'The Money Laundering Cycle' (United Nation office on Drugs and Crime 2019) < <https://www.unodc.org/unodc/en/money-launderinglaundrycycle.html> > accessed on July 21, 2019

⁶³ Federal Financial Institutions Examination Council, 'Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2014) < <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ffiec-bsa-aml-examination-manual.pdf>> accessed 17 July 2019

⁶⁴ UNODC, 'The Money Laundering Cycle' (United Nation office on Drugs and Crime 2019) < <https://www.unodc.org/unodc/en/money-launderinglaundrycycle.html> > accessed on July 21, 2019

The Money-Laundering Cycle

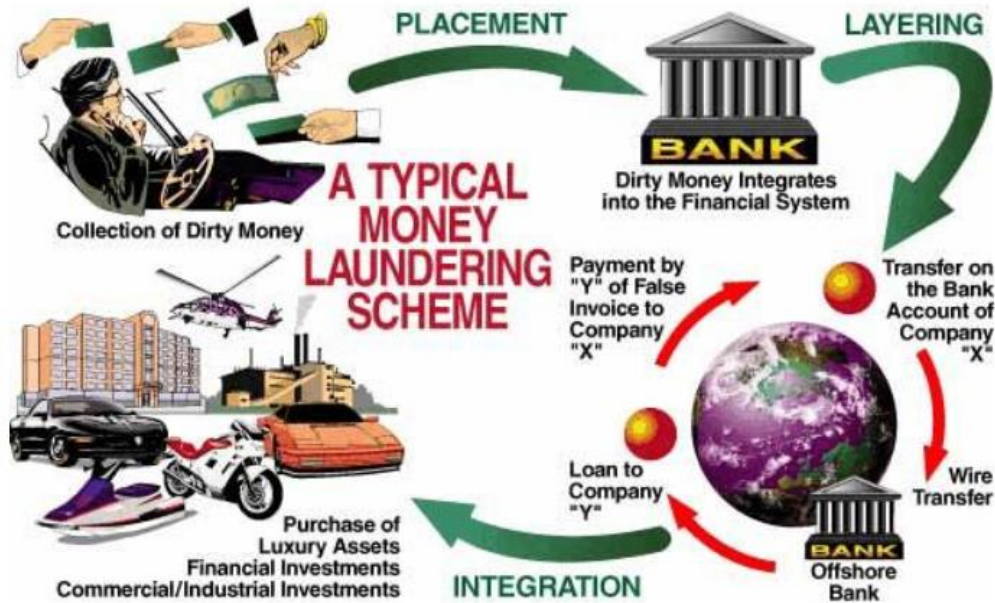


Figure No. 1⁶⁵ (United Nation office on Drugs and Crime)

The figure No. 1 is an illustration to reveal complex techniques, criminals use to launder money. The first and most vulnerable stage of laundering money is “placement”. The goal is to introduce the unlawful proceeds into the financial system without attracting the attention of financial institutions or law enforcement.⁶⁶ Placement techniques include structuring currency deposits in amounts to evade reporting requirements or commingling currency deposits of legal and illegal enterprises.⁶⁷ For example, dividing large amounts of currency into less-conspicuous smaller sums that are deposited directly into a financial institution, depositing a refund check from a cancelled vacation package or insurance policy, or purchasing a series of monetary

⁶⁵ ibid

⁶⁶ Federal Financial Institutions Examination Council, 'Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2014) < <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ffiec-bsa-aml-examination-manual.pdf>> accessed 17 July 2019

⁶⁷ Ibid

instruments (e.g., cashier's checks or money orders) that are then collected and deposited into accounts at another location or financial institution.⁶⁸

Once, criminals succeed to place illicit funds in the financial system, they proceed towards layering stage. This stage enables criminals to move funds around the financial system, often in a complex series of transactions to create confusion and complicate the paper trail.⁶⁹ For example, exchanging monetary instruments for larger or smaller amounts or wiring or transferring funds to and through numerous accounts in one or more financial institutions.⁷⁰

Finally, criminals seemingly "clean" funds integrate into streams of economic activity⁷¹ by using illicit fund to purchase and resale of real estate, investment securities, foreign trusts, or other assets. These transactions further shield the criminal from a recorded connection to the funds by providing a plausible explanation for the source of the funds.⁷²

Further, e-commerce is vulnerable for ML and usually dirty money integrates by selling electronic vouchers on marketplaces or auction sites and conveniently cleans funds transfer in the wallet, bank transfer, or is cashed.⁷³ Another method is to convert the money into cryptocurrency where it disappears off the radar; once cryptocurrency is sold, the funds from the sale become extremely difficult to trace back to the original source.⁷⁴

As discussed, first stage (placement) of ML is the most vulnerable stage whereby, illicit funds may integrate in the financial system. Therefore, it is crucial that regulated entities have RBA measures to identify and know the potential customer and prevent their system form criminals,

⁶⁸ Ibid

⁶⁹ Ibid

⁷⁰ Ibid

⁷¹ Mariano - Florentino Cuéllar, 'The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance (2003) 93 Journal of Criminal Law and Criminology 311

⁷² Federal Financial Institutions Examination Council, 'Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2014) <<https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ffiec-bsa-aml-examination-manual.pdf>> accessed 17 July 2019

⁷³ Vanessa Norhausen, 'The Battle Against Money Laundering' (Checkout.com, 19 March 2019) <<https://www.checkout.com/company/blog/post/the-battle-against-money-laundering>> accessed 06 September 2019

⁷⁴ ibid

dirty money and/ or illicit transaction. In order to explain risk and impact of criminal activities, some real cases illustrate here-in-below. Whereas, practical complications of Customer Due Diligence (CDD) and particularly identification of potential customer discusses here-in-below.

3.4 TERRORIST FINANCING

Terrorist financing involves the solicitation, collection or provision of funds with the intention that they may be used to support terrorist acts or organisations. Funds may stem from both legal and illicit sources.⁷⁵ The primary goal of individuals or entities involved in the financing of terrorism is not necessarily to conceal the sources of the money but to conceal both the financing and the nature of the financed activity.⁷⁶ Money laundering is only vehicle, by applying terrorist groups get access on unlimited money, to compensate fighters and their families; buy weapons, food, and fuel; and bribe crooked officials.⁷⁷ Since, money is the life blood for the terrorist and terrorist organization, FATF has emphasised the Transparency and identification of beneficial ownership of legal persons⁷⁸ and arrangements⁷⁹.

Overall, ML and TF presents the world community with a complex and dynamic challenge. Crime has become increasingly international in scope, and the financial aspects of crime have become more complex due to rapid advances in technology and the globalisation of the financial services industry⁸⁰ for example electronic frauds.

3.5 EFFECTS OF MONEY LAUNDERING & TERRORIST FINANCING

Implementation of an effective RBA is essential as ML has potentially devastating economic, security, and social consequences. It provides the fuel for drug dealers, terrorists, illegal arms

⁷⁵ International Monetary Fund, 'Anti-Money Laundering/ Combating the Financing of Terrorism (AML/CFT)' < <https://www.imf.org/external/np/leg/amlcft/eng/aml1.htm#moneylaundering> > accessed 20 July 2019

⁷⁶ Ibid

⁷⁷ Rhoda Weeks-Brown, 'cleaning up Countries are advancing efforts to stop criminals from laundering their trillions' (International monetary funds, 2018) 55 (4) finance and Development department 44 < <https://www.imf.org/external/pubs/ft/fandd/2018/12/imf-anti-money-laundering-and-economic-stability-straight.htm> > accessed 28 July 2019

⁷⁸ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019, Recommendation 24

⁷⁹ Ibid, Recommendation 25

⁸⁰ John McDowell and Gary Novis, 'The consequences of money laundering and financial crime' (Bureau of International Narcotics and Law Enforcement Affairs, US Department of State, 2001) 6(2) An Electronic Journal of the US Department of State < <http://usinfo.state.gov/journals/ites/0501/ijee/ijee0501.pdf> > accessed 30 August 2019

dealers, corrupt public officials, and others to operate and expand their criminal enterprises.⁸¹ For example, a Guinean minister helped a foreign company obtain important mining concessions in exchange for \$ 8.5 million in bribes. Falsely reporting that money as income from consulting work and private land sales, the minister transferred it to the United States and bought a luxury estate in New York⁸², and ill-gotten money conveniently integrated in the economy. Regardless, his effort to turn ill-gotten gains into a seemingly legitimate asset was ultimately unsuccessful and he was convicted of money laundering⁸³. Timely detection of laundering activities is the most challenging aspect in the implementation of an efficient AML program as criminals always find newer ways to use financial institutions for illegal activities.⁸⁴

The situation is getting alarming, and despite of International standards, guidelines, legislations and endless effort of AML/CFT regime; predicated crimes continue to cripple economies, distort international finances and harm citizens around the globe.⁸⁵ ML is a criminal activity against governments and countries and threatens national security because of its link with TF⁸⁶, whether because of lingering legal and institutional loopholes or innovation on the part of criminals (or both).⁸⁷

3.5a ECONOMIC DISTORTION AND INSTABILITY

ML has negative impact in the national and international economy, as money launderers are not interested in profit generation from their investments but rather in protecting their

⁸¹ *ibid*

⁸² Tessica C Watt, 'Money Laundering Watch Former Guinean Minister of Mines Sentenced to Seven Years in Prison for Laundering \$8.5 Million in Bribes Paid by Chinese Companies in Exchange for Mining Rights' (Ballard Spae LLP, 30 August 2017) < <https://www.moneylaunderingnews.com/2017/08/former-guinean-minister-mines-sentenced-seven-years-prison-laundering-8-5-million-bribes-paid-chinese-companies-exchange-mining-rights/>> accessed 28 July 2019

⁸³ *Ibid*

⁸⁴ Vani Muppayanamath, 'Anti-Money Laundering Challenges and Trends' (White paper, Tata Consultancy Services, 2017) < <https://www.tcs.com/content/dam/tcs/pdf/Industries/Banking%20and%20Financial%20Services/Anti-Money%20Laundering%20-%20Challenges%20and%20trends.pdf>> accessed 5 August 2019

⁸⁵ International Centre for Asset Recovery, 'Basel AML Index Report' (Basel Institute of Governance, 2018) < https://www.baselgovernance.org/sites/default/files/2019-02/basel_aml_index_10_09_2018.pdf> accesses 21 July 2019

⁸⁶ Norman Loyayza, Edgar Villa Martha Misas, 'Illicit activity and money laundering from an economic growth perspective A model and an application of Colombia' (2019) 159 *Journal of Economic Behaviour & Organization* 442

⁸⁷ Rhoda Weeks-Brown, 'cleaning up Countries are advancing efforts to stop criminals from laundering their trillions' (International monetary funds, 2018) 55 (4) *finance and Development department* 44 < <https://www.imf.org/external/pubs/ft/fandd/2018/12/imf-anti-money-laundering-and-economic-stability-straight.htm> > accessed 28 July 2019

proceeds.⁸⁸ Thus they invest their funds in activities that are not necessarily economically beneficial to the country where the funds are located.⁸⁹ For example Mossack Fonseca (Pamana)⁹⁰ has created 214,000 shell companies in the tax heavens making their real owners untraceable through public records and hide politicians and public officials and government leaders.⁹¹

Furthermore, financial crime redirects funds from sound investments to low-quality investments that hide their proceeds, economic growth can suffer.⁹² In some countries, for example, entire industries, such as construction and hotels, have been financed not because of actual demand, but because of the short-term interests of money launderers. When these industries no longer suit the money launderers, they abandon them, causing a collapse of these sectors and immense damage to economies that could ill afford these losses.⁹³

3.5b LOSS OF CONTROL OF ECONOMIC POLICY

Because of the clandestine nature of money-laundering, it is difficult to estimate the total amount of money that goes through the laundry cycle.⁹⁴ However, no one can deny that the world economy is in continuous threat due to huge level of money laundering, for example, in 2017 estimated amount of worldwide money laundering was from US\$500 billion to a staggering US\$1 trillion.⁹⁵ Moreover, recently reported that globally estimated amount of

⁸⁸ John McDowell and Gary Novis, 'The consequences of money laundering and financial crime' (Bureau of International Narcotics and Law Enforcement Affairs, US Department of State, 2001) 6(2) An Electronic Journal of the US Department of State < <http://usinfo.state.gov/journals/ites/0501/ijee/ijee0501.pdf> > accessed 30 August 2019

⁸⁹ Ibid

⁹⁰ Luke Haring, 'What are the Panama Papers? A guide to history's biggest data leak' The Guardian (London, 5 April 2016)

⁹¹ Three years after the Panama Papers Progress on Horizon' (Transparency International, 4 April 2019 < https://www.transparency.org/news/feature/three_years_after_the_panama_papers_progress_on_horizon accessed 14 September 2019

⁹² John McDowell and Gary Novis, 'The consequences of money laundering and financial crime' (Bureau of International Narcotics and Law Enforcement Affairs, US Department of State, 2001) 6(2) An Electronic Journal of the US Department of State < <http://usinfo.state.gov/journals/ites/0501/ijee/ijee0501.pdf> > accessed 30 August 2019

⁹³ Ibid

⁹⁴ UNODC, 'Money-Laundering and globalization' (United Nations office Drug and Crime, 2019) < <https://www.unodc.org/unodc/en/money-laundering/globalization.htm> > accessed 21 July 2019

⁹⁵ Council of Europe, 'Annual Report MONEYVAL Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism' (2017) < <https://rm.coe.int/moneyval-annual-report-2017-eng/16808af3c2> > accessed 21 July 2019

money laundered in a year is 2 - 5% of global Gross Domestic Product (GDP), or USD 1.6 to USD 4 trillion.⁹⁶

Keeping in mind quantum of ML, there is nothing strange that in some emerging market countries these illicit proceeds may dwarf government budgets, resulting in a loss of control of economic policy by governments. Indeed, in some cases, the sheer magnitude of the accumulated asset base of laundered proceeds can be used to corner markets or even small economies.⁹⁷ Further, such a huge amount of ML, is a direct question on effectiveness of RBA and there is yet room for changing it approach to fix.

