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# INTEGRATED ANTI-MONEY LAUNDERING INITIATIVES IN THE MALAYSIAN BANKING INDUSTRY TOWARDS FATF FULL-COMPLIANT STATUS

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**ABSTRACT**

**Background and Purpose:** This study aims to demonstrate the integrated anti-money laundering (AML) initiatives in the Malaysian banking industry, with particular focus towards achieving the Financial Action Task Force (FATF) full-compliant status.

**Methodology:** This study adopts a qualitative approach, which includes reviews and analysis of secondary data in relevant literature and documents relating to money laundering risk in the Malaysian banking industry.

**Findings**: The integrated AML initiatives combine domestic and international efforts, which are anchored by the Malaysian Central Bank and FATF, respectively. Malaysia has been proactively abiding by the FATF requirements, and affirmative progression can be seen from the improved FATF-compliant status throughout the years.

**Conclusion and Contributions:** This study adds new knowledge to the existing literature by integrating domestic and international AML efforts. Achieving a FATF full-compliant status is not impossible for Malaysia with the current integrated AML initiatives in place, and this forms a strong pillar that could protect the Malaysian banking industry from money laundering risk.

**Keywords:** Money laundering, AML, risk, banking industry, Malaysia.

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## 1.0 INTRODUCTION

The term "money laundering" is defined as the processing of illicit earnings to cover up their illegal source in an effort to legalize the benefits from crime (FATF, n.d.). Researchers have a common understanding of defining money laundering, albeit from different perspectives. According to Hinterseer (1997, p. 154), *"money laundering refers to a process used by individuals to prevent the origin and movement of money from being accurately traced so that the money can be used in the legal economy free of the taint of illegality and without fear of criminal, civil, or equitable legal sanction*." Another definition of money laundering by Simser (2013, p. 41) advocates that *"money laundering is a technique used by criminals to disguise the origin of ill-gotten gains with the intent of enjoying their 'cleansed' money without interference from predatory underworld rivals or law enforcement*." Money laundering risk is industry-aligned, and banking is categorised as one of the industries which is greatly exposed (KPMG, 2013). Banks are identified as the most inherently vulnerable sector to money laundering risk due to their nature of operations, including the diverse range of financial products offered (Bank Negara Malaysia (BNM), 2014; Edirisuriya, Gunasekarage, & Perera, 2019) and their extensive ability to move funds from entity to entity and from jurisdiction to jurisdiction rather swiftly (Ruce, 2011). Furthermore, with the advancement of both traditional-based and technology-based banking services, penetration of money laundering risk has become even more susceptible for banks in which illegal money is passed through the banks either consciously or unconsciously (Duncan, 2021; Idowu & Obasan, 2012). Banks are a preferred mode for money launderers (Mclaughlin & Pavelka, 2013; Sathye & Islam, 2011), and this is a problem that threatens financial stability, not only in Malaysia but also the rest of the world.

In recent years, a number of banks have been in the spotlight over their failures in managing money laundering risk. For instance, London-based HSBC Bank has been fined by the United States regulator for almost $2 billion for failing to stop Mexican drug traffickers from using its banking system to launder money (Mclaughlin & Pavelka, 2013). Another example is Standard Chartered Bank, which was fined for $340 million by the United States

regulator to settle allegations that the bank broke the United States money laundering laws in handling transactions for Iranian customers (Protess & Silver-Greenberg, 2012). Malaysia is not spared from this predicament, as there are cases of banks being fined for various money laundering related issues. For example, AmBank has been fined RM53.7 million due to offences linked to the 1 Malaysia Development Berhad (1MDB) scandal (Raj, 2015). These banks are substantial in size and ostensibly regulated to have implemented reliable internal controls; however, they were unable to stop money launderers from utilizing them as a middleman to launder illicit funds. With these kinds of cases involving banks, it comes to the question of what kind of mechanism should be in place to safeguard the banks from money laundering risk.

