Introduction to Anti-Money Laundering

USAID-Funded Economic Governance II Project

Central Bank of Iraq

Course Overview

Today, we will cover the following topics:

- Definition
- Example of Money Laundering
- Stages of Money Laundering
- Economic Effects
- Risks to Banks
- Global Initiatives
- Banks' Role
- Iraqi Initiatives

Definition of Money Laundering

Money Laundering:

The method of hiding, mixing and disguising the proceeds of criminal (including terrorist) activities through legally operating institutions (primarily banks) for the purpose of obscuring the origins of the proceeds.

Who uses Money Laundering?

Money Laundering is a tool used by people involved with:

- Drug Trafficking
- Organized Crime
- Tax evasion
- Political Bribery & Corruption
- Terrorism

Sample Transaction

Sample

Money Laundering has grown into an International Big Business.

- Each year, US$500 billion – US$ 1.5 trillion is laundered through banks.
- 2% - 5% of world economic output
- Banks provide a conduit of illicit money to flow

Stages

Placement

- Disposal of Cash Proceeds from illegal activities
- Proceeds are introduced into the Financial System in a manner that avoids detection
- To avoid detection, criminals will deposit large amounts of money in small batches

Stages

Layering

- The true character of the illegal cash proceeds are hidden through a series of transactions to erase the Audit Trail
- This can be accomplished by transferring money to:
  1. To off-shore banking centers with strict secrecy laws
  2. Bearer bonds
  3. Shell-holding companies
  4. Accounts held in the name of nominees

Stages

Integration

The last stage is when the successfully laundered money is **integrated** into the financial system without the legal authorities' knowledge and/or detection.

Economic Effects

Money laundering can negatively a country's:

- Economic structure
- Political structure
- Social structure

The following are some economic effects money laundering can have on a country

Economic Effects

Undermines legitimate Private Sector Efforts

- To hide the illegal proceeds, money launderers will use ‘front companies’
- The ‘front company’ has access to cheap illegal money, making their services and products cheaper
- Legitimate businesses cannot compete with the illegal & dishonest ‘front company’
- ‘Front companies’ will force many legitimate businesses out of business

Economic Effects

Loss of Control of Economic Policies

- Money laundering equals 2% to 5% of world economic output
- These proceeds dwarf government budgets in most emerging market countries
- These governments lose control of their economic policies

Economic Effects

Affects Currencies & Interest Rates

- Money Launderers are likely to invest funds in low-rate schemes that are less likely to be noticed
- Monetary instability increased due to misallocated funds
- May result in changes in money demand, international capital flow and interest and foreign exchange rates
- Makes sound economic policy difficult to achieve

Economic Effects

Economic Distortion & Instability

- **Money launderers are not interested in profit generation, but want to protect their illegal proceeds**
- **Often they invest their funds in activities that do not benefit the country & local economy**
- **Economic growth suffers**
- **Economic distortion and instability increases**

Economic Effects

Loss of Revenue

- Money laundering makes tax collection difficult
- Tax revenues decline
- Loss of tax revenue means the government must set higher tax rates on individuals and legitimate businesses

Economic Effects

Risks to Privatization Programs

- Money launderers have the financial power to out-bid legitimate investors when state-owned enterprises are privatized
- Many examples throughout the world where criminals buy state-owned enterprises and use the companies to launder their money
- Undermines the purpose of privatization and weakens the country's economy

Economic Effects

Damage a Country's Reputation

- In today's global economy, a country's reputation can be seriously damaged if it tolerates money laundering
- Confidence in the country's financial markets will erode
- Legitimate global financial opportunities disappear
- Sustainable economic growth slows

Risks to Bank

Due to banks' confidentiality principle coupled with their ability to perform large cashless transactions and transmit funds quickly and efficiently, they are often targets for money launderers.

If a bank knowingly, or unknowingly, becomes involved with money launderers, it can suffer serious consequences, including:

Risks to Bank

Reputation Risk

If a bank knowingly becomes involved, or is a victim of illegal money laundering activities, its reputation in the domestic and global market becomes tainted.

This can result in losing customers and the ability to conduct international transactions with other banks.

Risks to Bank

Legal Risk

Banks may become the subject of criminal investigations and lawsuits if they do not observe the ‘know your customer’ standards or from failing to practice adequate due diligence while evaluating and accepting a new customer.

Failure to follow proper practices can result in criminal liabilities, supervisory fines and other penalties.

Internationally, a bank can no longer plead ‘ignorance’ when asked about a customer’s business or activities.

Risks to Bank

Concentration Risk

Banks are expected to have information systems to identify credit concentrations & to set prudential limits to restrict exposures to single borrowers of groups of related borrowers.