3.5c UNDERMINING THE INTEGRITY OF FINANCIAL MARKETS

Financial institutions that rely on the proceeds of crime have additional challenges in adequately managing their assets, liabilities, and operations. For example, large sums of laundered money may arrive at a financial institution but then disappear suddenly, without notice, through wire transfers in response to non-market factors, such as law enforcement operations.⁹⁸ This can result in liquidity problems and runs on financial institutions.⁹⁹ Indeed, criminal activity has been associated with a number of financial institutions failures around the globe, including the failure of the first Internet bank and the European Union Bank.¹⁰⁰ Furthermore, some financial crises of the 1990s such as the fraud, money laundering, and bribery scandal at BCCI¹⁰¹ and the 1995 collapse of Barings Bank¹⁰² as a risky derivatives scheme carried out by a trader at a subsidiary unit had significant criminal or fraud components. Likewise, recently Versobank in Estonia has closed-down due to misconduct, misrepresentation and involvement of ML.¹⁰³ Likewise,

⁹⁶ UNODC, 'Money-Laundering and globalization' (United Nations office Drug and Crime, 2019) < <https://www.unodc.org/unodc/en/money-laundering/globalization.htm>> accessed 21 July 2019

⁹⁷ John McDowell and Gary Novis, 'The consequences of money laundering and financial crime' (Bureau of International Narcotics and Law Enforcement Affairs, US Department of State, 2001) 6(2) An Electronic Journal of the US Department of State< <http://usinfo.state.gov/journals/ites/0501/ijee/ijee0501.pdf> > accessed 30 August 2019

⁹⁸ Ibid

⁹⁹ Ibid

¹⁰⁰ Ibid

¹⁰¹ Steven Mufson and Jim McGee, 'BCCI scandal behind the 'bank of crooks and criminals'' The Washington post (Washington, 28 July 1991)

¹⁰² Richard W Stevenson, 'Breaking the Bank -- A special report.; Big Gambles, Lost Bets Sank a Venerable Firm' The New York Times (New York, 3 March 1995)

¹⁰³ Lennart Ruuda, 'Bank suspected of money laundering was closed down overnight' Postimees (Estonin, 27 March 2018)

another bank, Danske Bank has been ordered to close-up due to money laundering scandal.¹⁰⁴ Amazingly, these collapsed financial institutions were operating in the so-called 'low risk' countries but this fact indicates that there is some gap between regulators and regulated entities. And heavy penalties, strict accountability and sanction is not solution, as discussed in Part 4.6 of this paper but RBA regime need to do more to gain effectiveness.

3.5d IMPAIRMENT IN CURRENCIES VALUE AND INTEREST RATE

ML can also adversely affect currencies and interest rates, as launderers reinvest funds where their schemes are less likely to be detected, rather than where rates of return are higher. And it can increase the threat of monetary instability due to the misallocation of resources from artificial distortions in asset and commodity prices.¹⁰⁵ For example, Panama vulnerable to money laundering, including those related to corruption, drug trafficking and other predicate crimes, such as tax crimes committed abroad.¹⁰⁶ despite the vulnerability, panama has strong international financial linkage, for example offshore banks have a significant claim on Panamanian borrowers, which stood at US\$85 billion (137.7 percent of GDP) at end-September 2017.¹⁰⁷

The Panamanian authorities have identified banks as a higher risk sector for AML/CFT and causing domestically and internationally volatility in the interest rate.¹⁰⁸ In other words, the sheer magnitude of the economic power that accrues to criminals from money laundering has a corrupting effect on all elements of society.¹⁰⁹

¹⁰⁴ Martin Young, 'Short the Bankers Another major bank ordered closed for money Laundering' (News BTC, 6 September 2019) < <https://www.newsbtc.com/2019/02/20/short-the-bankers-another-major-bank-ordered-closed-for-money-laundering/> > accessed 06 September 2019

¹⁰⁵ John McDowell and Gary Novis, 'The consequences of money laundering and financial crime' (Bureau of International Narcotics and Law Enforcement Affairs, US Department of State, 2001) 6(2) An Electronic Journal of the US Department of State < <http://usinfo.state.gov/journals/ites/0501/ijee/ijee0501.pdf> > accessed 30 August 2019

¹⁰⁶ International Monetary Funds, PANAMA selected issues (IMF Country Report No. 19/12) 14 < [Panama Selected Issues: IMF Country Report No. 19/12; November 21, 2018](#) > accessed 30 August 2019

¹⁰⁷ ibid

¹⁰⁸ Ibid

¹⁰⁹ ibid

3.5e E-COMMERCE IMPAIRMENT DUE TO ONLINE FRAUD

As afore-stated that financial technology is vulnerable and companies who have lax controlled e-commerce system are easy target of the criminals. For example, recently it has discovered that criminals had begun using the in-game currency of video game 'Fortnite' to launder money.¹¹⁰ It found that stolen credit card details were being used to purchase V-bucks, the virtual currency used by players for in-game purchases.¹¹¹ The V-bucks are then sold on to players at a discounted rate, enabling the criminals to effectively "clean" the money.¹¹² Severity of misuse of technology development can be assessed by the fact that Fortnite's players (including the criminals) moved more than USD three billion worth of transactions through the game in 2018.¹¹³ Although accurate amount of illicit sales is unknown, a cybersecurity firm monitored eBay for only sixty days and found that over USD 250,000 in Fortnite's items or accounts were sold through the auction site¹¹⁴, which are suspected as illicit transaction. Further, e-commerce's popularity resulted in increased money flow and usage of mobile payments, which contribute largely to e-commerce sales, have all made the digital payments landscape vulnerable to criminal activity.¹¹⁵ Unfortunately, "Cybercriminals are already a step ahead and have found numerous loopholes in the relatively nascent e-commerce and Financial Technology (fintech) ecosystems".¹¹⁶

3.6 MONEY LAUNDERING MAY SUPPORT TO INCREASE TERRORISM

ML not only deteriorate economy but provides life blood (money) to the criminals and their illicit activities and threatened or actual use of illegal force and violence by non-state actors to attain

¹¹⁰ Anthony Cuthbertson, 'How children playing Fortnite are helping to fuel organized crime' The independence (London, 13 January 2019)

¹¹¹ Ibid

¹¹² Ibid

¹¹³ Cal Jeffery, 'Criminals are laundering money through kids playing Fortnite' (Techspot, 23 January 2019) < <https://www.techspot.com/community/topics/criminals-are-laundering-money-through-kids-playing-fortnite.251551/>> accessed 20 July 2019

¹¹⁴ Ibid

¹¹⁵ Vanessa Norhausen, 'The Battle Against Money Laundering' (Checkout.com, 19 March 2019) < <https://www.checkout.com/company/blog/post/the-battle-against-money-laundering>> accessed 06 September 2019

¹¹⁶ ibid

a political, economic, religious or social goal through fear, coercion or intimidation.¹¹⁷ Unfortunately, “the world has been gripped by a wave of terrorist attacks that began shortly after the 9/11 attacks”.¹¹⁸ According to most recent independent global statistics , it was recorded that within one year 10,900 terrorist attacks around the world, which killed more than 26,400 people, including 8,075 perpetrators and 18,488 victims.¹¹⁹ Similarly, In 2014 “terrorist violence was in peak and nearly 17,000 attacks and more than 45,000 total deaths were recorded”.¹²⁰ Moreover, a drastically hike in the violence can be evident that within eight months of 2019, about 1,441 terror attacks and 6,466 casualties has been reported.¹²¹

The aforesaid statistics and data establish that ML is what enables criminals to reap the benefits of their crimes, and a direct threat to economic stability.¹²² Illicit funds and illegal transactions leads to corruption and tax evasion, which make it difficult for governments to deliver sustainable and inclusive growth by diminishing the resources available for productive purposes, such as building roads, schools, and hospitals. “Criminal activity undermines state authority and the rule of law while squeezing out legitimate economic activity”.¹²³

Although, countries have adopted FATF’s recommendations, whether voluntary or under peer pressure, knowing the fact that once a country comes to be “viewed as vulnerable to illicit financial flows, their financial system may face long-term reputational damage, costly demands for additional documentation and the loss of business. This may marginalize already fragile

¹¹⁷ Gary LaFree, Laura Dugan and Erin Miller, Putting Terrorism in Context Lesson from the global terrorism database (1st edn, Routledge 2014)

¹¹⁸ ‘Will Terrorism continue to decline in 2019?’ (The conversation, 27 February 2019) < <https://theconversation.com/will-terrorism-continue-to-decline-in-2019-104466>> accessed 29 July 2019

¹¹⁹ ‘GDT Global Terrorist Database’ Codebook Inclusion Criteria and Variables’ (START, July 2018) < <https://www.start.umd.edu/gtd/downloads/Codebook.pdf>> accessed 30 July 2019 and Erine Miller and Willam Kammerer, ‘Global Terrorism in 2017’ (University of Maryland, August 2018) <https://www.start.umd.edu/pubs/START_GTD_Overview2017_July2018.pdf> accessed 30 July 2019

¹²⁰ *ibid*

¹²¹ (esri Terrorist attacks, 30 July 2019) < <https://storymaps.esri.com/stories/terrorist-attacks/>> accessed 30 July 2019

¹²² Rhoda Weeks-Brown, ‘cleaning up Countries are advancing efforts to stop criminals from laundering their trillions’ (International monetary funds, 2018) 55 (4) finance and Development department 44 < <https://www.imf.org/external/pubs/ft/fandd/2018/12/imf-anti-money-laundering-and-economic-stability-straight.htm> > accessed 28 July 2019

¹²³ *ibid*

economies, threaten remittance channels and foreign direct investment, and drive financial flows underground".¹²⁴

Unfortunately, regardless continue efforts and investment, AML regime have been staying ahead of the curve.¹²⁵ As the ML/FT typologies are advanced compare to AML/CFT regime due to their reactive ethos and despite having new piece of technology, legislation and regulation, there comes a new challenge. Yet, it is often believed that AML/CFT regime are barely scratching the surface when it comes to detection and prevention.¹²⁶ The criminals seem always to be a step ahead, adopting more and more sophisticated practices to move and "clean" money. As such, it seems almost impossible for the agencies to keep up with this constantly evolving landscape, because as soon as one avenue is closed, another opens-up.¹²⁷

Frustratingly, by the time procedures are in place to combat these new typologies, the criminals will have already moved on to another method of laundering money, such is the nature of the game.¹²⁸ While the reality of completely stopping such criminal activity is extremely difficult, however, the regulated entities may take some action to mitigate the phenomenon, including monitoring the transfer of high-value goods, identification of customer and sharing data with relevant law enforcement agencies.¹²⁹ that can be taken to mitigate the problem going forward, particularly as the current practices appear to have reached a stalemate in various cases.¹³⁰

¹²⁴ Ibid

¹²⁵ Michael Harris, 'Money laundering Part 2 - how money laundering is impacting compliance teams on the ground' (2019) 8 (2) Compliance & Risk Journal 8

¹²⁶ Ibid

¹²⁷ Ibid

¹²⁸ Ibid

¹²⁹ FATF Risk Based Approach Guidance : The Rational of Risk Based Approach (FATF 2019) < [https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 30 July 2019 and Cal Jeffery, 'Criminals are laundering money through kids playing Fortnite' (Techspot, 23 Jnauary 2019) < <https://www.techspot.com/community/topics/criminals-are-laundering-money-through-kids-playing-fortnite.251551/>> accessed 20 July 2019

¹³⁰ Michael Harris, 'Money laundering Part 2 - how money laundering is impacting compliance teams on the ground' (2019) 8 (2) Compliance & Risk Journal 8

3.7 CONSEQUENCES FOR NON-COMPLIANCE OF FATF'S STANDARDS

The importance of AML/CFT standards are so significant that almost every country has criminalized money laundering and terrorism financing and established a legal framework to freeze terrorist assets.¹³¹ The national regulations are becoming stricter ever and apart from fines and sanction, regulators continue to emphasize the role of individual compliance officers, senior executives and board members, and have increased attempts to hold them personally liable for compliance failures.¹³² For example, The Financial Crimes Enforcement Network ("FinCEN") and the U.S. Attorney's Office for the Southern District of New York announced that former Chief Compliance officer held personally liable and he was barred from performing a compliance function for three years and liable to pay a \$250,000 penalty due violation of Banking Secrecy Act 1970 (USA) and breach of AML Regulations.¹³³ Similarly, USA has imposed €15 million fine on Swiss Bank UBS's French subsidiary, and fines of up to € 500,000 for six top executives¹³⁴, as they failed to file suspicious activity reports and did not have a reasonably designed AML program to monitor high-risk accounts belonging to non-US residents.¹³⁵

The risk of non-compliance with AML (including but not limited to Know Your Customer ("KYC") and Sanctions) requirements continues to increase, and as evidenced by several high-profile fines and investigations in recent years, regulated entities are increasingly under pressure to identify ways to manage their AML risks more effectively.¹³⁶ As per an independent report since 2008 to 2018, the regulators of the worldwide (the North American, European and Asia Pacific regions) financial Institutions has fined approximately \$26 billion for non-compliance with AML,

¹³¹ Rhoda Weeks-Brown, 'cleaning up Countries are advancing efforts to stop criminals from laundering their trillions' (International monetary funds, 2018) 55 (4) finance and Development department 44 < <https://www.imf.org/external/pubs/ft/fandd/2018/12/imf-anti-money-laundering-and-economic-stability-straight.htm> > accessed 28 July 2019

¹³² Debevoise In Depth, '2018/2019 Anti-Money Laundering Review and Outlook' (Debevoise & Plimpton LLP, 5 February 2019) < [20190205_2018_Anti_Money_Laundering_Review_and_Outlook.pdf](#) > accessed 5 August 2019

¹³³ U S Department of Treasury v. Haider, *Case No. 015-cv-01518 (D Minn)*

¹³⁴ 'Swiss bank UBS faces French court ruling on fraud charges' Malaymail (Malaysia, 20 February 2019)

¹³⁵ Daniel Neale, 'Taking stock of 2018's money laundering scandals When is enough enough? (Part 1)' (Global Financial Integrity, 6 January 2019) < <https://gfintegrity.org/taking-stock-of-2018-part-1/>> accessed September 10, 2019

¹³⁶ PWC, 'Financial Crime Guidance 2018 An evolving Regulatory Landscape (2018)' < <https://www.pwc.co.uk/services/forensic-services/financial-crime/our-insights/financial-crime-guide-tool-and-global-financial-crime-resource-m.html> > accessed 29 July 2019

KYC and sanctions regulations.¹³⁷ Further, lately Financial Conduct Authority (FCA - UK) has imposed roughly £201.2 million fine on Standard Chartered Bank for non-compliance of AML/CFT standards, such as having poor control on CDD and on-going monitoring of high-risk products.¹³⁸

Concisely, only in 2018 financial regulators around the world imposed more than USD 2.9 billion in fines related to AML compliance failures, thirty-eight (38) AML enforcement actions initiated or concluded and eight (8) senior compliance managers were held personally liable, made them barred from employment and imposed approximately USD 2.7 million fines on them.¹³⁹

Prevention of ML/TF is not only challenge for the high-risk countries but unfortunately, the countries who has already considered as 'low-risk' jurisdictions¹⁴⁰ has faced recently high level of ML scandals.¹⁴¹ For example, it is reported on the response of internal investigation of a banker¹⁴² that USD 233 billion (€200bn) in payments was laundered through the Estonian branch of Danske Bank and cash flowing illegally out of Russia, the UK and the British Virgin Islands.¹⁴³ Whether these breaches happened due to intentional or unintentional lapses by the regulator (supervisory lapses) or by the subject regulated entities (poor quality of CDD, assignment of risk rate or having weak client monitoring system).¹⁴⁴ Consequently, the chief

¹³⁷ 'Global Financial Institutions Fined \$26 Billion for AML, Sanctions & KYC Non-Compliance Since 2008 Financial Crisis' (The fintech times, 27 September 2018) < <https://thefintechtimes.com/institutions-fined-26-billion-non-compliance-since-2008/> > accessed 29 July 2019

¹³⁸ 'FCA fines Standard Chartered Bank £102.2 million for poor AML controls' (Financial Conduct Authority, 9 April 2019) <<https://www.fca.org.uk/news/press-releases/fca-fines-standard-chartered-bank-102-2-million-poor-aml-controls>> accessed 30 July 2019

