

Asia, Africa and the Middle East

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Anti-Money Laundering – Are Developing Countries Ready for the Challenges Ahead?

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Synopsis:

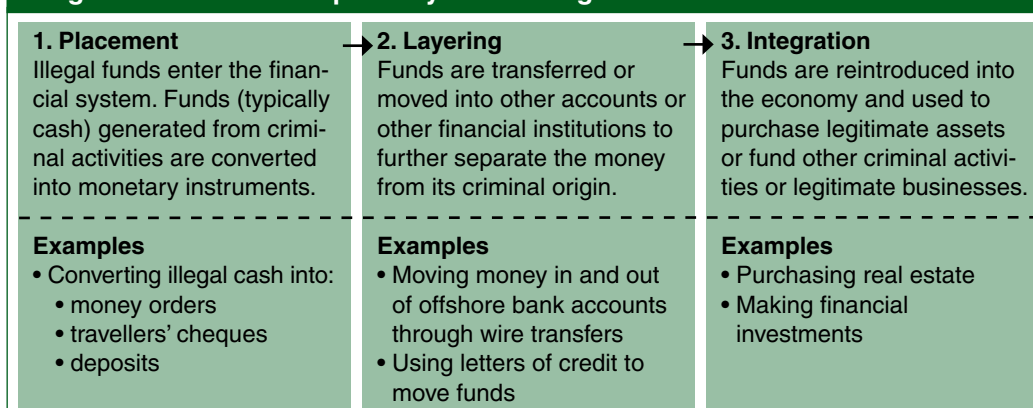
While stringent anti-money laundering (AML) legislation has proved effective in combating illegal activity in developed countries, it has resulted in the unfortunate step of propelling it into developing markets – primarily in the Asia-Pacific region. This means that developing countries are now facing an increasing threat of illegal activity. The onus of AML implementation lies with financial institutions, which see it as a financial and operational burden. However, the success of these AML programmes depends on a strong partnership between government bodies and financial institutions.

The long-recognised problem of money laundering – using financial transactions to conceal the identity, source, and destination of money – is not only linked to organised crime but also to tax evasion or false accounting. Money laundering is now recognised as a widespread problem practised by individuals, businesses, officials and governments.

The increasing complexity of financial crime has led to greater prominence in political, economic, and legal debate and, as a result, greater efforts have been made to combat transnational crime and to minimise the detrimental impact of capital extracted from the legitimate economy.

Sound anti-money laundering (AML) practice is a necessity for safeguarding the credibility and financial stability of all financial institutions.¹

Figure 1: The Three-step Money Laundering Process



Source: Infosys Technologies Ltd

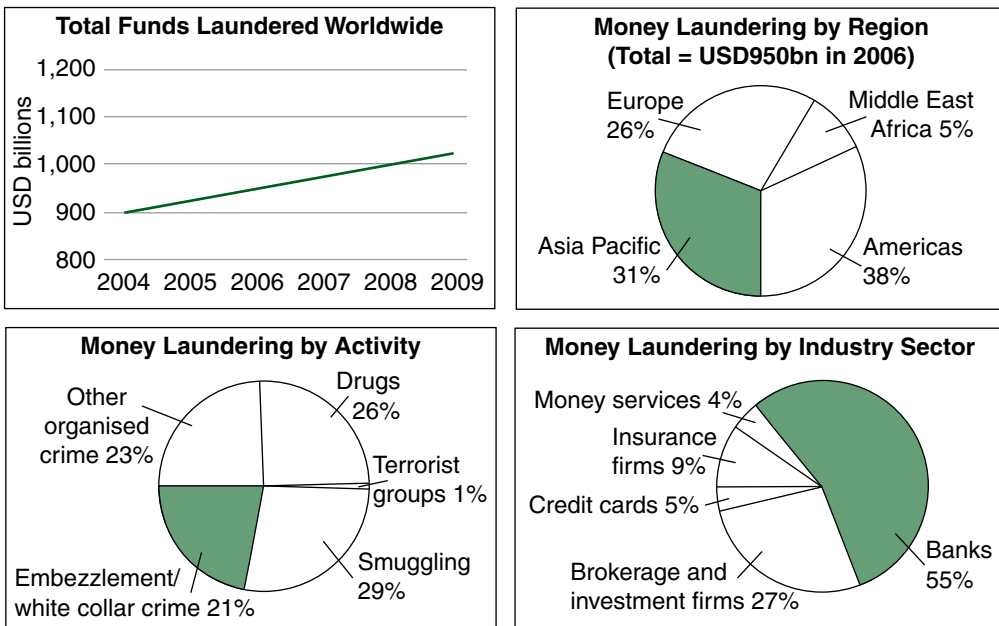
1. Speech by Zhou Xiaochuan, Governor of the People's Bank of China, at the first meeting of the Ministerial Joint Conference on AML, 27 August 2004, Beijing, China.