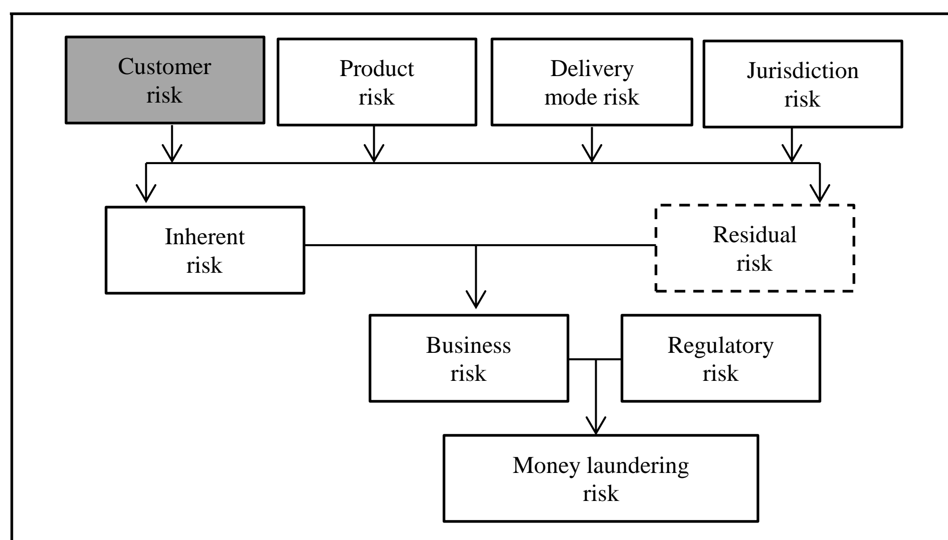
According to the Financial Action Task Force's (FATF), most recent and updated analysis of the 2018 Mutual Evaluation Report (MER), Malaysia has not yet fully complied with all 40 of the FATF's recommendations for anti-money laundering (AML) activities. The Malaysian Central Bank, which is Bank Negara Malaysia (BNM), the one that regulates the banking industry in Malaysia is proactively making a concerted effort to counter money laundering risk by closely complying with the FATF recommendations (Latif & Abdul-Rahman, 2018; Nazri, Zolkaflil, & Omar, 2019). However, there are still further improvements that need to be made, particularly in having an integrated AML regime. This is crucial considering that, with tighter regulations, money launderers would be deterred and less inclined to use the banks as their complicit. According to compliance experts, attempts to prevent money laundering in banks have resulted in money launderers shifting their modus operandi to less regulated institutions (Teichmann, 2017; Sarigul, 2013). BNM advocates that compliance with AML laws, regulations, and rules should always be top priority. Moreover, persistent supervision by the regulatory authorities at the domestic and international levels will ensure the banking industry's AML compliance program that will work robustly to combat money laundering.

The aim of this paper is to demonstrate the integrated AML initiatives affected in the Malaysian banking industry, with a particular focus towards achieving FATF full-compliant status. Subsequent sections will describe money laundering risk, and how it fits into the setting of the Malaysian banking industry, the integrated AML initiatives, and finally, the evaluation of FATF compliance status. Malaysia is not far behind in achieving FATF full-compliant status. Hence, the objectives of this paper are to provide insights into the initiatives that are already in place, as well as identify loopholes that can be taken into consideration for future FATF assessment.

## 2.0 OVERVIEW OF MONEY LAUNDERING RISK IN THE BANKING INDUSTRY

Money laundering risk in banks can be grouped under two broad categories – regulatory risk and business risk (which is sub-categorised into inherent and residual risk) (Sathye & Islam, 2011), as shown by Figure 1. Regulatory risk is associated with non-compliance with related requirements for AML, which includes customer identification, reporting, record keeping, and implementation of an AML program. Banks have to comply with a substantial number of legal obligations to safeguard them against money laundering risk. Business risk, on the other hand, implies uncertainty and danger of loss, as well as any event that poses a risk due to unforeseen circumstances that could cause banks to fail (Hoque & Said, 2021). Inherent business risks emanate from the customers' seeking banking services, the products offered to the customers, the delivery method of the products, and the geographical location from which the customer comes from or the location in which the offering of products and conduct of transactions take place. Business risks that might still exist despite a strong framework for managing money laundering risks are referred to as residual risks.

The bank officers' evaluation of client risk, namely the underlying business risk, is where the most important component of money laundering risk comes from. Both Sathye and Islam (2011) and Killick and Parody (2007) similarly explained the inherent business risk by giving emphasis on the description of the source of risk. The customers themselves, either individual or institutional customers, bear risks due to their source of income and wealth, their past activities, and the intended nature of the activities. The customers who are deemed as risky should be assigned a high alert on the possibility of an alleged money launderer, for example, politically exposed persons (PEPs), a customer who has an unusual request for service provision, and a customer whose source of funds is unexplained.




Source: Sathye & Islam (2011)

Figure 1: Classification of money laundering risk in banks

Product risk is the risk posed by the products the banks offer to their customers and their inherent attractiveness to money launderers as a means of illegal activity (Sathye & Islam, 2011). Some products offered by the banks may present greater appeal to money launderers. For instance, investment products with periodic annuity returns and full payment on maturity are considered more ideal for money launderers. The way the products are delivered to the customers also posed a different level of risk to the banks. Products that are delivered face-to-face generally pose a lower risk compared to those delivered online, considering that face-to-face interactions could provide more visual signs of money laundering.

With the Internet, customers are offered a variety of online transactions that do not require a direct interface with customers (McDowell & Novis, 2001; Sathye & Islam, 2011). For the banking industry, online transactions, for example, online fund transfers, pose a greater risk as the identity of the customer is not visually verified. For jurisdiction risk, money laundering risk can be country-specific, in which the economic activity that gave rise to the income or wealth was derived from or where the activity is to take place. Among these risk elements, customer risk is the strongest link that connects all four elements of risk. Banks need to develop profiles on these risk elements to form the basis, upon which customer identification documents are determined to ensure a thorough assessment of the related risks.