¹³⁹ Debevoise In Depth, '2018/2019 Anti-Money Laundering Review and Outlook' (Debevoise & Plimpton LLP, 5 February 2019) < 20190205_2018_Anti_Money_Laundering_Review_and_Outlook.pdf > accessed 5 August 2019

¹⁴⁰ International Centre for Asset Recovery, 'Basel AML Index Report' (Basel Institute of Governance, 2018) < https://www.baselgovernance.org/sites/default/files/2019-02/basel_aml_index_10_09_2018.pdf> accesses 21 July 2019

¹⁴¹ Rupert Neate and Jennifer Rankin, 'Danske Bank money laundering 'is biggest scandal in Europe' Unpleasant lesson of €200bn case shows need to be vigilant – European commission' The guardian (London, 20 September 2018)

¹⁴² Renae Merle, 'Democracy Dies in Darkness CEO of Denmark bank quits amid an alleged \$233 billion money-laundering investigation, (The Washing Post, 19 September 2018) < https://www.washingtonpost.com/business/2018/09/19/ceo-denmark-bank-quits-amid-an-alleged-billion-money-laundering-investigation/?utm_term=.8ac545f23d9c> accessed 28 July 2019 and Bradley Hope, Drew Hinshaw and Patricia Kowsmann, 'How One Stubborn Banker Exposed a \$200 Billion Russian Money-Laundering Scandal' (The Wall Street Journal, 23 October 2018) < <https://www.wsj.com/articles/how-one-stubborn-banker-exposed-a-200-billion-russian-money-laundering-scandal-1540307327>> accessed 28 July 20

¹⁴³ Rupert, 'Danske Bank chief resigns over €200bn money-laundering scandal Thomas Borgen admits most of £180bn that passed through Estonian branch was fraudulent' (London, 20 September 2018)

¹⁴⁴ Niklas Mangnsson, 'Days of Fear and Surprise as Nordic Laundering Scandal Widened' (Bloomberg, 29 March 2019) < <https://www.bloomberg.com/news/articles/2019-03-29/days-of-fear-and-surprise-as-nordic-laundering-scandal-widened> > accessed 01 August 2019

executive of the bank compelled to resign and flowing other international impacts and resultant other investigations has also opened against some regulated entities operating in low-risk countries.¹⁴⁵ Furthermore, this incident not only compelled to the regulated entities to re-designed AML process and made measures to prevent financial system to expose from illicit activities, but regulators to reconsider the regulation and supervisory system to prevent the countries form another devastation.¹⁴⁶ These re-engineering exercise is not so simple, it incur heavy cost to utilise human resources and time, and ultimately cause another damage to the economy by cutting profit of the regulated entities.

3.8 CONCLUSION:

The above discussion divulges that ML have a negative economic effect because they (i) generate economic distortions that decrease the productivity of licit factors in the economy; (ii) erode the financial and real sectors that are infiltrated by asset laundering, generating bankruptcy risks and ultimately financial crises; and (iii) undermine government institutions through corruption and capture.¹⁴⁷

Further, ML has increased substantially in recent years in both, 'high-risk' and 'low-risk' countries due to (1) Excessive human intervention on the decision making process; (2) insufficient and redundant regulation, controls and measure; (3) lack of skilled and professional personnel; (4) incompetent transaction monitoring system (fail to identify suspected illegal activities); and particularly; (5) well versed criminals with knowledge of financial system and capacity to abuse and misused.

Therefore, FATF has recommended countries are obligated to implement effective AML/CFT standards to respond the economic threat and to avoid heavy penalties and sanctions by prioritizing the efforts. In order to implement an effective RBA framework, the regulated entities are required: (1) to increase transparency (beneficial owner) in the financial transactions; (2) adopt smart transaction monitoring system; (3) prompt suspicious transaction/ activity reporting

¹⁴⁵ Ibid

¹⁴⁶ BNN, 'Bank in Estonia adopted increased Anti-Money Laundering regulations' Baltic News Network (Baltic, 25 March 2019)

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¹⁴⁷ Norman Loyayza, Edgar Villa Martha Misas, 'Illicit activity and money laundering from an economic growth perspective A model and an application of Colombia' (2019) 159 Journal of Economic Behaviour & Organization 442

procedures; (4) Trained and professional human resources who are capable to assess, identify and mitigate the AML/CFT risk.

CHAPTER 4

COMPLICATIONS WITH CURRENT RISK-BASED APPROACH: ASSESSMENT AND APPLICATION

4.1 INTRODUCTION

Regulated entities are required to develop RBA framework to 'identify, assess and take effective action to mitigate ML and TF risks'.¹⁴⁸ Therefore, RBA encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks.¹⁴⁹

The rationale of RBA's implementation looks sound due to flexible approach but several practical complications and conditions associated with it as prescribed in chapter 4 and 5. The issues, that need to be resolved through a coordinative way of thinking to the problem of detecting and controlling money laundering and terrorist financing is to be successfully adopted.¹⁵⁰

4.2 LITERATURE REVIEW

The traditional theories of risk are not easily transferable to the arena of AML¹⁵¹ because conceptualisation such as 'rule-based but risk-orientated'; and 'uncertainty-based approach' is not enough. The stakeholders need to take a more practical view, keeping in mind sensitivity and effect of ML/TF as discussed in chapter 3.

Unfortunately, these theories' emphasis only on SAR, whereas AML/CFT compliance is not merely SAR but a piece of RBA compliance. With compliance of RBA the regulated entities are required to assess, identify and set measures to prevent ML/TF, throughout customer relationship (from on-boarding till closing the relationship).

¹⁴⁸ Rebecca L. Stanley and Ross P. Buckley, 'Protecting the West, Excluding the Rest The Impact of the AML/CFT Regime on Financial Inclusion in the Pacific and Potential Responses' (2016) 17 Melbourne Journal of International Law 83

¹⁴⁹ FATF Guidance for A Risk-Based Approach for the Banking sectors (FATF 2014) <<http://www.fatf-gafi.org/publications/fatfrecommendations/documents/risk-based-approach-banking-sector.html>> accessed 30 July 2019

¹⁵⁰ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

¹⁵¹ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

Moreover, assessing, identifying and managing risk requires excessive human intervention. Hence, implementation of an effective RBA involves decision-making process and judgment of Individuals who are responsible to undertake AML/CFT risk assessment (here-in-after called 'responsible person'), whereas decision-making process is itself based on uncertainty.

4.2a DEFINING RISK

The Oxford English Dictionary defines risk as "the probability of a negative occurrence". Therefore, risk is an uncertain event or condition that, if it occurs, has a positive or negative effect on activities. A risk has a cause, and if it occurs, a consequence.¹⁵² Further, as a risk is concerned with unpredictable events that might occur in the future whose exact likelihood and outcome is uncertain but could potentially affect their interests/objectives in some way.¹⁵³

4.2b DEFINING UNCERTAINTY

According to Oxford dictionary "uncertainty" means "not able to be relied on; not known or definite". Thus, uncertainty is understood in its most basic form as not knowing for sure, due to lack of information or ambiguous information.¹⁵⁴

4.2c RISK AND UNCERTAINTY

There is a misconception that 'Risk' and 'uncertainty' are same and ignore its basic differences, for example a risk can be assessed, its possibility of occurrence can be predicated, and finally it could be managed by set measures up. Whereas, uncertainty is a state where prediction of a future outcome is not possible, nor probability of outcome could be assigned therefore management of uncertainty is not possible.¹⁵⁵ Risk is, therefore, easier to conceptualise, event based and typically underpinned by hard data. Uncertainty, in contrast encompasses the

¹⁵² Erik W Larson and Clifford F Gray, *Project Management The Managerial Process* (5th ed, New York McGraw-Hill Irwin 2011) p 211

¹⁵³ Martin Loosemore, John Raftery, Charlie Reilly and Dave Higgon, *Risk Management in Projects* (2nd ed, Routledge 2006) p 8

¹⁵⁴ Gudela Grote, 'Promoting safety by increasing uncertainty—Implications for risk management' (2015) *Safety Science* <<http://dx.doi.org/10.1016/j.ssci.2014.02.010>> accessed 25 July 2019

¹⁵⁵ Fahad Usmani, 'Risk Vs Uncertainty in project management' (PM Study Circle, 24 July 2019) <<https://pmstudycircle.com/2012/02/risk-vs-uncertain>> accessed 01 August 2019

unknown, the intangible and the immeasurable and can be viewed as the source of all risk.¹⁵⁶ However, one can say that 'risk is considered as a subset of uncertainty.'¹⁵⁷

4.3 DECISION-MAKING PROCESS

RBA prerogatives fixability and entitles to the regulated entities to apply decision-making mechanism while assessing the ML/TF risk and decisions-making process provides a reflection of the uncertainty of outcome.¹⁵⁸ This is in stark contrast with decision-making under conditions of risk where it is expected that the consequences of a particular decision are known with some degree of certainty in advance of making the decision.¹⁵⁹

The decision-making technique possess five crucial stages: (1) defining the situation; (2) determining what is relevant; (3) determining the scope and validity of factual knowledge; (4) developing all the alternative solutions; and (5) the chosen solution must be made effective in action.¹⁶⁰

Whereas, Human judgement occurs in a world of substantial environmental uncertainties, based on limited information available and the person's perception on the subject being judged.¹⁶¹ Hence, one can say that judgement and decision making is a psychological construct to understand how judgement and decision making are made by both individual and group.¹⁶²

4.4 RBA AND ITS IMPACT ON DECISION-MAKING PROCESS:

RBA allows to recognise uncertainty due to unknowns consequences and outcomes of decisions and judgments. As the regulated entities are uncertain about the response of their decision by

¹⁵⁶ Fiona Saunders, 'Differentiating between Risk and Uncertainty in the Project Management Literature' (2016) The University of Manchester < <http://fionasaunders.co.uk/wp-content/uploads/2016/07/Differentiating-between-Risk-and-Uncertainty-in-the-Project-Management-Literature.pdf>> accessed 20 July 2019

¹⁵⁷ Dionysios Demetis and Ian O Angell, 'The risk-based approach to AML representation, paradox, and the 3rd directive' (2007) 10 (4) Journal of Money Laundering Control 412

¹⁵⁸ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

¹⁵⁹ Paul W Glimcher, Neuroeconomics decision making and the brain (Elsevier Academic Press 2009)

¹⁶⁰ Peter F Drucker, 'Long-range planning challenge to management science' (1959) 5(3) Management Science Journal 247

¹⁶¹ Yusarina Mat Isa, Zuraidah Mohd Sanusi, Mohd Nizal Haniff and Paul A, Barnes, 'Money Laundering Risk From the Bnaker's and Regulators perspectives' (2015) 28 Procedia Economics and Finance Journal 7

¹⁶² Ira Solomon, Ken T Trotman, 'Experimental judgment and decision research in auditing the first 25 years of AOS' (2003) 28(4) Accounting, Organizations and Society 395

regulators and their customers,¹⁶³ from the beginning on various occasions, for example (a) while assigning or not assigning high risk to a specific customer and perform enhanced or simplified due diligence; (b) initiate or not initiate internal investigation where transaction monitoring system alerts; and (c) particularly, they fail to report a transaction that eventually turned out to be ML; or report a legitimate transaction as suspicious with all the attended consequences in term of delay.¹⁶⁴

RBA framework is flexible and as well as complicated therefore responsible person within regulated entities are demanded to exercise their intuition and judgement in assessing the customer risk characteristic.¹⁶⁵ In a daily routine, responsible person needs to assess the risk of the customer, judge whether the customer possess high or low risk customer and eventually decide whether to proceed with the financial transactions solicited by the customer.¹⁶⁶

Risk assessment involves judgement, of which RBA would involve both anchoring and adjustment heuristic rules of thumb, for example; own knowledge will be used as an anchor while the knowledge of other people will be adjusted for perceived differences.¹⁶⁷ As decision-making process based on personal knowledge and skills rather to have universal systemic framework for AML/CFT within regulated entities to support more consistent decision making. hence, knowledge gap may cause serious lapses and consequently regulated entities are compelled to pay hefty penalties for failing to properly assess ML/TF risk,¹⁶⁸ as earlier highlighted that in the last decade (2008 -2018) globally USD \$ 26 billion in fines has been imposed for non-compliance of RBA framework, such as; sub-standard Know Your Customer (KYC) and breach of sanctions regulations.¹⁶⁹

¹⁶³ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

¹⁶⁴ Ibid

¹⁶⁵ Jackie Johnson, 'How will the financial services sector respond to the Financial Action Task Force's increased customer due diligence requirements' (2003) 5(2) Journal of International Banking Regulation 127

¹⁶⁶ Anthony H Presutti, 'Anchor and adjustment heuristic effect on audit judgement' (1995) 10(9) Managerial Auditing Journal 13

¹⁶⁷ Ibid

¹⁶⁸ Yusarina Mat Isa, Zuraidah Mohd Sanusi, Mohd Nizal Haniff and Paul A, Barnes, 'Money Laundering Risk From the Bnaker's and Regulators perspectives' (2015) 28 Procedia Economics and Finance Journal 7

¹⁶⁹ Fenergo, 'Global Financial Institutions Fined \$26 Billion for AML, Sanctions & KYC Non-Compliance' (Dublin, Ireland, 26 September 2018) < [https://www.fenergo.com/press-releases/global-financial-institutions-fined-\\$26-billion-for-aml-kyc.html](https://www.fenergo.com/press-releases/global-financial-institutions-fined-$26-billion-for-aml-kyc.html) > accessed on 5 August 2019

The big quantum of losses to the regulated entities has undoubtedly affected the financial system and questions were asked what has gone wrong with the regulated AML/CFT risk management system, in particular; risk assessment for money laundering? Could the losses be avoided should the personnel of the banking institutions be more cautious in assessing the money laundering risk?¹⁷⁰

The scholars responded to above questions and suggested that in order to assess ML risk responsible persons are required to learn money launders' twisted mentality¹⁷¹ and use their intuitions. An individual may achieve risk assessment competency with adequate knowledge, skill and techniques that allow identification, evaluation and development of the individual behaviour in carrying out the assigned roles.¹⁷² However, risk assessment of a responsible person may influence by both internal factors (personal characteristics) and external factors (environment of the society, professional bodies, internal policies, core system or the work place where the individual is being employed).¹⁷³

4.5 RISK-BASED APPROACH

RBA includes the concepts of risk, risk assessment, and risk management,¹⁷⁴ whereas, there is no defined criteria to assess and manage the risk, which allow regulated entities of differing sizes, structures and practices to develop their own appropriate systems.¹⁷⁵ The RBA aims to provide control to the organization itself to design an AML program that suits it, and correspondingly changing the approach from following the letter of the law to practical

¹⁷⁰ Yusarina Mat Isa, Zuraidah Mohd Sanusi, Mohd Nizal Haniff and Paul A, Barnes, 'Money Laundering Risk From the Bnaker's and Regulators perspectives' (2015) 28 *Procedia Economics and Finance Journal* 7

¹⁷¹ Gilles Favarel-Garrigues, Thierry Godefroy and Pierre Lascoumes, 'Sentinels in the Banking Industry Private Actors and the Fight against Money Laundering in France' (2008) 48(1) *British Journal of Criminology* 1

¹⁷² Noel Harding and Ken T Trotman, 'Improving Assessments of Another Auditor's Competence' (2009) 28 (1) *AUDITING A Journal of Practice & Theory* 53

¹⁷³ Edward J Joyce and Robert Libby, 'Some Accounting Implications of Behavioral Decision Theory Processes of Judgment and Choice' (1981) 19(2) *Journal of Accounting Research* 544

¹⁷⁴ FATF on Money Laundering, Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing-High Level Principles and Procedures (June 2007) < <https://www.fatf-gafi.org/media/fatf/documents/reports/High%20Level%20Principles%20and%20Procedures.pdf> > accessed 30 July 2019.