Complying with AML legislation is a growing challenge for all financial institutions. Most established financial institutions still operate on legacy systems, and accommodating changes in AML regulations every few years is time consuming and expensive. Standardisation of AML processes is evolving into a significant challenge on both an enterprise-wide and country-wide basis, since financial institutions need to cater to the unique needs of each country as well as each company. In the future, financial institutions will need to be proactive in this field rather than simply complying with AML legislation. The new focus will be on implementing a risk-based approach that results in a win-win situation for both regulators and enterprises.

AML Trends

Tighter AML regulations in the US and Europe are pushing money laundering activities east, into Asia Pacific. Money laundering fund circulation is expected to reach USD1,000bn by 2009.²

Figure 2: Recent AML Trends across the World



Source: Celent Research

AML Programme

AML legislation was first implemented in the 1970s, when the US passed the Bank Secrecy Act – the basis of most existing AML legislation. AML legislation is applicable to all financial institutions, including banks, brokerage houses, financing companies, savings and loan companies, mortgage companies, co-operatives, security brokers, security dealers, insurance companies, pension funds and

2. “Anti-Money Laundering: Challenges and Solutions”, Celent report, Finsight Risk and Compliance Summit 2007, 9 March 2007, Mumbai, India.

insurance brokers. In some countries, it is also applicable to lawyers, notaries, accountants, real estate agents, casinos, trust and company service providers, and retail traders. Non-compliance with AML regulations can result in huge penalties for an enterprise; it can also prove to be a threat to continuing operations. For example, U.S. Trust was fined USD10m for violations and deficiencies in internal control and inadequate compliance with the Bank Secrecy Act. The Riggs Bank was fined USD25m for failing to design and implement an AML programme. To develop an AML programme, there needs to be a strong understanding of the implementation problems, as well as the associated and potential benefits. Figure 3 provides an outline of an AML programme.

Figure 3: AML Programme

AML Programme	Description	Problems	Risks	Benefits of AML
Risk-based approach to customer due diligence/ know your customer (KYC).	Identification of potential customers and beneficial owners through trustworthy sources.	Manual, time-consuming process when electronic data verification is not possible.	Identity theft and fraud.	Reduces operational, regulatory risk and risk of adverse impacts on business.
Ongoing transaction monitoring for suspicious activity.	Generates suspicious activity reports on a regular basis to stop crimes at early stages.	Time consuming as it requires constant monitoring of activities.	Loss of revenue.	Vital for ensuring effectiveness of AML processes.
Screening for sanctioned entities (watch list filtering) at account opening and on an ongoing basis.	Performs sanctions and politically exposed person (PEP) checks at the application stage to avoid relations with any unwanted individuals or entities.	Sanctions lists need to be continually updated and rematched against existing customer bases.	Unwanted relationship and economic activity with criminal entities.	Reduces chances of damage to brand name and business.
Effective AML employee education/ training throughout the enterprise.	Helps employees understand the importance of the AML legislation.	Personnel training and education is a major expense, costing about 64% of an AML programme. ³	Illicit behaviour and chances of insider fraud.	Improves internal control and success rate of AML programme.

Source: Infosys Technologies Ltd

Developed Countries and AML

Different countries have different AML legislation. This often results in non-standardised processes in the same business unit across the globe. Achieving AML compliance can be a very challenging task for established financial institutions, even in developed countries.