The operations of banks are about taking risks, albeit calculated ones (Al-Tamimi & Al-Mazrooei, 2007; Mat Isa et al., 2021). Nevertheless, some risks, such as money laundering risk, are not inherently drawn by the nature of banking operations, but inadvertently absorbed into the banking industry due to poor control and non-compliance with AML policies (Naheem,

2015; Pramod, Li, & Gao, 2012), as well as due to the inability of the bank officers to filter the risk posed by the customers (Dhillon et al., 2013; Favarel-Garrigues, Godefroy, & Lascoumes, 2007). Banks would face criminal charges if they knowingly accept money laundering risk into their institutions (Simser, 2013).

In the context of this study, money laundering risk is defined as the money laundering-related threats and vulnerabilities faced by the banks in the course of conducting their banking businesses. The three different processes for converting illegal money into legitimate money, namely placement, layering, and integration, are broadly applicable to banks (Idowu & Obasan, 2012; Simwayi & Guohua, 2011). The three-staged process of money laundering can be simplified due to the fact that the stages can often overlap, and in some cases, any of the stages can be skipped. It should be noted that some money laundering transactions can also be affected in one or two stages, depending on the money laundering technique being used. Commonly, in passing through these stages, the criminals are more interested in laundering the money to fuel their next criminal activities, and not get caught by the authorities than generating returns from the illegal money.

## 3.0 LANDSCAPE OF THE MALAYSIAN BANKING INDUSTRY

In Malaysia, the banking industry comprises licensed institutions, namely commercial banks, Islamic banks, international Islamic banks, and investment banks. As of December 2021, there are 26 commercial banks (including 19 licensed foreign banks), 18 Islamic banks (including one international Islamic bank) and 11 investment banks (BNM Website). Commercial banks are the largest and most significant providers of funds in the banking system. The main functions of commercial banks are to provide retail banking services (accepting of deposits, granting of loans and advances, and financial guarantees), trade finance facilities (letters of credit, discounting of trade bills, shipping guarantees, trust receipts, and banker’s acceptance), treasury services, cross-border payment services, and custody services (safe deposit). Commercial banks are also authorised to deal in foreign exchange and are the only banking industry allowed to provide current account facilities.

Domestic and foreign Islamic banks serve the same function as commercial banks, with the exception that they are run in accordance with Shariah principles (Islamic laws), which forbid the payment or acceptance of interest fees (known as "riba"), and any actions that foster uncertainty (known as "gharar"). The operations of investment banks are slightly different from those of commercial banks and Islamic banks, where the product offerings are in the short-term money market and capital raising activities, including financing, specialising in syndication,

corporate finance and management advisory services, arranging for the issue and listing of shares, as well as investment portfolio management.

All banks are under the purview of BNM, which is the statutory body that is entrusted to promote monetary and financial stability in Malaysia (BNM, 2018). Financial system stability is achieved by developing a sound, resilient, progressive, and diversified financial sector, which serves to support economic growth. The seven functional areas that are spearheaded by BNM are economics and monetary policy, investment and operations, regulations, payment systems, supervision, organisational development, and communications. Among these, two of the areas, regulation and supervision, are the closest links between the banking industry and the money laundering risk management framework.

All banks are bound by all the relevant acts administered by BNM. Among others, the statutes that need to be complied with by the banking industry are the Financial Services Act 2013, Islamic Financial Services Act 2013, Money Services Business Act 2013, Anti-Money Laundering, Anti-Terrorism Financing, and Proceeds of Unlawful Activities Act 2001 (AMLA). BNM has been proactive in tackling globalisation and market liberalisation under the Financial Sector Masterplan (2001-2010), and Financial Sector Blueprint (2011-2020) set out for the emergence of new players in the banking industry, which call for strong risk management practices across the banking industry (BNM, 2011, 2020). This has heightened the need for a more responsive risk management framework that includes management of money laundering risk.

In Malaysia, the crimes of money laundering have been expanded to implicate expansive predicate offences, in which AMLA has listed 365 such offences. Figure 2 highlights the most notable crimes with different levels of threats that elucidate money laundering. Among those crimes, corruption, fraud, and illicit drug trafficking top the chart to post a high level of threat from money laundering. In 2021, Malaysia deteriorated by five spots to rank 62 in the global rankings of Transparency International Malaysia's (TI-M) Corruption Perceptions Index (CPI) 2021, marking the second consecutive year of a decline in the rankings (Idris, 2022). This is supported by PricewaterhouseCoopers (PwC, 2020), which shows corruption is one of the disruptive economic crimes in Malaysia. Similarly, other kinds of fraud, including asset misappropriations, customer fraud and cybercrime, accounted for almost 50% (PwC, 2020). Drug trafficking remains one of the most notorious crimes in Malaysia, with millions of ringgits traded each year (United Nations Office on Drugs and Crime, 2019). Given the various types of crimes, criminals are constantly finding ways of cleaning up their dirty money, and banks are commonly the easiest target.