(Note FATF has issued separate guidelines for each sector and can be access < [https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 30 July 2019

¹⁷⁵ Lishan Ai, 'Rule-based but risk-oriented" approach for combating money laundering in Chinese financial sectors' (2012) 15 (2) *Journal of Money Laundering Control* 198

management of risk.¹⁷⁶ This transfer of control from regulatory body to the regulated entity provides flexibility but requires the regulated entities to be knowledgeable of ML/TF risks they face.¹⁷⁷

In other words, RBA requires regulated entities to apply enhanced measures in areas of high risk and simultaneously allows them to take a simplified approach where there are lower risks involved.¹⁷⁸ Therefore, one can say that RBA framework is based on decision-making process and is influenced by external and internal factors such as regulatory requirements and other organizational factors such as internal control systems and compliance.¹⁷⁹ FATF's seems confused while applying RBA, one hand the regulated entities have been granted discretion to develop suitable RBA framework and eventually provided scope of human action, error, manipulation and creative compliance.¹⁸⁰ On the other hand, imposes heavy penalties and sanction due to unknow outcome of decision and abolishes RBA's objectives, such as flexibility and application of knowledge and intuitions.

4.6 COMPLICATIONS OF RISK-BASED APPROACH

4.6a LACK OF SKILLED PERSONNEL

Regulated entities are now increasingly moving away from entirely rules-based (red flag) transaction monitoring algorithm and supplement these with flexible, intelligence, self-learning algorithms to deduct AML/CFT patterns.¹⁸¹ Therefore, the practical application of so-called RBA requires resources to gather and interpret information on risk, develop AML procedures and systems, as well as well-trained personnel with a sound understanding of the risk and who are

¹⁷⁶ FATF Risk Based Approach Guidance The Rational of Risk Based Approach (FATF 2019) < [https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/documents/riskbasedapproach/?hf=10&b=0&s=desc(fatf_releasedate))> accessed 30 July 2019

¹⁷⁷ Lishan Ai, 'Rule-based but risk-oriented" approach for combating money laundering in Chinese financial sectors' (2012) 15 (2) Journal of Money Laundering Control 198

¹⁷⁸ Financial Action Task Force, 'FATF Guidance for a Risk-Based Approach Prepaid Cards, Mobile Payments and Internet-Based Payment Services' (2013) < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-RBA-NPPS.pdf> > accessed 21 July 2013

¹⁷⁹ Yusarina Mat Isa, Zuraidah Mohd Sanusi, Mohd Nizal Haniff and Paul A, Barnes, 'Money Laundering Risk From the Bnaker's and Regulators perspectives' (2015) 28 Procedia Economics and Finance Journal 7

¹⁸⁰ Anna Simonova, 'The risk-based approach to anti-money laundering problems and solutions' (2011) 14 (4) Journal of Money Laundering Control 346

¹⁸¹ Shijia Gao, Dongming Xu, Huaqing Wang and Peter Green, 'Knowledge-based Anti-money Laundering A Software Agent Bank Application' (2009) 13 (2) Journal of Knowledge Management 63

capable of making sound judgements.¹⁸² Whereas, unfortunately these skills are not readily found in either regulators or regulated entities in many jurisdictions¹⁸³ due to lack of formal training and education but mainly RBA's personal liabilities/ accountability theory.

4.6b LIABILITIES OF RESPONSIBLE PERSON(S):

Successful implementation and effective operation of RBA to AML/CFT depends on strong senior management, leadership and oversight of the development and implementation of the RBA across the regulated entities.¹⁸⁴ Further, breach of RBA regulation may cause risk of sanctions and fines for the regulated entities and responsible person(s) also held to be penalized and suffer(s) loss of job.¹⁸⁵ Since, human intervention and decision-making is an inevitable part of the disclosure process¹⁸⁶, and responsible person will not be provided with immunity from legal action merely because he is obliged under the law to complete SAR.¹⁸⁷ It could potentially find themselves subject to a claim for defamation, it may strike fear into the hearts of responsible persons¹⁸⁸ and cause hindrance in effective implementation of RBA in the regulated entity.

Responsible person gradually became the target of "regulators," in which some ended up "unemployed" at the stake for all non-compliant obligations and wrongdoings.¹⁸⁹ For example, USA Financial Crimes Enforcement Network (FinCEN) issued \$ 1 million civil penalty and enjoin from further employment in any financial institution, against Thomas E Haider (former Chief

¹⁸² Lishan Ai, John Broome and Hao Yan, 'Carrying out a risk-based approach to AML in China partial or full implementation?' (2010) 13(4) Journal of Money Laundering Control 394

¹⁸³ Ibid

¹⁸⁴ FATF, 'All Publications: FATF Risk Based Approach Guidance' < [https://www.fatf-gafi.org/publications/?hf=10&b=0&q=guidance&s=desc\(fatf_releasedate\)](https://www.fatf-gafi.org/publications/?hf=10&b=0&q=guidance&s=desc(fatf_releasedate))> accessed 30 July 2019

¹⁸⁵ Debevoise In Depth, '2018/2019 Anti-Money Laundering Review and Outlook' (Debevoise & Plimpton LLP, 5 February 2019) < [20190205_2018_Anti_Money_Laundering_Review_and_Outlook.pdf](#) > accessed 5 August 2019

¹⁸⁶ Shah v HSBC Private Bank (UK) Ltd [2009] EWHC 79 (QB)

¹⁸⁷ Brian Boehmer, 'Reporting Suspicious Activity to the NCA – the latest case of Lonsdale v. Nat West Bank' (Lockton, 08 February 2019) < <https://www.locktonsolicitors.co.uk/news/reporting-suspicious-activity-to-the-nca-the-latest-case-of-lonsdale-v-nat-west-bank.html>> accessed 15 August 2019

¹⁸⁸ Ibid

¹⁸⁹ Hourad Afsar, 'Personal liability or talent drain' (ACAMS, 9 May 2016) < <https://www.acamstoday.org/personal-liability-or-talent-drain/>> accessed 10 September 2019

Compliance Officer) allegedly failed to ensure that company implement an effective AML program.¹⁹⁰

In another case, Dubai Financial Services Authority (DFSA) has imposed a fine of USD 45,000 (AED 165,150) and a restriction from performing any functions in financial industry, for a period of 3 years, on a compliance personnel, namely Hany Lotfy Awwad Abdelwahab, for providing the DFSA with false, misleading or deceptive information, and for obstructing the DFSA by failing to comply with DFSA investigative notices.¹⁹¹ Similarly, Hongkong's Securities and Futures Commission (SFC) has issued a reprimand to Hung Lai Ping, a former responsible officer of Delta Asia Securities Limited (Delta Asia), and fined her \$150,000 for managerial and supervisory failures and impaired AML regulation compliance.¹⁹²

These examples show that RBA made responsible persons more vulnerable than ever in their day-to-day operations as the personal liability issue continues to exist.¹⁹³ As compliance officers are held accountable for individual and organisational wrongdoings more frequently, they are becoming more worried about managing their own personal risk than their job.¹⁹⁴ While they must manage the overall risk of their organization on one hand, they have to watch their back on the other. Consequently, competent and talented professionals are moving their way out of the industry.¹⁹⁵ And focus on accountability has an impact on the ability to recruit and retain skilled senior staff. For example, some top-level positions are difficult to fill as most think that no paycheck could match the risk of going to "jail."¹⁹⁶

¹⁹⁰ Steve Hudak, 'FinCEN and Manhattan U.S. Attorney Announce Settlement with Former MoneyGram Executive Thomas E. Haider' (Financial Crimes Enforcement Network, 4 May 2017) < <https://www.fincen.gov/news/news-releases/fincen-and-manhattan-us-attorney-announce-settlement-former-moneygram-executive> > accessed 15 September 2019

¹⁹¹ 'DFSA Takes Action Against Hany Lotfy Awwad Abdelwahab' (Dubai Financial Service Authority, 22 April 2015) < <https://www.dfsa.ae/News/News-Detail/DFSA-Takes-Action-Against-Hany-Lotfy-Awwad-Abdelwa> > accessed 15 September 2019

¹⁹² 'SFC reprimands and fines Hung Lai Ping for managerial and supervisory failures' (Securities and Future Commission, 19 May 2014) < <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=14PR102> > accessed 15 September 2019

¹⁹³ Hourad Afsar, 'Personal liability or talent drain' (ACAMS, 9 May 2016) < <https://www.acamstoday.org/personal-liability-or-talent-drain/> > accessed 10 September 2019

¹⁹⁴ Ibid

¹⁹⁵ Ibid

¹⁹⁶ Stacey English and Susannah Hammond, 'Cost of Compliance' (Thomson Reuters, 2015) < https://www.cover.co.za/wp-content/uploads/2015/05/Cost_of_Compliance_2015-6.pdf > accessed 16 July 2019

Under RBA framework responsible person has two choices, either to report a SAR, or not to report.¹⁹⁷ From the regulators' point of view, the problem arises with the decision 'not to report' rather than with the reporting.¹⁹⁸ If a responsible person fails to report an activity as suspicious based on his own sound judgement, the regulators would not excuse the decision, but instead would seek to penalise him for failure to report a suspicious activity that subsequently became a ML activity.¹⁹⁹ The responsible person cannot ordinarily be certain that the outcome of the activity he is considering is going to result in money laundering, nor will he be certain of the impact of the money laundering activity in the event that it happens.²⁰⁰

Due to aforesaid reasons ML / TF can be categorised as an uncertain territory and concept of the uncertainty-based approach seems correct. However, they only talk about SAR and basic issues like CDD, Identification of the customer, transparency has neglected badly. Therefore, regulated entities, particularly financial institutions are always uncertain about the transaction's true nature, that is, every transaction can be potential ML. This may be because although financial institutions are readily able to make assessments about credit and fraud risk, assessing ML and TF risk in financial terms is notoriously difficult.²⁰¹

It, therefore, seems unfair to penalise to responsible person in the face of these uncertainties if he makes an incorrect decision.²⁰² The risk based approach assumes implicitly that responsible person should know the outcome of his decision, and as such, he should be liable for that decision given that 'sanctions or fines are levied for false negatives, that is, for not reporting transactions which are later prosecuted as ML or judged to be suspicious ex post.²⁰³ This idea is not seems wise, that responsible person and regulated entities get penalised due to outcome

¹⁹⁷ Elod Takats, 'A Theory of "Crying Wolf" The Economics of Money Laundering Enforcement' (2011) 27(1) Journal of Law, Economics & Organization 32

¹⁹⁸ Ibid

¹⁹⁹ Ibid

²⁰⁰ Ibid

²⁰¹ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

²⁰² Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

²⁰³ Elod Takats, 'A Theory of "Crying Wolf" The Economics of Money Laundering Enforcement' (2011) 27(1) Journal of Law, Economics & Organization 32

of judgement, but needed to consider quality of decision-making process leading to the decision.²⁰⁴

Therefore, this paper suggest that regulators and regulated entities/ responsible person need to work together to achieve the right balance in this current environment.²⁰⁵ For example, regulators are required to handle the issue of personal liability with a less radical approach while disseminating a stronger culture of compliance; whereas responsible person may apply better methods in managing their individual accountability risk in order to avoid any regulatory disturbance.²⁰⁶

4.6c ARBITRARY CATEGORISATION OF RISK

Interestingly, AML regime have not defined 'risk' but classified the risk into two categories namely 'inherent risk' and 'residual risk'.²⁰⁷ However, there is conflict within FATF's RBA, as one hand FTAF has bestowed discretionary power to the regulated entities to assess, identify and manage risk keeping in mind their own condition and on the other hand they arbitrary categorize inherent risks and classified as high risk customer, product and jurisdiction rather than following objective criteria.²⁰⁸ For example; a customer, is automatically considered a high risk if he is politically exposed person (PEP), by virtue of being a top government official or a relative of such a person and applies to both domestic, foreign and international organisation PEPs²⁰⁹, likewise a Non-profit organizations (NPOs)²¹⁰; Money of value transfer services

²⁰⁴ Boris Holzer and Yuval Millo, London School of Economics and Political Science '*From risks to second-order dangers in financial markets unintended consequences of risk management systems*' (Centre for Analysis of Risk and Regulation, CARR Discussion Papers (DP 29) 2004)

²⁰⁵ Hourad Afsar, 'Personal liability or talent drain' (ACAMS, 9 May 2016) < <https://www.acamstoday.org/personal-liability-or-talent-drain/>> accessed 10 September 2019

²⁰⁶ Ibid

²⁰⁷ Milind Sathye & Jesmin Islam, 'Adopting a risk-based approach to AMLCFT compliance the Australian case (2011) 18(2) Journal of Financial Crime 169

²⁰⁸ Stuart Ross and Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

²⁰⁹ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019, Recommendation 08

²¹⁰ *ibid*, Recommendation 12

(MVTs)²¹¹, High Risk countries²¹², Non-resident customer (individual or non-individual), non-individual with complexed structure (three or more layers)²¹³.

Likewise, there is arbitrary classification of countries as 'low risk' and 'high risk', However, the criteria of classification undefined.²¹⁴ For example, USA has the highest level of money laundering in the world²¹⁵ but is considered a low risk country, while countries for example, Pakistan, Sri Lanka, Syria, Trinidad and Tobago, Tunisia and Yemen with fewer incidents of money laundering, in both value and frequency, are considered high risk countries because of lax control and lack of 'political will'.²¹⁶

Therefore, arbitrary designation clearly contradicts the essence of an approach that is truly risk based, as regulated entities are no more entitled to apply RBA, while dealing with designated customer, products and countries.