Positives

Mature, well-developed AML legislation is in place. Government and regulatory bodies understand the importance of AML regulations and subsequently they are enforced accordingly. Developed

3. “Anti-Money Laundering: Challenges and Solutions”, Celent report, Finsight Risk and Compliance Summit 2007, 9 March 2007, Mumbai, India.

countries have sound telecommunications infrastructure and data is electronically stored for different public and private services.

Issues

Despite all available infrastructure through government bodies, the onus of AML implementation lies with financial institutions. Most institutions see it as a financial and operational burden. Depending on the size and different lines of business for a given financial institution, the scope of a given AML programme can vary significantly. A lack of clarity over compliance and tighter timelines can result in ad hoc implementation of AML processes rather than a long-term, strategic solution.

The process of building new business rules into a legacy system is a significant challenge, and the scope of an AML programme is often determined by internal system limitations. Furthermore, it can take many years to implement a comprehensive AML solution, and changes in regulations every few years represent a considerable challenge.

Developing Countries and AML

Money laundering activities are being pushed into developing countries due to tighter regulations in the developed world. To further compound the problem, in comparison to developed countries, developing countries face a much broader slate of challenges in curbing these activities.

Issues

Most developing countries already have AML legislations in place, but they are not as advanced as those in developed countries. In some cases, a growing population and the inability of governments to cater to basic needs have resulted in illegal activity at many different levels. A lack of a centralised electronically stored credit database for all citizens makes it difficult to verify and validate information.

Figure 4: Comparison between Developed and Developing Countries

Area	Developed Countries	Developing Countries
AML legislation.	Tighter AML legislation and experience have led to a structured AML process. Financial institutions know what is required and non-compliance can lead to heavy penalties.	Focus on AML legislation is fairly new. Processes are still evolving and domestic institutions are still in the early stages of developing AML programmes.
Risk-based approach to customer due diligence/ know your customer (KYC).	Numerous public and private data repositories available for entry-level checks. Credit history of citizens can be ordered digitally. Application processing times are short.	Difficult to obtain data of every citizen from a credit bureau in many countries. Application processing times can be long.
Technology.	AML first-generation solutions have been developed over time. Migration to second-generation solutions with tighter regulations in response to the surge in money-laundering activity.	To implement second-generation AML solutions without basic infrastructure may create further problems.
Ongoing transaction monitoring for suspicious activity.	Integration of all financial transactions and monitoring is achievable.	Transaction monitoring is possible only on a standalone basis in absence of information integration.

In some developing countries there are various types of financial institutions, some of which may not be regulated. Furthermore, many financial transactions are still manual, even though a lot of development has taken place in the last few years. Paper-based processes rather than electronic media still dominate in some countries.

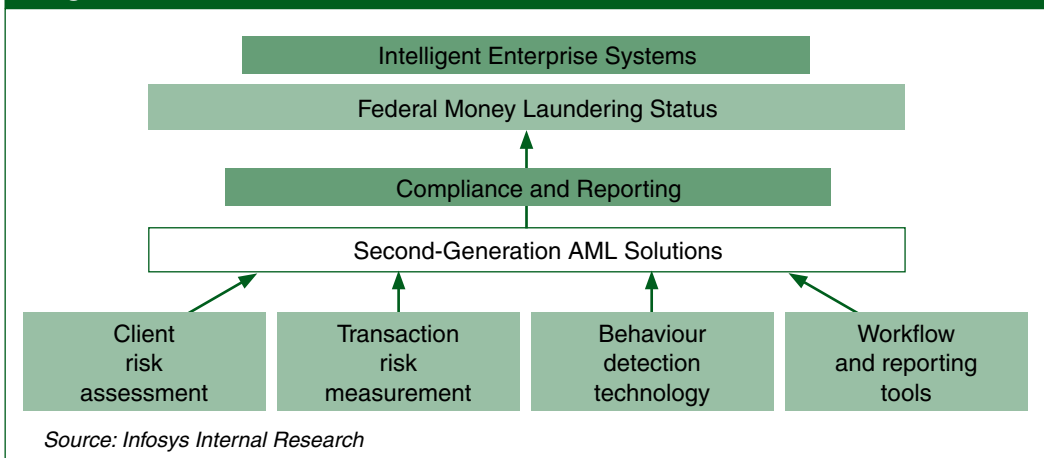
Technology and AML

The failure to meet stringent AML regulations or to allow suspicious transactions to go undetected can have a severe impact on any financial entity, including damage to its reputation, market capitalisation, as well as its customer perception and loyalty.