| Types of crime | Threat level | Types of crime | Threat level |
|---|---|---|---|
| Corruption<br>Fraud<br>Illicit drug trafficking<br>Organised crimes<br>Smuggling | High | Money counterfeit<br>Environmental crimes<br>Illegal remittance<br>Murder<br>Kidnapping<br>Insider trading and market manipulation | Medium |
| Counterfeiting and piracy of products<br>Robbery and theft<br>Human trafficking/ migrant smuggling<br>Sexual exploitation<br>Tax evasion<br>Terrorism and terrorism financing | Medium High | Extortion<br>Illicit trafficking of stolen goods<br>Illicit arms trafficking<br>Sea robbery | Low |

Source: BNM (2018)

Figure 2: Money laundering threat level of different crimes

Money launderers for the various predicate offences would require a mechanism to transform the money from illicit origins to make it appear legitimate, and banks are the preferred choice (McDowell & Novis, 2001). Money launderers target banks because of their inherent appeal in terms of convenience of location, wide range of products and services offered, and money launderers' peculiar preferences (BNM, 2014). As shown in Figure 3, money laundering affects various sectors with a high inherent threat, predominantly in the banks within the financial sector category.

Moving forward, the banking industry is expected to face greater challenges in view of its increased size and complexity. The emerging landscape demands the banking industry to enhance their risk management standards to address risks that may evolve from changing industry practices and the operating environment. With respect to money laundering risk, the complexity of transactions, and the diminishing of the financial border are expected to pose greater challenges to the banking industry in the years to come (Nazri et al., 2019). Banks need to ensure that their defence against money launderers is consistently strong across their operations, and that adequate infrastructure is in place to facilitate risk management. This will ensure that potential risks to financial stability in the new financial landscape continue to be addressed through timely and appropriate measures.

| Financial sectors | Vulnerability level | Non-financial sectors | Vulnerability level |
|---|---|---|---|
| Banking institutions | High | Casino | High |
| Money changing | | Lawyers | Medium |
| Non-bank remittance | | Offshore trust | |
| Fund/Unit trust | Medium | Company secretaries | |
| Offshore banking | | Real estate agents | |
| Non-bank deposit taking | | Onshore trust | |
| Stockbroking | Low | Gaming | Low |
| Life insurance | | Jewellers | |
| Money Lending | | Accountants | |
| Non-bank cards | | Pawnbroking | |
| E-money | | Notaries | |

Source: BNM (2014)

Figure 3: Inherent vulnerabilities of different sectors to money laundering risk

## 4.0 INTEGRATED AML INITIATIVES

The AML initiatives stand on two basic pillars – prevention and enforcement (Levi & Reuter, 2006; Pamungkas, 2020). Prevention covers four aspects, which are sanctions, regulation and supervision, reporting and customer due diligence (CDD), while enforcement takes charge of three aspects, which are confiscation, prosecution and punishment, and investigation. In responding to the ever-evolving money laundering risk, Malaysia has taken proactive steps to adopt a comprehensive and integrated framework in combating money laundering that involves both national and international building blocks. By preventing criminals from profiting from the proceeds of unlawful activity and simultaneously fostering local and international confidence in financial institutions that operate in Malaysia, an effective AML program safeguards the integrity of the financial system (BNM, 2014). The subsequent sections outline the domestic and international AML regimes which shape the foundation upon which Malaysia establishes its AML initiatives - the legal requirements of AMLA as the main pillar of AML law enforcement in Malaysia and the Malaysian banking industry's role in combatting money laundering risk.

### 4.1 Domestic and International AML Regime

The BNM is the key authority in safeguarding financial stability in Malaysia, and the AML regime is a framework that guides its AML prevention and enforcement efforts. Figure 4 shows

that the Malaysian AML regime is designed to cover four important aspects - the legal and regulatory framework; preventive measures for reporting institutions[1], financial intelligence unit and law enforcement agencies, and domestic and international cooperation. This AML regime harmonises and integrates national and international efforts to combat the threat of money laundering. Within BNM, this AML regime shapes a comprehensive framework that acts as the fundamental reference for the formulation of higher-level policy as well as the operations of the working agencies.

Source: BNM Website

Figure 4: Malaysian AML regime

The implementation of the AML regime on the domestic front is coordinated by the National Coordination Committee to Counter Money Laundering (NCC) (BNM, 2014, 2015). The NCC is made up of 16 members drawn from supervisory and regulatory agencies, law enforcement agencies (LEAs), and policy-making ministries, with BNM serving as the secretariat. The objectives of the NCC are to develop and implement the national strategy, policies, and measures to counter money laundering and to ensure that the national AML framework is consistent with international standards. Under the ambit of NCC, the National Risk Assessment (NRA) is conducted to assess the country's exposure and vulnerabilities of various sectors to money laundering risk (BNM, 2014). Results of the NRA are communicated to the reporting

[1] 'Reporting institutions' in AMLA are those institutions listed in the First Schedule of the Act, which, among others, include commercial and Islamic banks; international Islamic banks; investment banks; the Federal Territory of Labuan conventional and Islamic banks; and the Federal Territory of Labuan conventional and Islamic investment banks.

institutions, supervisors, regulators, and LEAs to assist in prioritising the deployment of resources to combat money laundering. The NRA is also seen as the preparatory assessment for MER, which is a wide-ranging assessment of a jurisdiction's performance in implementing the FATF standards (FATF, 2012).