4.6d RBA FAILED TO DEFINE SUSPICION

Although RBA emphasises on SAR and recommends substantial penalties and strict accountability but failed to define 'suspicion' and a task which left to the national courts of law.²¹⁷ Hence, court of Appeal (UK) defined 'suspicion' and ruled that there should be 'more than a fanciful possibility' that a person is handling criminal property or involving themselves in money laundering.²¹⁸ A 'vague feeling of unease' would not suffice, but the law did not require the suspicion to be clear or firmly grounded or based upon reasonable grounds.²¹⁹ Ultimately, the RBA has resulted in the filling of SAR on a scale which has overwhelmed the system and

²¹¹ *ibid*, Recommendation 13

²¹² *Ibid*, Recommendation 19

²¹³ FATF Guidance for A Risk-Based Approach for the Banking sectors (FATF 2014) <<http://www.fatf-gafi.org/publications/fatfrecommendations/documents/risk-based-approach-banking-sector.html>> accessed 30 July 2019

²¹⁴ J C Sharman, 'Power and Discourse in Policy Diffusion Anti-Money Laundering in Developing States' (2008) 52(3) *International Studies Quarterly Journal* 635

²¹⁵ Burak Dolar and William F II Shughart, 'Enforcement of the USA Patriot Act's anti-money laundering provisions Have regulators followed a risk-based approach?' (2011) 22(1) *Global Finance Journal* 19

²¹⁶ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) *Security Journal* 24

²¹⁷ Simon D Norton, 'Suspicion of money laundering reporting obligations Auditor compliance, or sceptical failure to engage?' (2018) 50 *Critical perspectives on accounting Journal* 56

²¹⁸ R v Da Silva [2006] EWCA Criminal 1654; [2007] 1 WLR 303

²¹⁹ *Ibid*

making the detection of crime less effective.²²⁰ Further details and implications are discussed in part 4.2.e, here-in-below.

4.6e FLOOD OF SUSPICIOUS ACTIVITY REPORTS (SARs)

The regulated entities are responsible to report to Financial Intelligence Unit (FIU), if they suspect or has reasonable grounds to suspect that funds are the proceeds of a criminal activity or are related to terrorist financing.²²¹ Consequently, so-called RBA compliance caused an explosion of the SARs received by FIU on daily basis, for example within one year (2017) globally, more than three million SARs received by FIUs.²²² However, there is no data centre which can confirm number of positive link or match of these SAR with criminals or criminal activity. Nevertheless, average of positive reporting can be assessed through NCA's 2018 (UK) report; in this year, 463,938 (four hundred sixty-three thousand nine hundred and thirty-eight)²²³ ostensible SARs received by FIU (UK) and only 28 cases were identified as true match, whereby only 40 individuals being arrested.²²⁴ This reflects a combination of increased regulatory requirements, a broader range of institutions subject to BSA/AML regulations, stronger compliance programs at regulated entities or possibly a weak detection system generating too many alerts (false negatives and false positives) analysed and promoted to cases and disclosed to the regulators.²²⁵

As earlier stated, that FinCEN and international bodies including FIU have never disclosed what percentage of SARs result in successful prosecution.²²⁶ However, above FCA (UK)' report²²⁷,

²²⁰ Simon D Norton, 'Suspicion of money laundering reporting obligations Auditor compliance, or sceptical failure to engage?' (2018) 50 *Critical perspectives on accounting Journal* 56

²²¹ FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019, Recommendation 20

²²² Jenna Danko, 'The effectiveness of suspicious Activity Reports' (ORACLE, 16 February 2018) < <https://blogs.oracle.com/financialservices/the-effectiveness-of-suspicious-activity-re>> accessed 15 August 2019

²²³ National Crime Agency, 'Suspicious Activity Reports (SARs) Annual Report 2018' (2018) <<https://nationalcrimeagency.gov.uk/who-we-are/publications/256-2018-sars-annual-report/file>> accessed 20 August 2019 and Caroline Binham, 'UK Money Laundering Reports hit record level in 2018' *Financial Times* (London, 10 January 2019)

²²⁴ National Crime Agency, 'Suspicious Activity Reports (SARs) Annual Report 2018' <<https://nationalcrimeagency.gov.uk/who-we-are/publications/256-2018-sars-annual-report/file>> accessed 20 August 2019

²²⁵ Jenna Danko, 'The effectiveness of suspicious Activity Reports' (ORACLE, 16 February 2018) < <https://blogs.oracle.com/financialservices/the-effectiveness-of-suspicious-activity-re>> accessed 15 August 2019

²²⁶ Jibid

²²⁷ National Crime Agency, 'Suspicious Activity Reports (SARs) Annual Report 2018' <<https://nationalcrimeagency.gov.uk/who-we-are/publications/256-2018-sars-annual-report/file>> accessed 20 August 2019

reflects that the SAR filing is a black box²²⁸ and does not contribute to fight against ML/TF. Most probably, criminal activity does not come with a convenient red flag as it is completely indistinguishable from all other legitimate financial transactions.²²⁹

4.6f CONFLICT BETWEEN REGULATORS AND JUDICIAL DECISION

RBA carry legal and reputational risk, if regulated entities decide to initiate a SAR and consequently customer face delays in services. For example, where a financial institution had frozen a customer's personal account and six business accounts and made several SARs to the National Crime Agency (NCA) UK.²³⁰ The customer issued proceedings claiming that the bank was in breach of contract for failing to execute his instructions, had breached the Data Protection Act 1998 by unjustifiably withholding personal data, and defamed him by repeatedly suggesting that the money in his accounts may have been derived from crime.²³¹

The High court accepted customer's application and allowed inspection of SAR, contrary to FATF's standards.²³² Whereas bank's application for strike out/ summary judgment on breach of contract had refused and held that even bank had a genuine suspicion that the money in the customer's account was the proceed of crime, still that suspension required evidence²³³ and relied upon previous judgment, wherein the learned judge ruled that to be a suspicion rather than a mere feeling of unease it had to be based on possible facts, but the sufficiency of those possible facts as a grounding for that suspicion was irrelevant, unless good faith was in issue.²³⁴

On the other hands, if regulated entities fail to report SAR, they may face heavy regulatory fines and sanctions. For example, regulated entities globally have paid \$321 billion in fines from 2009

²²⁸ Jennna Danko, 'The effectiveness of suspicious Activity Reports' (ORACLE, 16 February 2018) < <https://blogs.oracle.com/financialservices/the-effectiveness-of-suspicious-activity-re>> accessed 15 August 2019

²²⁹ Valsamis Mitsilegas, Money laundering counter-measures in the European Union A new paradigm of security governance versus fundamental legal principles (Vol 20 Kluwer Law International 2003)

²³⁰ Lonsdale v National Westminster Bank plc [2018] EWHC 1843 (QB); [2018] 7 WLUK 430

²³¹ *ibid*

²³² FATF Recommendation, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation' Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019, Recommendation 21

²³³ *ibid*

²³⁴ Shah v HSBC Private Bank (UK) Ltd [2009] EWHC 79 (QB)

to 2016 for an abundance of regulatory failings from money laundering to market manipulation and terrorist financing.²³⁵ Further, according to a report during 2018, more than 16 regulated entities, have penalised due to non-filing or delayed filing of SARs²³⁶

The courts do not follow a strict approach or clear parameters when reaching decision on SAR relating to ML offences.²³⁷ This lack of a strict approach causing confusion as responsible person may not be clear on what to do. This impacts on the ability and efforts of regulatory objectives. If the outcome of a case touching on suspicions cannot be predicted with any degree of certainty, it will affect the ability of the regulators to commence action against certain individuals.²³⁸ Also, the courts use unnecessary technicalities while interpreting certain aspects of the money laundering regulations.²³⁹ For instance, it was held that property would be classed as criminal where the property was criminal property at the time of commission of offence.²⁴⁰ Here, the court found the defendant not guilty because at the time the property came into the possession of the defendant it was not criminal property.²⁴¹ Unfortunately, due to ambiguous regulation, courts and other authority compelled to intervene according to their own wisdom.

4.7 REGULATORY COST DECLINES COMMERCIAL GOAL

In order to reduce the heavy duties and cost of AML/CFT rule-based approach from the regulated entities, the FATF shifted the strategy to RBA.²⁴² Whereas, when regulated entities begin putting in place an RBA, they start to realize that it is not easy to put the theory in to practice.²⁴³ The effectiveness of RBA depends on the regulated entities agreeing with the

²³⁵ Jenna Danko, 'The effectiveness of suspicious Activity Reports' (ORACLE, 16 February 2018) < <https://blogs.oracle.com/financialservices/the-effectiveness-of-suspicious-activity-re>> accessed 15 August 2019

²³⁶ Debevoise In Depth, '2018/2019 Anti-Money Laundering Review and Outlook' (Debevoise & Plimpton LLP, 5 February 2019) < [20190205_2018_Anti_Money_Laundering_Review_and_Outlook.pdf](#) > accessed 5 August 2019

²³⁷ Adebola Adeyemi, 'Slipping through the net: The financial conduct authority's approach in lessening the incidence of money laundering in the UK' (2018) 21(2) Journal of Money Laundering Control 203

²³⁸ Ibid

²³⁹ Ibid

²⁴⁰ R v Amir (Abida Shaheen) [2011] EWCA Crim 146 (CA); [2011]4 All ER 417 (CA)

²⁴¹ Ibid

²⁴² ishan Ai, John Broome and Hao Yan, 'Carrying out a risk-based approach to AML in China partial or full implementation?' (2010) 13(4) Journal of Money Laundering Control 394

²⁴³ Ibid

regulators about what risks need to be controlled and the manner of control.²⁴⁴ The regulated entities for effective RBA, “have put in place the required processes, work force and systems to prevent, detect illicit activity and report suspicious activities”.²⁴⁵ And these RBA’s protocol are “pushing regulated entities overall cost of compliance to the roof”.²⁴⁶ Hence, the shift in AML approach which was hoped to lead to regulatory cost reductions lead to increased costs, and the risk of failure is high.²⁴⁷ This not only means a breakdown in the effectiveness of the regulatory system but exposes the institution to regulatory risk and costs (such as penalties for non-compliance and legal cost due to customers’ complaints).²⁴⁸

The tension inherent in the AML fight between the commercial ethos and regulatory injunctions can, on the practical level, create dilemmas²⁴⁹ as ‘ultimately, AML runs against the traditional ethos as well as the strategic objectives of the regulated entities.’²⁵⁰ Ultimately, non-profit functions’ (for example compliance and audit) costs has negative impact on the profit of the regulated entities.

4.8 CONCLUSION

Hence, keeping in mind above discussion one can say that implementation of an effective RBA is difficult and complex.²⁵¹ As regulators on how enforce and test compliance against such RBA, and regulated entities remain nervous whether their own perception of risk will match regulatory expectations.²⁵² Since the probability of an activity being ML is not known with certainty, decisions should be evaluated based on the process of identifying the nature of the transaction

²⁴⁴ Stewart Sam, ‘Coping with the FSA’s risk-based approach’ (2005) 13(1) *Journal of Financial Regulation and Compliance* 43

²⁴⁵ Jenna Danko, ‘The effectiveness of suspicious Activity Reports’ (ORACLE, 16 February 2018) <<https://blogs.oracle.com/financialservices/the-effectiveness-of-suspicious-activity-reports>> accessed 15 August 2019

²⁴⁶ Ibid

²⁴⁷ Lishan Ai, John Broome and Hao Yan, ‘Carrying out a risk-based approach to AML in China partial or full implementation?’ (2010) 13(4) *Journal of Money Laundering Control* 394

²⁴⁸ Ibid

²⁴⁹ Gilles Favarel-Garrigues, Thierry Godefroy and Pierre Lascoumes, ‘Sentinels in the Banking Industry Private Actors and the Fight against Money Laundering in France’ (2008) 48(1) *British Journal of Criminology* 1

²⁵⁰ Ana Isabel Canhoto, ‘Barriers to segmentation implementation in money laundering detection’ (2008) 8(2) *The Marketing Review* 163

²⁵¹ Stuart Ross, Michelle Hannan, ‘Money laundering regulation and risk-based decision-making’ (2007) 10(1) *Journal of Money Laundering Control* 106

²⁵² Dionysios Demetis and Ian O Angell, ‘The risk-based approach to AML representation, paradox, and the 3rd directive’ (2007) 10 (4) *Journal of Money Laundering Control* 412

and not on whether a transaction turned out to be money laundering activity.²⁵³ Further, the regulators and regulated entities are required to go beyond popular measures of risk and consider a deeper dive in identifying ML and regulatory risks.²⁵⁴

²⁵³ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

²⁵⁴ Sven Stumbaar, 'As recent money-laundering scandals move from the Baltics to Scandinavia, who will be next?' (International Banker, 19 June 2019) < <https://internationalbanker.com/finance/the-end-of-european-money-laundering-scandals-or-just-the-beginning/> > accessed 01 August 2019

CHAPTER 5

RISK BASED APPROACH: PRACTICAL COMPLICATIONS AND CHALLENGES TO IMPLEMENT EFFECTIVELY

5.1 INTRODUCTION

As stated in chapters 3 that regulated entities are compelled to respond to financial crime and predicated offence by structured prevention and detection efforts in ways that are proportionate to the risks involved.²⁵⁵ Whereas, reality is quite different and despite strict RBA regulations, focus on individual and institutional accountability, substantial civil penalties and criminal liabilities; there is no such thing as 'zero risk' in the ML/TF.²⁵⁶ This fact can be evident from the breaches illustrated in chapter 3 which confirms that so-called "low risk" countries pose high-level financial crime risk.²⁵⁷

The aim of this chapter to highlight practical challenges the regulated entities tackling with²⁵⁸ while they conduct know your customer (KYC) and customer due diligence (CDD) to comply with RBA framework.