The challenge for banks is to adopt vigorous programs for the detection of suspicious transactions. Failure to report suspicious transactions under money laundering legislation may subject banks to criminal sanctions.

Risks to Bank

Correspondent Bank Relationships

If a bank does not have adequate anti-money laundering practices in place, it can effect its relationship with its international correspondent bank relationships.

International banks <u>will</u> <u>not</u> and <u>cannot</u> do business and conduct transactions with banks that do not practice basic anti-money laundering techniques.

Risks to Bank

Corporate Governance

Money laundering can compromise the corporate governance structure of a bank.

This is especially true among small banks when it comes to attracting deposits and customer selection.

Global Initiatives

There are several initiatives by international organizations to establish standards and best practices to combat and control money laundering.

The three primary international organizations are:

- ✓ Financial Action Task Force (FATF)
- ✓ Basel Committee on Banking Supervision
- ✓ Wolfsberg Principles

Global Initiatives

BearingPoint

Financial Action Task Force (FATF)

- FATF is a 26 member intergovernmental, policymaking body
- Established in 1989 after the 1988 UN Drug Convention
- Membership includes the major financial centers in Europe, North America and Asia
- FATF has developed the 40 Recommendations that member countries are expected to adopt.
- 40 Recommendations promote guidelines for a country's criminal justice system and law enforcement and the financial system including its regulations and international cooperation

Global Initiatives

Basel Committee on Banking Supervision

25 Core Principles for Effective Banking Supervision:

Principle # 15: Bank supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "Know Your Customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, by criminal elements.

Global Initiatives

Basel Committee on Banking Supervision

<u>Customer Due Diligence for Banks (Know Your Customer)</u>

This document establishes the essential elements of a "Know Your Customer" standards and policies.

Provides the following guidelines for banks:

- **Customer acceptance and identification**
- **On-going monitoring of accounts and transactions**
- **Risk management**

Global Initiatives

Wolfsberg Principles

This is the banking industry's response to the threat of money laundering. The Principles are an agreement among 11 major international banks to guide the conduct of international private banking.

The principles seek to control money laundering by cutting across jurisdictional issues and address the serious reputation damage banks suffer in the media due to money laundering.

Banks' Role

Banks have been identified as the primary focus of money laundering because they are the entry point for laundered money to enter the financial system.

Therefore, most efforts to combat this illegal activity are focused on banks.

Banks have certain obligations to fight money laundering.

The following highlights some of the responsibilities banks have:

Banks' Role

Keep Identification Records

Banks must maintain records identifying their customers for a certain time period to prove the financial institution has sufficient knowledge of its clients.

Banks' Role

<u>Report Suspicious Transactions to Authorities</u>

Whenever there are reasonable grounds to suspect money laundering activity is occurring, the bank has the responsibility to report the suspicious activity to legal authorities.

Banks' Role

Comply with Central Bank Directives

The bank has the responsibility to comply with any and all Central Bank of Iraq directives.

Banks' Role

<u>Designate a Money Laundering Officer</u>

The bank should designate a specific individual at each branch and office as the 'Money Laundering Officer'.

Banks' Role

Provide Staff Training

The bank should provide regular training programs to the staff on how to identify suspicious transactions and what are the reporting requirements.

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Anti-Money Laundering Law of 2004

Under the law, the Central Bank's Supervision Department has numerous duties and responsibilities to help identify and combat money laundering.

Anti-Money Laundering Law: Section 3

Under this section, the CBI has the following duties:

- The CBI is responsible for supervising banks for compliance to anti-money laundering laws
- CBI must inform the banks they are responsible for establishing internal policies, procedures, controls and training programs. Banks also must establish a Compliance Officer

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CBI Duties (Continued):

- CBI shall issue & periodically update a list of financial activities that may be "suspicious transactions"
- The CBI is responsible to conduct on-site inspections or has the authority to delegate this responsibility to another supervisory authority
- The CBI has the responsibility to compile & distribute a list of individuals and organizations suspected of illicit activities

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Right to Information:

Financial institutions are required to provide the CBI access to all information and documents it requests.

Regulatory Enforcement:

The CBI has the authority to:

- Issue orders to cease activities
- Assess monetary penalties to financial institutions and/or individuals
- Publish the results of any enforcement action, including names
- Bar individuals from banking
- Withdraw banking licenses

Central Bank of Iraq

Money Laundering Reporting Office

The CBI should establish an office that will:

- Collect, process, analyze and disseminate information on financial transactions
- Help implement policy on preventing money laundering and financing crime and terrorism
- Cooperate & exchange information with other Iraqi authorities
- Represent Iraq at international organizations & conferences

BearingPoint

Money Laundering Reporting Office

- Will verify information reported to it
- Must report suspicious transactions & activities to responsible prosecuting & investigating authority
- All information must be kept confidential