The Financial Intelligence and Enforcement Department (FIED) of BNM is responsible for performing BNM's functions as the competent authority under the AMLA (BNM, n.d.c). The Financial Intelligence Unit (FIU) is a set-up in the FIED whose functions are to manage and provide comprehensive analysis of the financial intelligence received relating to money laundering. The financial intelligence inputs may come from various sources such as suspicious transaction reports (STRs) and cash threshold reports (CTRs) received from the reporting institutions, LEAs, and foreign FIUs. The financial intelligence information is then disseminated to the respective LEAs for further action. The LEAs have the power to enforce the law under AMLA for any offence that is committed or has reason to suspect the commission of an offence under their respective purview. To assist in the investigation, the LEAs may also request assistance from the FIED.

The FIU is in collaboration with other countries' FIUs through the establishment of the Egmont Group of Financial Intelligence Units (Egmont Group) (FATF, 2012). The Egmont Group is a group of global FIUs established to provide a forum to improve cooperation among countries in the fight against money laundering. It is also an effort to foster the implementation of AML measures among the member countries. As of February 2022, there are 166 member countries worldwide, and Malaysia has been a part of the Egmont Group since July 2003. The FIU has participated actively in the coalition by sharing information and financial intelligence with other members through a secured network. The members of the Egmont Group meet regularly to find ways to promote the advancement of the FIUs and develop a platform for information exchange, training, and the sharing of expertise.

At the international level, FATF is an inter-governmental body established by the G7 countries in 1989 and based in Paris that acts as the international body for AML standards setting (FATF, 2012). The mandate of the FATF is to set standards and to promote effective implementation of legal, regulatory, and operational measures for combating money laundering and other related threats to the integrity of the international financial system. In collaboration with other international stakeholders, the FATF also works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse. One of the first tasks of the FATF was to develop recommendations to combat money laundering, known as the 40 Recommendations on AML Initiatives, which set out the measures national

governments should take to implement effective AML programmes. In developing the AML standards, FATF incorporates the key principles of the United Nations Conventions and Resolutions (UNSCRs) such as the Vienna Convention (United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances), the Palermo Convention (The International Convention against Transnational Organized Crime), Security Council Resolution 1373 and Security Council Resolution 1267. Malaysia was accorded 'Observer' status by the FATF in 2014, and was later converted to full member status by the FATF in February 2016. Inclusion as a full FATF member not only demonstrates Malaysia's strong commitment to combat money laundering, but also reflects a safer business environment in Malaysia with controlled money laundering risk.

At the regional level, Malaysia is a member of the Asia/Pacific Group on Money Laundering (APG), which is a FATF-style regional body (APG website). APG is an autonomous and collaborative international organisation that was established in 1997. As of December 2021, the members of APG comprise 41 countries and a number of international and regional observers, such as FATF, the International Monetary Fund, the World Bank, the United Nations Office on Drugs and Crime, and the Egmont Group. Malaysia has been a member of APG since May 2000, and is subjected to periodic assessment of MER. The MER involves an assessment of a country's formal compliance with FATF's 40 recommendations on AML initiatives and how effectively those recommendations have been implemented.

Within the banking community, the Basel Committee on Banking Supervision is a committee of banking supervisory authorities established by the central bank governors in 1974 (Basel Committee on Banking Supervision, 2013). It provides a forum for cooperation on banking supervisory matters, including money laundering risk. Though the committee does not have any superior authority over the governments and central banks to which it makes recommendations, its guidelines are broadly followed by the banking industry all over the world. BNM has shown strong support for the Basel Committee's efforts in combating money laundering by adopting the money laundering-related guidelines issued by the committee.

Another organisation that is playing its role within the banking community is the World Bank, which focuses more on the affairs of developing countries (The World Bank, 2017). Similar to the Basel Committee on Banking Supervision, the World Bank issues circulars and policy papers on money laundering within a broader context, such as resource implications and capacity building to strengthen the AML regime worldwide. A more exclusive collaboration of thirteen global banking industries, known as the Wolfsberg Group, works together to develop frameworks and guidance for the banking community in managing financial crime

risk, particularly with respect to AML policies and related collective programs. With the all-inclusive AML regime that comprises domestic and international mechanisms, a cross-border concerted efforts are vital in the fight against money laundering risk.

### 4.2 Legal Requirements of AMLA

The main legal and regulatory aspect of the AML effort in Malaysia is AMLA, which was initially gazetted as a statutory law in July 2001 and came into force in January 2002 (AMLA, 2001). It covers the offences of money laundering in general, including investigation, freezing, seizure, and forfeiture of the proceeds of serious crimes and suspicious transactions. In 2014, AMLA was amended to provide for the offences of money laundering, measures for the prevention of money laundering activities, investigation of powers for law enforcement agencies, and public prosecutors to freeze and seize any properties involved in or derived from money laundering activities, proceeds derived from unlawful activities, instrumentalities of an offence, and the power of the court to forfeit properties derived from the proceeds of serious crimes. The amended AMLA came into force on 1st September, 2014.