5.2 CUSTOMER DUE DILIGENCE AND KNOW YOUR CUSTOMER

It appears that the use of terms "CDD" and "KYC" are sometimes confusing.²⁵⁹ Therefore, it is necessary to clarify the meaning of these terms through examining the history and the development of these concepts.²⁶⁰

²⁵⁵ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

²⁵⁶ International Centre for Asset Recovery, 'Basel AML Index Report' (Basel Institute of Governance, 2018) < https://www.baselgovernance.org/sites/default/files/2019-02/basel_aml_index_10_09_2018.pdf> accessed 21 July 2019

²⁵⁷ Daniel Neale, 'Taking stock of 2018's money laundering scandals When is enough enough? (Part 1)' (Global Financial Integrity, 6 January 2019) < <https://gfintegrity.org/taking-stock-of-2018-part-1/>> accessed September 10, 2019 and Daniel Neale, 'Taking stock of 2018's money laundering scandals When is enough enough? (Part 2)' (Global Financial Integrity, 9 January 2019) < <https://gfintegrity.org/taking-stock-of-2018-part-2/>> accessed September 10, 2019

²⁵⁸ Yvonne Lootsma, 'Blockchain as the Newest Regtech Application - the Opportunity to Reduce the Burden of KYC for Financial Institutions' (2017) 36 (8) Banking & Financial Services Policy Report 16

²⁵⁹ Chat Le Nguyen, 'Preventing the use of financial institutions for money laundering and the implications for financial privacy' (2018) 21 (1) Journal of Money Laundering Control 47

²⁶⁰ Ibid

The term “due diligence” has its origins in Anglo-American law, particularly in the statutory regulations controlling the capital market in the United States (USA).²⁶¹ Originally, the due diligence concept appeared in security laws designed to protect investors. It then has evolved into the systematic and professional investigation of business opportunities and risks during on-going sale negotiations.²⁶² It may entail financial, marketing, human resources, legal and tax, environmental and organizational due diligence.²⁶³ In other words, the object of the due diligence process is to obtain information and engage in evaluation of the background of a target company including its structure, the capabilities of its employees, its market opportunities and risks.²⁶⁴ With regard to AML/CFT it normally refers to the investigation procedure of a new customer’s background conducted by the regulated entities prior to doing business with the new customer.²⁶⁵

Whereas, the term “KYC” originated in a legislative report on the US Bank Secrecy Act, but they were not defined in that report and no examples were given to illustrate what KYC means.²⁶⁶ Since 1970, the US government has deployed US banks as the principal agencies to track down the proceeds of crime by imposing an obligation to know their customers and to report suspicious transactions.²⁶⁷

KYC and CDD have been introduced as evolving concepts designed to be adaptable and effective for use in regulated entities.²⁶⁸ These terms do not have a fixed content, and they frequently appear to be used interchangeably.²⁶⁹ However, CDD is often used to refer to a

²⁶¹ Picot G, *Handbook of International Mergers and Acquisitions Preparation: Implementation and Integration*, (eds) (Palgrave Macmillan 2002) 154

²⁶² *ibid*, 154-155

²⁶³ *ibid*, 155-178

²⁶⁴ *ibid*, 178

²⁶⁵ Chat Le Nguyen, ‘Preventing the use of financial institutions for money laundering and the implications for financial privacy’ (2018) 21 (1) *Journal of Money Laundering Control* 47

²⁶⁶ Daniel Mulligan, ‘Know your customer regulations and the international banking system towards a general self-regulatory regime’ (1998) 22(5) *Fordham International Law Journal* 2322

²⁶⁷ Thomas D Grant, ‘Toward a Swiss solution for an American problem an alternative approach for banks in the war on drugs’ (1995) 14 (21) *Annual Review of Banking law* 225

²⁶⁸ Chat Le Nguyen, ‘Preventing the use of financial institutions for money laundering and the implications for financial privacy’ (2018) 21 (1) *Journal of Money Laundering Control* 47

²⁶⁹ Louis De Koker, ‘Money laundering control and suppression of financing of terrorism some thoughts on the impact of customer due diligence measures on financial exclusion’ (2006) 13(1) *Journal of Financial Crime* 26

standard that is broader than KYC.²⁷⁰ KYC could be conceived of as the specific CDD standard imposing on the regulated entities the duty to identify their customers.²⁷¹

5.3 CUSTOMER DUE DILIGENCE OR NIGHTMARE?

The regulated entities are responsible to undertake CDD measures, for example (1) identifying the customer and verifying the customer's identity using reliable, independent source of documents, data or information; (2) identifying the beneficial owner such that the regulated entities is satisfied that it knows who the beneficial owner is. For legal person and arrangements, this should include regulated entities undertaking the ownership and control structure of the customer; (3) understand and, as appropriate, obtaining information on the purpose and intended nature of the business relationship; (4) conducting ongoing due diligence on the business relationship and structuring of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the entities' knowledge of the customer, their business and risk profile, including where necessary, the source of funds.²⁷²

In 2014 the US (IRS) introduced the Foreign Accounts Tax Compliance Act (FATCA) regulations, demanding regulated entities, particularly financial institutions to report US taxable customers. Simultaneously, Organisation of Economic Co-operation and Development (OECD) has developed Common Reporting Standard (CRS) for the Automatic Exchange of Information (AEOI), regarding bank accounts on global level (105 countries), between tax authorities.²⁷³ Hence, apart from above responsibilities a new aspect that falls in the scope of CDD is the determination of reportable accounts to government authorities of a multitude of countries. This process requires regulated entities to classify the tax status of the customer toward the country of which they are a fiscal resident. The Customer declares this information to the regulated

²⁷⁰ Ibid

²⁷¹ Chat Le Nguyen, 'Preventing the use of financial institutions for money laundering and the implications for financial privacy' (2018) 21 (1) Journal of Money Laundering Control 47

²⁷² FATF on Money Laundering, Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing-High Level Principles and Procedures (June 2007) < <https://www.fatf-gafi.org/media/fatf/documents/reports/High%20Level%20Principles%20and%20Procedures.pdf> > accessed 30 July 2019, Recommendation 10 and 28

²⁷³ OECD, 'What is the CRS?' < <https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/> > accessed 15 July 2019

entities as part of the client's identification information. The fiscal residence of the client can be stored along with the client's other KYC/ CDD information in the system.²⁷⁴

CDD is a process of identifying and verifying the customer; periodically monitoring of customer and their transaction; initiating SARs; keeping eyes on customer's unusual activities (personal status or business); responding to the investigation authorities' queries. However, due to words limitation this chapter discusses only one aspect of CDD, that is: 'customer identification'.

5.4 CUSTOMER IDENTIFICATION AND VERIFICATION

The identification and verification processes are therefore not merely aimed at recording the customer's correct name but at obtaining sufficient information to draw an appropriate business and risk profile of the customer.²⁷⁵ Profiling enables the regulated entities to assess and mitigate the risks posed by the customer.²⁷⁶ It also supports customer monitoring because it assists the regulated entities to anticipate the customer's normal transaction pattern. A transaction that deviates from that pattern may attract the attention of the regulated entities' customer monitoring program and may result in a report to FIU.²⁷⁷

Hence, the reliability of profiling depends however on the sufficiency and accuracy of the customer information that is gathered. Therefore, 'customer identification' contain four main steps, such as (i) information collection (taking ID credentials), (ii) verification (verifying the customer against credentials and verifying the credentials themselves), (iii) checking customers against government lists, and (iv) recordkeeping.²⁷⁸ Apparently, identification process seems simple, but carries several complications, specifically if, potential customer is high risk, for example PEP or legal person or arrangement with complex structure. Complex structure defines in part 34.3b here-in below.

²⁷⁴ Gareth Peters and Guy Vishnia, 'Blockchain Architectures for Electronic Exchange Reporting Requirements EMIR, Dodd Frank, MiFID I/II, MiFIR, REMIT, Reg NMS and T2S' (2016) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2832604&download=yes> accessed 17 July 2019

²⁷⁵ Bank for international Settlements, 'Basel Committee on Banking Supervision Customer Due Diligence (Basel Committee on Banking Supervision 2001)' < <https://www.bis.org/bcbs/publ/d405.htm>> accessed 15 August 2019

²⁷⁶ Louis de Koker, 'The FATF's customer identification framework fit for purpose?' (2014) 17(3) Journal of money laundering control 281

²⁷⁷ Ibid

²⁷⁸ Federal Financial Institutions Examination Council, Bank Secrecy Act Anti-Money Laundering Examination Manual (2014) < https://bsaaml.ffiec.gov/docs/manual/01_Introduction/01.pdf > accessed 10 August 2019

5.4a INFORMATION COLLECTION

The regulated entities are obliged to collect substantial personal information from the prospective customer, for example name, birthdate, nationality, address, profession, National identification number (individual) and legal/ incorporation documents, nature of business, information of intermediate companies, personal information of Directors, authorized signatories, beneficial owners (non-individual).²⁷⁹

The collection of identity and other personal documents is not difficult in developed countries (for example USA, UK, Germany) mainly; identity document is mandatory for every resident and citizen due to state rules; and secondly they are well aware about law therefore, most people would not have difficulty in providing the necessary documents.²⁸⁰ Whereas, under developed countries (for example Bangladesh, Pakistan, Afghanistan, Africa) where the general population did not see the importance of registering births and deaths, and as a result, many people from remote villages do not have formal identification documents.²⁸¹ Further, many citizens do not ever intend to travel and thus do not require passports and would not see the need to incur the expense of acquiring this document. Similarly, driving is a novelty reserved for the wealthy, and as such, driver's licenses are not owned by most working-class citizens.²⁸² Furthermore, vast rural areas of these countries are still reliant on kerosene lamps and wood burners and therefore do not have utility bills or other such forms of identification.²⁸³ This situation is further exacerbated by the land registry where manual ledgers are still used. The land is also passed down, with many generations acquiring the property before it is notarised, and therefore, address verification is not as simple and straight forward as it is in the developed world.²⁸⁴

²⁷⁹ Yvonne Lootsma, 'Blockchain as the Newest Regtech Application— the Opportunity to Reduce the Burden of KYC for Financial Institutions' (2017) 36 (8) Banking & Financial Services Policy Report 16

²⁸⁰ 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' (2017) 20(4) Journal of Money Laundering Control 428

²⁸¹ Ibid

²⁸² Ibid

²⁸³ Ibid

²⁸⁴ Ibid

Hence, due to unavailability of identification documents deprive many customers from financial services and ultimately, it encourages cash economy, which are vulnerable for ML/ TF. Therefore, merely enactment of strict AML/CFT regulation is not enough for prevention of financial crime, but the legislators are required to work together with the regulated entities to amend the stricter clauses as per their circumstance. For example, UK has introduced 'standard evidence' and 'non-standard evidence' and recommended that 'non-standard' identification documents are acceptable in special circumstance, such as people don't have standard identification documents.²⁸⁵

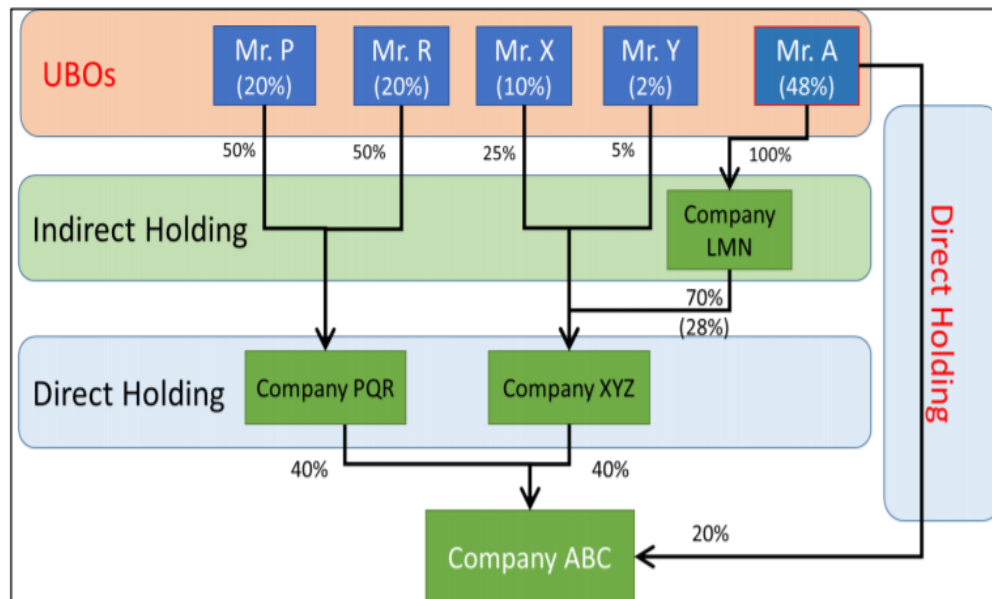
5.4b VERIFICATION OF IDENTIFYING DOCUMENTS

Identity information required to verify through an ID card or official (state) document.²⁸⁶ Although, verification individual customer is not simple and nor cost effective (will discuss here-in-below) but for the corporate customer, it is more complexed and required significant time and effort.²⁸⁷ In addition to verifying the details from the enterprise, intermediate entities, Directors, authorized signatories and ultimate beneficial owners (here-in-after called 'relevant individuals') also have to be identified and verified.

²⁸⁵ Tim Edmonds, 'Bank accounts problems of identification' (House of common library, briefing paper 03366, 2017)

²⁸⁶ Yvonne Lootsma, 'Blockchain as the Newest Regtech Application— the Opportunity to Reduce the Burden of KYC for Financial Institutions' (2017) 36 (8) Banking & Financial Services Policy Report 16

²⁸⁷ *ibid*



In above structure, the ultimate beneficial ownership is as follows

- Mr. X 10% shareholder in ABC via company XYZ [25% of 40%],
- Mr. R 20% shareholder in Company ABC via Company PQR [50% of 40%]
- Mr. P 20% shareholder in Company ABC via Company PQR [50% of 40%]
- **Mr. A is a highest shareholder with 48%** (i.e. 20 % Direct in ABC + 28% via Company PQR & XYZ), hence he is an UBO.

Figure 2²⁸⁸:

Further, identification is a process of investigation, therefore unwrapping of a corporate customer is essential to prevent financial system from AML/CFT. Figure 2 is an example of unwrapping and discloses the process to determine direct and ultimate beneficial owner of non-individual customer to detect potential financial fraud; for example, tax evasion. The above figure shows that initially 'Company ABC' seems one unit, however mining of the entity reveals that it carries three intermediate companies and ultimately owned by five individuals.

Apart from identification of ultimate beneficial owner, regulated entities are obliged to have an overview of the company organigram and all the intermediary entities that exercise a determined amount of control in the company, as well as the entities in which the company holds a certain threshold of shares.²⁸⁹ As such, a great part of KYC consists of identifying and

²⁸⁸ My KYC Bank, Know your customer Direct ownership and ultimate Beneficial Ownership < <https://www.mykycbank.com/Downloads/UBO%20Description.pdf>> accessed 16 July 2019

²⁸⁹ Djuri Baars, 'Towards Self-Sovereign Identity using Blockchain Technology' (2017) < https://essay.utwente.nl/71274/1/Baars_MA_BMS.pdf> accessed 16 July 2019

verifying the correct relationships between companies. This information is subject to frequent change due to the increase or decrease of control or ownership stakes.²⁹⁰

CDD is not only concerned with the recording of identifying particulars, but also with “verification”. Verification refers to the authentication of the identifying particulars²⁹¹ through government’s data system or document issuance authority. Therefore, regulated entities are expected to refer to reliable, independent source documents, data or information to verify the customer’s identifying particulars.²⁹² As afore-stated that verification is not as simple and straight forward²⁹³ due to unavailability of formal documents and data. In addition, the identification and verification requirements have placed obligations on the regulated entities that are expensive to meet. To the extent that such expenses are reflected in increased costs of services, financial barrier to access is raised.²⁹⁴

Therefore, responsible person has the challenge to advise on and implement compliance risk management systems that are, on the one hand, affordable, realistic and supportive of the business of the regulated entities and, on the other hand, ensure compliance with the law²⁹⁵.

5.4c CUSTOMER NAME SCREENING AGAINST SANCTION LIST

The third requirement of customer identification is to check the customer name (including intermediaries, related individuals and connected PEPs) against national and International sanction list and report, if there ‘positive true match’. Hence, the regulated entities oblige to link their internal system to screening lists (for example, governmental and intercontinental sanctions, terrorism, other illegal activities, political exposure, and negative press) while using

²⁹⁰ Yvonne Lootsma, ‘Blockchain as the Newest Regtech Application— the Opportunity to Reduce the Burden of KYC for Financial Institutions’ (2017) 36 (8) Banking & Financial Services Policy Report 16

²⁹¹ Financial Action Task Force, “FATF guidance anti-money laundering and terrorist financing measures and financial inclusion”, (FATF 2013) < <http://www.fatf-gafi.org/publications/financialinclusion/documents/reviseguidanceonamlcftandfinancialinclusion.html>> accessed 15 August 2019

²⁹² Louis de Koker, ‘The FATF’s customer identification framework fit for purpose?’ (2014) 17(3) Journal of money laundering control 281

²⁹³ Ibid

²⁹⁴ Louis De Koker, ‘Money laundering control and suppression of financing of terrorism some thoughts on the impact of customer due diligence measures on financial exclusion’ (2006) 13(1) Journal of Financial Crime 26

²⁹⁵ Ibid

external providers for screening purposes.²⁹⁶ In order to effective identification process regulated entities are compelled to have an automated screening system, so that it hits in real time and block onboarding, until the hit is investigated and cleared.²⁹⁷

Apart from automation cost, name screening process is itself challenging as despite international AML/CFT regime publish centralized sanction list, the regulated entities force to screen name of the prospective customers through more than 14 sanction lists. These include but not limited to, lists published by the United Kingdom's Financial Conduct Authority (FCA), U.S. Office of Foreign Assets Control (OFAC) and the United Nations Security Council, and each local jurisdictions' regulatory and law enforcement agencies, such as the Indonesia National Counter Terrorism Agency (INPT) and other countries designated lists.