The First Schedule of AMLA contains a list of reporting institutions, which consists of two broad categories – financial institutions and designated non-financial businesses and professions. These reporting institutions are obligated to take certain measures designed to prevent money laundering offences. The Second Schedule of AMLA lists 365 serious offences under 42 pieces of legislation, which if committed, are likely to result in a person benefitting or deriving proceeds from the offences committed (AMLA, 2001). The penalties upon conviction of an offence were substantially increased – a money laundering offence would carry a penalty of up to 15 years of imprisonment and a fine of not less than five times the value of the proceeds of the crime or RM5 million, whichever is higher. The enforcement of AMLA is undertaken by the various ministries and agencies (i.e., the LEAs) based on the nature of a crime and predicate offences under their respective purview of legislation listed in the Second Schedule of AMLA.

BNM has been appointed as the competent authority under the AMLA by the Minister of Finance (AMLA, 2001; BNM, 2014). As the competent authority, BNM’s roles include receiving and analysing STRs from the reporting institutions; disseminating information on suspected offences derived from STRs analysis to the appropriate LEAs (such as Royal Malaysian Police, Royal Malaysian Customs, and Malaysian Anti-Corruption Commission) for investigation; and making recommendations to the relevant supervisory authority, enforcement agencies, and reporting institutions arising from any report or information

received. Nevertheless, as AMLA is enforced by various agencies depending on their legislative purview, BNM is, as the competent authority, only empowered to investigate money laundering offences relating to the laws administered by BNM.

The LEAs are those agencies that are given the power to enforce the laws enacted by the Parliament of Malaysia (AMLA, 2001). With respect to the enforcement of AMLA, there are a total of 11 LEAs involved. The Royal Malaysian Police and BNM are the two main LEAs that are tasked with enforcing the law with respect to money laundering offences. Other LEAs include Companies Commission of Malaysia, Department of Wildlife and National Parks, Inland Revenue Board of Malaysia, Labuan Financial Services Authority, Malaysian Anti-Corruption Commission, Malaysia Palm Oil Board, Ministry of Domestic and Trade, Cooperatives and Consumerism, Royal Malaysian Customs Department, and Securities Commission Malaysia. These LEAs are entrusted to enforce the provisions of AMLA which fall under their respective jurisdictions by referring to the nature of the predicate offences and the legislation within their purview.

### 4.3 AML Initiatives within the Malaysian Banking Industry

All banks are required by law to undertake preventive measures to prevent their institutions from being used as a conduit for money laundering activities (AMLA, 2001; BNM, n.d.a). The preventive measures include conducting a risk assessment, execution of CDD, submission of STRs and CTRs, maintenance and retention of records of transactions, and implementation of an AML compliance program that is reflective of the banks' money laundering risk profile (BNM, n.d.a). AMLA specifically requires the banks to establish preventive measures such as customer identification and due diligence, reporting suspicious transactions, record keeping, appointment of compliance officers, and conducting AML training (AMLA, 2001). Banks must implement a flexible set of preventive measures that are proportionate to their level and nature of money laundering risk while remaining within the scope of AMLA requirements.

Money laundering risk assessment comprises a whole range of assessment, ranging from the front-customer reception (on-boarding) and transaction analysis (transaction monitoring) (Mat Isa et al., 2015). The first step of risk assessment involves the conduct of CDD, which enables the banks to be aware of the background of a customer in determining if the customer is likely to be suspicious. The banks need to adopt a risk-based approach that mandates CDD checks on customers, giving particular attention to those deemed as risky, such as people with PEP status and habitual crime offenders. In the event the customer and the transactions performed are suspicious, the banks need to submit STRs and CTRs to the FIU

(BNM, n.d.b). In all dealings, the banks are required to maintain an account, records, business correspondence, and documents relating to an account, business relationship, transaction, or activity with a customer for a period of at least six years from the date the account is closed, or the business relationship, transaction, or activity is completed or terminated.

An AML compliance programme, which is central to the management of money laundering risk in the Malaysian banking industry, includes compliance management, employee training, and system infrastructure (BNM, 2015). Banks are mandated by AMLA to establish a compliance function and appoint compliance officers in every branch who are responsible for keeping records as well as reporting any suspicious transactions (AMLA, 2001). Banks are also required to conduct employee training and provide guidance to employees on AML policies and procedures and how to identify suspicious activities (BNM, 2014). It is thus important for banks to allocate an adequate level of resources to appointing compliance officers, training budgets for all employees involved in the prevention of money laundering, and provide training and technical assistance necessary in strengthening the banks in the fight against money laundering. In addition, banks must also provide significant financial support for AML by investing in robust system infrastructures such as screening and monitoring systems.

The AML initiatives at the banks are largely steered through the direction of the board of directors and senior management, in line with the laws and regulations enforced by BNM. AML implementation within the banks should be overseen by the board of directors, which should approve the AML policies and monitor the implementation of such policies. The board of directors is responsible for fostering an AML compliance culture and creating a governance practice that should meet regulatory expectations. The senior management of the banks should implement AML measures and regard compliance with AML laws and regulations beyond just a tick-mark requirement (Nance & Tsingou, 2020; Podder, 2022). Furthermore, AMLA imposes certain monitoring obligations on banks in Malaysia that must be integrated into the banks' internal AML programs. Those monitoring programs should reflect the level of risk the banks face and must be continuously on alert for any emerging facets of money laundering risk. In order to have a secure banking sector, the board of directors and top management must make sure that activities for controlling money laundering risk go beyond simple compliance.

Moving forward, banks are expected to face greater challenges in view of their increased size and complexity. The contribution of the banks is expected to strengthen, with assets of the banking industry rising to almost three times of GDP by 2020 (2010: 2.4 times of GDP) (BNM, 2011). The emerging landscape demands that banks enhance their risk

management standards to address risks that may evolve from changing industry practices and operating environments. With respect to money laundering risk, the complexity of transactions and the diminishing of the financial border are expected to pose greater challenges to banks in the years to come (McDowell & Novis, 2001). Banks need to ensure that their defence against money launderers is consistently strong across their operations and that adequate infrastructure is in place to facilitate risk management. This will ensure that potential risks to financial stability in the expanding financial landscape continue to be addressed through timely and appropriate measures.

## 5.0 EVALUATION OF FATF COMPLIANCE THROUGH MUTUAL EVALUATION REPORT

Malaysia has undergone four series of the country assessment conducted by the FATF and APG – in 2001, 2002, 2007 and 2015, with a follow-up and re-rating exercise in 2018. The results of this country's assessment, known as the Mutual Evaluation Report (MER), outline the country's compliance with the FATF's 40 recommendations on AML initiatives. In 2001, MER was specifically focused on the Labuan International Offshore Financial Centre (LIOFC) (APG, 2001). The MER was a joint collaboration between APG and the Offshore Group of Banking Supervisors (OGBS). The other countries covered during the first series of MER are Samoa, Chinese Taipei, and Macau (China), for the reason that these offshore centres were more prone to the abuse of money launderers.

Despite the decision to separately evaluate LIOFC and Malaysia, the MER takes into consideration the national laws of Malaysia, which are applicable in LIOFC. This has given weight to the argument that the MER in 2001 was a sneak peek of what Malaysia had in place for its AML regime. The findings of MER 2001 suggested no serious problem of money laundering in the LIOFC. Nevertheless, the MER was short-changed in view that the Anti-Money Laundering Bill 2001 (thereafter known as AMLA) had just been introduced at that time, and a full evaluation of the compliance with FATF 40 recommendations on AML initiatives is contingent upon the passage of this legislation. The MER has nevertheless made several valuable recommendations, which were later adopted to strengthen the AML regime for the country.

Once the AMLA came into force, the second exercise of MER was conducted in 2002. This full-fledged evaluation of Malaysia's AML regime was inconclusive given that implementation of AMLA was still at the teething stage. Nevertheless, no major findings were noted, and the APG team applauded Malaysia for its strong commitment towards international

AML measures. The MER also noted that work had already begun to address many of the issues identified, including the passage of comprehensive AML legislation; the establishment of an FIU; extensive training and awareness campaign; and the enactment of mutual assistance legislation (APG, 2002).

In 2007, the second full-fledge MER was conducted, covering the evaluation of the institutional framework, the relevant AML laws, regulations, guidelines, and other requirements, and the regulatory and other systems in place to deter money laundering, as well as examining the capacity, the implementation, and the effectiveness of all these systems (APG, 2007). From 28 recommendations put forward by MER 2001 and MER 2002, only four recommendations were yet to be accomplished by the time MER 2007 was conducted. The latest full MER, which was issued in 2015, outlined 14 key findings, including both the strength and weaknesses of the country's AML regime (APG, 2015). It also made 11 priority recommendations that must be implemented in order to strengthen efforts to combat money laundering.

For MER 2007 and MER 2015, the rating of MER compliance with FATF 40 recommendations on AML initiatives is made according to four levels of compliance – Compliant (C), Largely Compliant (LC), Partially Compliant (PC), and Non-Compliant (NC) (APG, 2007, 2015). Table 1 presents the summarised number of ratings accorded for compliance with the FATF's 40 recommendations on AML initiatives for both MER 2007 and MER 2015.