As aforesaid that regulated entities must be alert to transactions that involve parties identified on a sanctions list.²⁹⁸ This is sometimes difficult, particularly as it relates to screening customer lists for persons whose names are not originally in Roman characters, such as suspected terrorists from Middle Eastern countries or sanctions lists in Asian countries. For example, most of the names of "designated terrorists" on the sanction lists also include numerous "Also Known As" alternatives.²⁹⁹ While some names may be aliases, others are confusing because the customs are not understood.³⁰⁰ Therefore, a responsible person is also responsible to knowledge to understand Arab naming customs and protocols to alleviate the confusion,³⁰¹ such as:

²⁹⁶ Alan Gelb, 'Balancing Financial Integrity with Financial Inclusion The Risk-Based Approach to "Know Your Customer' (2016) Centre for Global Development, Washington DC, CDG Policy paper 074 < <https://www.cgdev.org/sites/default/files/CGD-Policy-Paper-Gelb-KYC-Financial-Incl.pdf>> accessed on 16 July 2019

²⁹⁷ Ibid

²⁹⁸ Study Guide, CAMS Certification Exam (6th edn, The Association of Certified Anti-Money Laundering Specialists (ACAMS) Miami, USA)

²⁹⁹ Ibid

³⁰⁰ Ibid

³⁰¹ Ibid

- All names are transliterated from an Arabic script in which short consonants are most often left out. So, the name Mohammed might be written on a financial account as Mohamed or Mohamad.³⁰²

- Arabic names are typically long. A person's second name is the father's name. If a "bin" or "ibn" precedes the name, it indicates "son of." If a family name is included at the end, it will sometimes have "al" preceding it.³⁰³

- There is widespread use of certain names such as "Mohamed," "Ahmed," "Ali," or any name with the prefix "Abd-" or "Abdul," which means "servant of," and is followed by one of 99 suffixes used to describe God.³⁰⁴

- Many Arabic names begin with the word "Abu." If it is a first name, it is probably not the person's given name, because "Abu" means "father of." "Abu," followed by a noun, means something like "freedom" or "struggle," and is used by both terrorists and legitimate political leaders. Only when "Abu" is a prefix of a surname should it be accepted as a given name.³⁰⁵

Let's, take a look on the sanction lists,

5.4c(i) TREASURY DEPARTMENT'S OFFICE OF FOREIGN ASSETS CONTROL (OFAC)

OFAC administers and enforces economic and trade sanctions imposed by the United States against targeted foreign countries, terrorist, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction.³⁰⁶ RBA standards enforces that regulated entities to have policies, procedures, and processes for

³⁰² Ibid

³⁰³ Ibid

³⁰⁴ Ibid

³⁰⁵ Ibid

³⁰⁶ Federal Financial Institutions Examination Council, 'Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2014) <<https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/ffiec-bsa-aml-examination-manual.pdf>> accessed 17 July 2019

ensuring compliance with sanctions. Whereas, compliance with OFAC' Specially Designated Nationals ("SDN list")³⁰⁷ is a cumbersome exercise.

This Sanctions List Search application ("Sanctions List Search") is designed to facilitate the use of the Specially Designated Nationals and Blocked Persons list ("SDN List") and all other sanctions lists administered by OFAC, including the Foreign Sanctions Evaders List, the List of Persons Identified as Blocked Solely Pursuant to E.O. 13599, the Non-SDN Iran Sanctions Act List, the Part 561 list, the Sectoral Sanctions Identifications List and the Non-SDN Palestinian Legislative Council List. Given the number of lists that now reside in the Sanctions List Search tool, it is strongly recommended that users pay close attention to the program codes associated with each returned record. These program codes indicate how a true hit on a returned value should be treated. The Sanctions List Search tool uses approximate string matching to identify possible matches between word or character strings as entered into Sanctions List Search, and any name or name component as it appears on the SDN List and/or the various other sanctions lists. Sanctions List Search has a slider-bar that may be used to set a threshold (i.e., a confidence rating) for the closeness of any potential match returned as a result of a user's search. Sanctions List Search will detect certain misspellings or other incorrectly entered text, and will return near, or proximate matches, based on the confidence rating set by the user via the slider-bar. OFAC does not provide recommendations with regard to the appropriateness of any specific confidence rating. Sanctions List Search is one tool offered to assist users in utilizing the SDN List and/or the various other sanctions lists; use of Sanctions List Search is not a substitute for undertaking appropriate due diligence. The use of Sanctions List Search does not limit any criminal or civil liability for any act undertaken as a result of, or in reliance on, such use.

[Download the SDN List](#) [Visit The OFAC Website](#)
[Download the Consolidated Non-SDN List](#) [Program Code Key](#)

Lookup

Type: All
Name: Muhammad
ID #:
Program: All (dropdown menu open showing 561-Related, BALKANS, BELARUS)
Minimum Name Score: 100

Address:
City:
State/Province:*
Country: All
List: All

Search Reset

Lookup Results: 470 Found

Name	Address	Type	Program(s)	List	Score
MUHAMMAD, Rahman Zayb Faqir	Bashgram Laal Qila Wersakay	Individual	SDGT	SDN	100
MUHAMMAD, Rahman Zeb Faqir	Bashgram Laal Qila Wersakay	Individual	SDGT	SDN	100
MIRE, Muhammad		Individual	SDGT	SDN	100
DAR, Muhammad Harris		Individual	SDGT	SDN	100
HARIS, Muhammad		Individual	SDGT	SDN	100

Figure 3: OFAC search with 470 matches³⁰⁸:

In the above figure shows that there are several occasions when responsible person tries to screen name of their prospective customer, regardless manual or through automated system against sanction list, they could get a huge (470) matches and they become responsible to conduct investigation against each match and obtain further documents and information form prospective customer, especially when OFAC data is haphazard, with zero consistency and missing information.

³⁰⁷ William & Mary, 'Treasury Department's Office of Foreign Asset Control (OFAC)' <<https://www.wm.edu/offices/techtransfer/ExportControls/Regulations/OFAC/index.php>> accessed 17 July 2019

³⁰⁸ OFAC, Sanction list search < <https://sanctionssearch.ofac.treas.gov/>> accessed on 17 July 2019

5.4c(ii) HM TREASURY: FINANCIAL SANCTIONS TARGETS

The office of Financial Sanctions Implementation (OFSI)/ HM Treasury publishes sanction list of all those subject to financial sanctions imposed by the United Kingdom and keep it updated in different formats³⁰⁹ The list contains basic information (full name, any known aliases, Honorary, professional or religious titles, date of birth, place of birth, nationality, passport details, national identification numbers, address, nicknames, title of the financial sanctions regime under which designated person is listed, date when the designated person was added to list by HM Treasury, date when the information regarding the designated person and unique ID reference number) of the individuals / non-individuals who are subject to UK sanction.³¹⁰

UK sanction list better than OFAC as format and information are consist and organized.



Office of Financial Sanctions Implementation
HM Treasury

CONSOLIDATED LIST OF FINANCIAL SANCTIONS TARGETS IN THE UK

Last Updated: 10/07/2019

Status: Asset Freeze Targets

REGIME: Afghanistan

INDIVIDUALS

- Name 6:** ABBASIN 1: ABDUL AZIZ 2: n/a 3: n/a 4: n/a 5: n/a.
DOB: --/--/1969. **POB:** Sheykhani Village, Pirkowti Area, Orgun District, Paktika Province, Afghanistan **a.k.a:** MAHSUD, Abdul Aziz **Other Information:** UN Ref TLA.155.11. Key commander in the Haqqani Network under Sirajuddin Jallalouline Haqqani. Taliban Shadow Governor of Orgun District, Paktika Province, as of early 2010. **Listed on:** 21/10/2011 **Last Updated:** 17/05/2013 **Group ID:** 12156.
- Name 6:** ABDUL AHAD 1: AZIZRAHMAN 2: n/a 3: n/a 4: n/a 5: n/a.
DOB: --/--/1972. **POB:** Shega District, Kandahar Province, Afghanistan **Nationality:** Afghan **National Identification no:** 44323 (Afghan) (tazkira) **Position:** Third Secretary, Taliban Embassy, Abu Dhabi, United Arab Emirates **Other Information:** UN Ref TLA.121.01. **Listed on:** 23/02/2001 **Last Updated:** 29/03/2012 **Group ID:** 7055.
- Name 6:** ABDUL AHMAD TURK 1: ABDUL GHANI 2: BARADAR 3: n/a 4: n/a 5: n/a.
Title: Mullah **DOB:** --/--/1968. **POB:** Yatimak village, Dehrawood District, Uruzgan Province, Afghanistan **a.k.a:** (1) AKHUND, Baradar (2) BARADAR, Abdul, Ghani **Nationality:** Afghan **Position:** Deputy Minister of Defence under the Taliban regime **Other Information:** UN Ref T.L.B.24.01. Arrested in Feb 2010 and in custody in Pakistan. Extradition request to Afghanistan pending in Lahore High Court, Pakistan as of June 2011. Belongs to Popalzai tribe. Senior Taliban military commander and member of Taliban Quetta Council as of May 2007. **Listed on:** 02/04/2001 **Last Updated:** 29/03/2012 **Group ID:** 7060.
- Name 6:** ABDUL BASEER 1: ABDUL QADEER 2: BASIR 3: n/a 4: n/a 5: n/a.
Title: General/Maulavi **DOB:** --/--/1964. **POB:** (1) Surkh Rod District, Nangarhar Province, Afghanistan **a.k.a:** (1) BASIR, Abdul, Qadir (2) HAJI, Ahmad (3) HAQQANI, Abdul, Qadir (4) OADIR, Abdul **Nationality:** Afghan **Passport Details:** D 000974 (Afghan) **Position:** Military Attaché, Taliban Embassy, Islamabad, Pakistan **Other Information:** UN Ref TLA.178.01. Financial advisor to Taliban

Figure 4: HMT sanction list³¹¹


³⁰⁹ HM Treasury, 'Office of Financial Sanctions Implementation guidance < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/292095/fin_sanc_consolidated_list_format_guide.pdf > accessed on 17 July 2019

³¹⁰ HM Treasury, 'Office of Financial Sanctions Implementation guidance < <https://www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets> > accessed on 17 July 2019

³¹¹ HM Treasury, 'Office of Financial Sanctions implementation' (10 July 2019) < <http://hmt-sanctions.s3.amazonaws.com/sanctionsconlist.pdf> > accessed on 17 July 2019

5.4c(iii) UNITED NATIONS SECURITY COUNCIL

The Security Council can act to maintain or restore international peace and security under Chapter VII of the United Nations Charter. Sanctions measures, under Article 41, encompass a broad range of enforcement options that do not involve the use of armed force. Since 1966, the Security Council has established 30 sanctions regimes, in Southern Rhodesia, South Africa, the former Yugoslavia (2), Haiti, Iraq (2), Angola, Rwanda, Sierra Leone, Somalia and Eritrea, Eritrea and Ethiopia, Liberia (3), DRC, Côte d'Ivoire, Sudan, Lebanon, DPRK, Iran, Libya (2), Guinea-Bissau, CAR, Yemen, South Sudan and Mali, as well as against ISIL (Da'esh) and Al-Qaida and the Taliban.³¹²



United Nations Security Council Consolidated List

Generated on: 18 July 2019

"Generated on refers to the date on which the user accessed the list and not the last date of substantive update to the list. Information on the substantive list updates are provided on the Council / Committee's website."

Composition of the List

The list consists of the two sections specified below:

A. Individuals
B. Entities and other groups

Information about de-listing may be found at:
<https://www.un.org/securitycouncil/ombudsperson> (for res. 1267)
<https://www.un.org/securitycouncil/sanctions/delisting> (for other Committees)
<https://www.un.org/securitycouncil/content/2231/list> (for res. 2231)

A. Individuals

KPi.033 Name: 1: RI 2: WON HO 3: 4: na
Title: na **Designation:** DPRK Ministry of State Security Official **DOB:** 17 Jul. 1964 **POB:** na **Good quality a.k.a.:** na **Low quality a.k.a.:** na **Nationality:** Democratic People's Republic of Korea **Passport no:** 381310014 **National identification no:** na **Address:** na **Listed on:** 30 Nov. 2016 **Other information:** Ri Won Ho is a DPRK Ministry of State Security Official stationed in Syria supporting KOMID.

KPi.037 Name: 1: CHANG 2: CHANG HA 3: 4: na
Title: na **Designation:** President of the Second Academy of Natural Sciences (SANS) **DOB:** 10 Jan. 1964 **POB:** na **Good quality a.k.a.:** Jang Chang Ha **Low quality a.k.a.:** na **Nationality:** Democratic People's Republic of Korea **Passport no:** na **National identification no:** na **Address:** na **Listed on:** 30 Nov. 2016 **Other information:**

KPi.038 Name: 1: CHO 2: CHUN RYONG 3: 4: na
Title: na **Designation:** Chairman of the Second Economic Committee (SEC) **DOB:** 4 Apr. 1960 **POB:** na **Good quality a.k.a.:** Jo Chun Ryong **Low quality a.k.a.:** na **Nationality:** Democratic People's Republic of Korea **Passport no:** na **National identification no:** na **Address:** na **Listed on:** 30 Nov. 2016 **Other information:**

Figure 5: UN sanction list³¹³

³¹² United Nations Security Council < <https://www.un.org/securitycouncil/sanctions/information> > accessed 17 July 2019

³¹³ United Nations Security Council, 'United Nation Security Council consolidated list < <https://scsanctions.un.org/fop/fop?xml=htdocs/resources/xml/en/consolidated.xml&xslt=htdocs/resources/xsl/en/consolidated.xsl> > accessed 17 July 2019

Amazingly, today 14 ongoing sanctions regimes which focus on supporting political settlement of conflicts, nuclear non-proliferation, and counter-terrorism. The measures have ranged from comprehensive economic and trade sanctions to more targeted measures such as arms embargoes, travel bans, and financial or commodity restrictions.³¹⁴

Moreover, the FATF has declared that PEP (national and international) and their associates are high risk, whereas, there is no specific way to identify the PEP and its associates due to unavailability of official database.³¹⁵ Though there are dozens of private providers that offer PEPs databases; however, the information contained in them can be a challenge due to lack of available and useful information about the identity of PEPs around the world.

Frustratingly, every sanction list is different and regulated entities are compelled to screen name of prospective customer against more than 14 international and unlimited national sanction lists. Consequently, while, looking at the process of on-boarding, corporations' expectation that their customer on-boarding time raised with the average increased to 32 days in 2017 from 28 in 2016.³¹⁶ And in some jurisdiction, tedious CDD and identification may take anything up to 6-7 weeks to onboard a new individual customer and 34 weeks to onboard a new Non-individual customer. For every day that a client is not onboarded, it costs the equivalent of a full day's trade – so if the client is trading \$1 million per day, then it quickly accrues to over \$200 million over the 34-week duration.³¹⁷

Ultimately, the regulated entities are compelled to deploy expensive software, hire services of external providers and compliance personnel to meet FATF standards. Such a lengthy and costly process is not desirable for economy growth, customer and business. Regardless of cost, there is no guarantee nor any way to measure to know that embedded sanction list in the

³¹⁴ United Nations Security Council < <https://www.un.org/securitycouncil/sanctions/information> > accessed 17 July 2019

³¹⁵ Study Guide, CAMS Certification Exam (6th edn, The Association of Certified Anti-Money Laundering Specialists (ACAMS) Miami, USA)

³¹⁶ Refinitiv, 'KYC compliance - the rising challenge for corporates (2017) < <https://www.refinitiv.com/en/resources/special-report/kyc-compliance-the-rising-challenge-for-corporates/>> accessed 16 July 2019

³¹⁷ Marc Murphy, 'Managing regulatory data for faster compliance and client onboarding' (Bobs guide, 10 May 2017) < <https://www.bobsguide.com/guide/news/2017/May/10/managing-regulatory-data-for-faster-compliance-and-client-onboarding/> > accessed 10 September 2019

external service providers are accurate and reflecting real time updates, which cause lapses and ultimately regulated expose with unwanted customers.

5.4d RECORD KEEPING

The regulated entities are required to maintain, for at least five years, all necessary records; such as CDD measures (e.g. copies or records of official identification documents like passports, identity cards, driving licences or similar documents), business correspondence, including the results of any analysis undertaken (e.g. inquiries to establish the background and purpose of complex, unusual large transactions), both domestic and international, to enable them to comply swiftly with information requests from the competent authorities.³¹⁸ Record keeping helps the company understands the entire relationship with the customer. In addition, a systematic record keeping workflow helps the company meets its reporting obligations in retrieval and submission of appropriate data to their local financial intelligence unit or regulators.³¹⁹

“Increasingly protracted, complex and costly processes associated with RBA compliance and record-keeping underscore the challenges equally financial institutions and their corporate customers.”³²⁰ “In 2017 financial institutions with \$10 billion or more in revenue have seen their average spend on RBA related procedures increase to USD \$150 million comparatively from USD \$142 million in 2016, while their number of deployed employees has skyrocketed to an average of 307 CDD compliance professionals in 2017 from 68”. Despite this rise in headcount, just over a third of firms reported that scarce resources remain their biggest challenge in conducting KYC and customer due diligence (CDD) processes.³²¹

³¹⁸ FATF Recommendation, ‘International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation’ Updated June 2019 < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> > accessed 15 July 2019, Recommendation 11

³¹⁹ JX Low, ‘How to conduct proper customer due diligence (CDD)’ (AML-CFT 14 November 2018) < <https://aml-cft.net/conduct-proper-customer-due-diligence-cdd/> > accessed 10 September 2019

³²⁰ Thomson Reuters, ‘Thomson Reuters 2017 Global KYC Surveys Attest to Even Greater Compliance Pain Points’ (Thomson, 26 October 2017) < <https://www.thomsonreuters.com/en/press-releases/2017/october/thomson-reuters-2017-global-kyc-surveys-attest-to-even-greater-compliance-pain-points.html> > accessed 16 July 2019

³²¹ Refinitiv, ‘KYC compliance - the rising challenge for corporates (2017) < <https://www.refinitiv.com/en/resources/special-report/kyc-compliance-the-rising-challenge-for-corporates/> > accessed on 16 July 2019

“Similarly, for financial firms, documenting and maintaining current KYC records to keep compliant remains difficult and surprisingly, average 18 percent of regulated entities takes action, when an event occurs to trigger a KYC review”.³²² “Due to endless regulatory requirement, in 2017, less than one third (30%) of corporate respondents make their financial institutions aware of all material changes involving KYC and CDD”³²³ and compelled to do own CDD to keep update their records. While financial institutions have continued to invest significant resources in KYC, the compliance issues and concerns both they and their clients face appear to be rising.³²⁴

Although, according to FATF 4th round assessment, record-keeping is the only FATF’s RBA requirement which has complied almost every country. However, there are some instance, where regulators imposed substantial penalties due to breach of record-keeping standards. For example, In 2017, the FCA levied 229.4 million pounds (\$307 million) in penalties, which is a 10-fold increase from 22.2 million pounds in 2016.³²⁵

While the administrative burdens and high costs of implementing a compliant CDD program can be overwhelming, especially for smaller firms, the obstacle has also created an opportunity for organizations to enhance their competitive advantage.³²⁶ This has resulted in increasing complex and extensive CDD requirements, with a cost that is estimated \$60 million annually on average,³²⁷ while the customer experience was evaluated as poor.

5.5 CONCLUSION

RBA Regulations have strained CDD obligations in order to mitigate growing counterparty risks. Specifically, new KYC on-boarding and reporting provisions are designed to limit client risk in

³²² Thomson Reuters, ‘Thomson Reuters 2017 Global KYC Surveys Attest to Even Greater Compliance Pain Points’ (Thomson, 26 October 2017) < <https://www.thomsonreuters.com/en/press-releases/2017/october/thomson-reuters-2017-global-kyc-surveys-attest-to-even-greater-compliance-pain-points.html>> accessed 16 July 2019

³²³ *ibid*

³²⁴ *Ibid*

³²⁵ Pinchas, FCA fines for Non-Compliance with its record-keeping requirements’ (Tele Message, 29 January 2018) < <https://www.telemessage.com/fca-fines-non-compliance-recordkeeping-requirements/>> accessed 16 July 2019)

³²⁶ Thomson Reuters, ‘How banks can turn the KYC compliance challenge into a competitive advantage’ (2019) < <https://legal.thomsonreuters.com/en/insights/articles/how-banks-can-turn-the-kyc-compliance-challenge-into-a-competitive-advantage> > accessed on 15 July 2019

³²⁷ *Ibid*

the form of AML, terrorism financing, tax evasion and politically exposed persons.³²⁸ The recent Panama Papers leak³²⁹ has fuelled even stricter CDD reforms³³⁰, designed to identify the real owners of business bank accounts.³³¹

Unfortunately, despite spending a substantial sum on CDD regulated entities are exposed due to ML/TF and regulatory penalties and sanctions and on the other hand, customer satisfaction is suffering from increased regulatory requirements. As before entering into a financial relation, customers, and in particular corporate customers have to go through lengthy paperwork procedures, for which regulated entities have insufficient skilled resources to handle the process.³³²

³²⁸ Thomson Reuters, 'How banks can turn the KYC compliance challenge into a competitive advantage' (2019) < <https://legal.thomsonreuters.com/en/insights/articles/how-banks-can-turn-the-kyc-compliance-challenge-into-a-competitive-advantage> > accessed on 15 July 2019

³²⁹ Bastian Obermayer, Frederik Obermaier, Vanessa Wormer and Wolfgang Jaschensky, 'The secrets of dirty money: These are the Panama Papers' < <https://panamapapers.sueddeutsche.de/articles/56ff9a28a1bb8d3c3495ae13/> > accessed on 15 July 2019

³³⁰ 'FinCEN Final Rule New Customer Due Diligence Requirements' (Trulioo, 9 January 2019) < <https://www.trulioo.com/blog/fincen-final-cdd-rule/> > accessed 15 July 2019

³³¹ Thomson Reuters, 'How banks can turn the KYC compliance challenge into a competitive advantage' (2019) < <https://legal.thomsonreuters.com/en/insights/articles/how-banks-can-turn-the-kyc-compliance-challenge-into-a-competitive-advantage> > accessed on 15 July 2019

³³² José Parra-Moyano and Omri Ross, 'KYC Optimization Using Distributed Ledger Technology' (2017)1(1)SSRN < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2897788 > accessed 16 July 2019

CHAPTER 6

CONCLUSION AND RECOMMENDATION

6.1 CONCLUSION

Financial crime (ML/TF) is real problem to the regulated entities and to the nation as whole. As money is the lifeblood of crime and without ML, criminals would have no mechanism to launder their dirty money and claim it as clean.³³³ Therefore, in order to address this problem FATF has issued RBA standards and thereby, regulated entities are obliged to assess, identify and mitigate the risk by applying RBA and deploy their resources more efficiently by focusing on higher-risk areas.³³⁴

However, RBA seems an attractive concept but poses theoretical and practical implementation problems. Part of the problem stems from the conceptualisation of risk; the comprehensive importation of the concept of risk from other disciplines without proper realignment; and the lack of agreement on the objective of AML/ CFT is to prevent ML and combat TF within regulated entities.³³⁵

Secondly, arbitrary risk classification (high risk) due to customer, product and country type, clearly misses the objective of RBA (asses, identify and take effective action). As the countries and regulated entities are compelled to apply 'high risk' measures on the designated categories without applying their specific circumstance and consequently incurring high cost to comply with high-risk's protocol.

Thirdly, RBA transmits a clear contradiction, at one hand RBA is flexible and regulated entities are empowered to make a judgment to report or not report an activity, and on the other hand it imposes personal liabilities on the outcome of the decision.

³³³ Yusarina Mat Isa, Zuraidah Mohd Sanusi, Mohd Nizal Haniff and Paul A, Barnes, 'Money Laundering Risk from the Banker's and Regulators perspectives' (2015) 28 *Procedia Economics and Finance Journal* 7

³³⁴ Alan Gelb, 'Balancing Financial Integrity with Financial Inclusion The Risk-Based Approach to "Know Your Customer"' (2016) Centre for Global Development, Washington DC, CDG Policy paper 074 < <https://www.cgdev.org/sites/default/files/CGD-Policy-Paper-Gelb-KYC-Financial-Incl.pdf>> accessed on 16 July 2019

³³⁵ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) *Security Journal* 24

Further, if discuss practical difficulties, RBA has not achieved its objective of minimising the compliance cost. Instead of countries and regulated entities are incurring heavy cost on systems, work force, external providers to implement RBA (CDD, identification of customer, name screening, transaction monitoring and initiating SARs). Further, forced to pay penalties whether lapses are intentional or unintentional.

More importantly, on boarding is the first step where regulated entities can stop illicit money and dirty transactions. Because if "dirty money" enter in the international financial system, the more difficult it is to identify its origin.³³⁶ Whereas, regulated entities suffer challenges in identification of prospective customer and forced to involve in tedious exercise due to governments, regulators and international RBA regime's unclear and hazy data (as briefed in chapter 5). Consequently, regulated entities expose their system with illicit funds and transactions, which cause ineffectiveness of RBA.

Concisely, apparently idea of RBA strikes but its implementation challenges provide a great room of improvement.

6.2 RECOMMENDATION

Apparently, almost every country has criminalised ML and TF and established a legal framework to freeze terrorist assets.³³⁷ But there are several gaps and in order to achieve an effective AML/CFT compliance, FATF needs to work together with countries (including developing countries) to achieve the right balance in their current environment.³³⁸

³³⁶UNODC, 'Money-Laundering and globalization' (United Nations office Drug and Crime, 2019) < <https://www.unodc.org/unodc/en/money-laundering/globalization.htm>> accessed 21 July 2019

³³⁷ Rhoda Weeks-Brown, 'cleaning up: Countries are advancing efforts to stop criminals from laundering their trillions' (International monetary funds, 2018) 55 (4) finance and Development department 44 < <https://www.imf.org/external/pubs/ft/fandd/2018/12/imf-anti-money-laundering-and-economic-stability-straight.htm> > accessed 28 July 2019

³³⁸ Adebola Adeyemi, 'Slipping through the net: The financial conduct authority's approach in lessening the incidence of money laundering in the UK' (2018) 21(2) Journal of Money Laundering Control 203

6.2a RECOMMENDATIONS FOR FATF

The FATF needs to consider that as ML/TF is not merely a risk but create a situation where the probability of occurrence of an event is known but the consequences in the event of occurrence remain unknown.³³⁹

Therefore, FATF required to take following steps to improve the effectiveness of RBA.

- i. Provide a better conceptualisation of the problem of risk within the AML/CFT domain;³⁴⁰
- ii. Ensure that personal liability should be depending on quality of decision-making process leading to the decision, rather outcome of decisions. This is because this amendment will help to align the interest of regulated entities with those of regulators without the need for fines and other pressures.³⁴¹
- iii. Create a centralized depository for sanction lists and provide a universal guideline for the national and international institutions (for example OFAC, HM treasury, UN council) so that data could be stored in universal format. And enable regulated entities to retrieve sanction lists from one forum and conduct name screening (on-boarding and periodically) without wasting time and money.

6.2b RECOMMENDATION FOR REGULATORS

The regulators need to consider that only AML/CFT regulations and strict compliance is not enough. They need to introduce a culture of support and integrity for effectiveness of RBA.

Therefore, countries are needed to have strong process and adequate system of:

- i. public institutions, political rights and rule of law;
- ii. high levels of financial/ political transparency;
- iii. independent press;
- iv. adequate resources to control financial system;

³³⁹ Abdullahi Usman Bello and Jackie Harvey, 'From a risk-based to an uncertainty-based approach to anti-money laundering compliance' (2017) 30 (1) Security Journal 24

³⁴⁰ Ibid

³⁴¹ Ibid

- v. cash-less economy; and
- vi. prohibition of smuggling activity and (7) restriction on drug, human and wildlife products trafficking.³⁴²
- vii. develop consistency between AML regime and other law with cooperation of legislative bodies, to avoid contradiction between regulators and court's decision

Furthermore, implementation of RBA is needs consistency in a reliable manner. Following which needs to be agreement between the regulators and regulated entities about what the elements of a risk assessment system should be, and this in turn needs to be based on an understanding of how different forms of financial activity give rise to risk.³⁴³

6.2c RECOMMENDATION FOR REGULATED ENTITIES

Efficient and effective RBA compliance is assured when regulated entities will be willing to wholeheartedly support the desire of regulators to prevent ML/TF.

Therefore, the regulated entities required to develop highly sophisticated risk transaction monitoring system,³⁴⁴ hire well trained personnel with sound understanding of the AML/ CFT risk and more important certainty of sound judgments or decisions,³⁴⁵ place accountability and procedural transparency, arrange periodically training to enhance skill of the responsible person.

³⁴² International Centre for Asset Recovery, 'Basel AML Index Report' (Basel Institute of Governance, 2018) <https://www.baselgovernance.org/sites/default/files/2019-02/basel_aml_index_10_09_2018.pdf> accesses 21 July 2019

³⁴³ Stuart Ross, Michelle Hannan, 'Money laundering regulation and risk-based decision-making' (2007) 10(1) Journal of Money Laundering Control 106

³⁴⁴ Stravros Gadinis and Colby Mangels, 'Collaborative Gatekeepers' (2016) 73 (2) Washington & Lee Law Review 797

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