Table 1: Mutual evaluation report ratings for 2007, 2015 and 2018*

| Types of Ratings | MER 2007 | MER 2015 | MER 2018* |
|---|---|---|---|
| Compliant (C) | 5 | 16 | 20 |
| Largely Compliant (LC) | 19 | 21 | 18 |
| Partially Compliant (PC) | 15 | 3 | 2 |
| Non-Compliant (NC) | 1 | 0 | 0 |

Note: * Under FATF's Follow Up and Re-Rating Review

Based on Table 1, it is clearly seen that Malaysia has improved tremendously over the years in terms of compliance with the FATF recommendations. The most significant change is the conversion of 10 LC-level and 1 PC-level to result in 16 C-level in MER 2015 as compared to only 5 C-level in MER 2007. Another notable change is the upgrades of 12 PC-level, which comprise a shift of 10 LC-level and 2 C-level respectively. The single NC-level in MER 2007

has also been upgraded to LC-level in MER 2015. Recently, in 2018, FATF has issued an Enhance Follow-Up Report and Technical Compliance Re-Rating for Malaysia, which has seen further improvement with only two recommendations remaining as PC. In 2018, four recommendations were upgraded to register 20 C-level, with a corresponding reduction for LC-level and PC-level. These improvements indicate Malaysia's strong and continuous commitment to improving its AML initiatives (APG, 2018).

These country assessments provide Malaysia with the platform for further improvements in the measures undertaken to combat money laundering. The ratings give an indication of the situation, but what is more important are the recommendations provided by the MERs. These recommendations are the driving factors for Malaysia to move forward and improve its AML initiatives in making the country a deterrent force for money launderers to commit their crimes. It is thus very crucial for all stakeholders, in particular, those directly associated with money laundering risk, such as banks and other financial intermediaries, to follow through on the MERs recommendations and take a proactive approach in implementing the recommendations that concern their institutions.

## 6.0 DISCUSSION AND CONCLUSION

Money laundering impairs the banks for two reasons: Firstly, it erodes the integrity of the institutions, and secondly, it may pose a threat to financial liability. Numerous studies have found that money laundering endangers bank stability and is economically damaging. Despite concerted efforts by various parties to address the money laundering problem at the domestic and international levels, including the establishment of an AML prevention and enforcement regime and legal provisions, money laundering continues to pose a significant threat, particularly to the banking industry. Nevertheless, it is not impossible for the banks to eventually win the fight against money laundering given that a solid foundation has been laid down through an integrated AML initiative as discussed above.

In today's dynamic environment, money launderers will always try to resort to new ways of committing their illegal activities. Thus, banks as well as the regulatory authorities should be one step ahead in formulating robust AML initiatives, which cannot stand alone but rather should be integrated to prevent any loopholes that can be exploited by money launderers. The banks are the key implementors for AML initiatives, but the involvement of various other parties is crucial to providing support in reaching a holistic effort. As money laundering risks could transcend beyond borders, the need for international synergy initiated by FATF and APG in particular is even more demanding. Banks are increasingly in need of domestic and

international support to fight money laundering given that criminals nowadays are far more sophisticated in circumventing laws and regulations.

In the context of the Malaysian banking industry, BNM is the anchor on the domestic front, assisted by the LEAs and the banks themselves in ensuring that the shield against money laundering is intact to disallow any penetration of money laundering risk. The enactment of AMLA has significantly changed the landscape of the banking industry in Malaysia with various requirements that need to be legally complied with by the banks. In the absence of AMLA, no other statute could comprehensively cover the provisions for the predicate offences, and the fines and penalties that could be imposed on money launderers. Thus, AMLA in itself is a strong message to the money launderers that the offences are legally bounded and punitive actions can be taken as provided by the Act.

Malaysia cannot fight money laundering alone, so close collaboration with international bodies such as FATF and APG has greatly curated the way the country manages money laundering risk. The country assessment conducted through MER provides a benchmark that can be used to assess how Malaysia is doing compared to the other countries. The MER reporting shows that there may be room for improvement after the different steps have been put in place, giving Malaysia a chance to catch up to other top nations in the fight against the menace of money laundering. Eventually, with continuous improvements and support from the various parties, these integrated initiatives would be the catalyst for Malaysia to achieve full-compliant status for all FATF 40 recommendations for AML initiatives.

This study provides insights for banks in managing their money laundering risk. The banks should be aware of the existing integrated initiatives that are in place and ensure that they play their role in supporting the whole initiative. The integrated AML initiatives harmonise national and international efforts to combat the threat of money laundering. The banks can act as the connecting point that implement the national strategy, policies, and measures to counter money laundering and to ensure that the national AML framework is consistent with international standards. Apart from the banking industry, this study could also provide some inputs for other institutions, which are similarly exposed to money laundering risk, such as insurance companies, unit trusts, stockbroking companies, etc.

This paper is confined to reviewing secondary sources relating to money laundering, which could prove to limit the ability to interpret the findings of this study. In spurring further discussion relating to this study, a future study could explore how banks are managing money laundering cases and their impacts on the overall health of the institutions. Additionally, an in-depth study could be conducted to examine how banks (as well as other financial institutions)

and the authorities can collaborate to mitigate money laundering risk. Along with this, further study could also be conducted on the prospect of achieving FATF full-compliant status and how the status could have impacted the way banks react to money laundering risk. As money laundering is a real problem in the economy, having a solid understanding of the different facets of money laundering could provide a better interpretation of the scale of the problem in the Malaysian economy.

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