Financial entities can cope with the increasing threats of money laundering by implementing a sophisticated AML software solution that is able to determine the current level of risk exposure through the collection and collation of required data. Initial versions of AML software solutions were based on static data and rule-based thresholds, that is, transactions were flagged if they had a value over a fixed amount. There were many limitations to these original solutions, and newer AML regulations required more sophisticated information systems that could collate greater knowledge of customers, their financial standing and all the activities related to their accounts.

The new set of AML solutions – intelligent enterprise systems – are able to develop and adapt accordingly, identifying new money-laundering schemes as they arise. These solutions use a detailed customer profile for investigation purposes, identify the transactions with greater risks, follow the patterns of the business behaviour and report if any suspicious activity is found. These solutions are based on link analysis, sequence matching, data aggregation and analysis, and neural networks.

Figure 5: Second Generation AML Solution



Challenges for Developing Countries

Despite having these second-generation tools to mitigate money-laundering risks, there are many issues and challenges to the implementation of AML programmes in developing countries.

- Financial crime prevention professionals need to enhance their skill set to enable the implementation of these solutions based upon their understanding of emerging technologies.
- Enhanced comprehensive databases have been designed and created to encapsulate all the necessary data, but in most developing countries, even the most vital information is not captured electronically. This will remain a significant challenge in coming years.
- Current technological solutions may help identify and curtail money laundering within an individual institution, but they do not solve the problem on a cross-institutional basis.
- The capabilities of the solutions should be clearly known to the people using them. Users should also be aware of the approach to be followed in respective situations. If branch operations are small, then rules-based reports generated internally may suffice. Peer-group analysis is essential for creating detection rules for illicit behaviour.
- Internal audits should also be given due importance. Auditors can be pivotal in combating money laundering; hence they should be well versed on all current AML regulations.
- While monitoring activities across institutions and governments, the required information sharing and analysis is minimal. The interfaces between these entities should be well regulated under a central regulatory body, which is not currently in practice.

The Road Ahead

There needs to be a focus on the following issues for developing countries to go forward:

- The creation of integrated case management tools that address enterprise-wide development and that cater to multiple compliance requirements.
- An enhanced focus on understanding the various transaction monitoring software, frameworks and approaches. Based on this understanding, financial crime professionals need to develop their skill set to enable them to implement these solutions effectively.
- There needs to be proper maintenance of a comprehensive centralised database and a standardised approach to keeping client records. A few of the necessary changes are imminent, such as the introduction of compulsory national identity cards in many developing countries. Yet, there is still a lot more ground to cover.
- Data from individual institutions could be submitted in a specific format to a common storage repository. This repository could then be analysed for a wide array of high-risk behaviours or suspicious activities.
- The creation of national regulatory bodies would help to create consistent global messaging standards, providing a common data repository, and accomplishing appropriate analysis of data, while protecting privacy rights consistent with national policies.
- Extensive information sharing and analysis is necessary for implementing systems that can monitor activity across institutions and governments.

- Financial institutions should consolidate AML compliance efforts under one umbrella and adopt organisation-wide technology solutions rather than standalone AML solutions for different lines of business. Integration of similar functional areas could result in tighter control.
- Financial institutions should operate with consistent and stringent standards across all regions/geographies to avoid the risk of exposure to money laundering in an area with lower standards of jurisdiction.

Conclusion

Developing countries have a long way to go before they can match the efforts of developed countries in the area of AML. Developing countries have to take more effective action and generate a grassroots-level focus amongst financial institutions. It is difficult to implement control over money-laundering activities without support from legislative and executive bodies. A lack of awareness and a lack of political will are major hindrances to AML implementation. The creation of AML-focused regulatory bodies and a close partnership with financial institutions to implement the necessary AML programmes are necessary take the cause forward.

Financial entities also have to take a more dynamic approach – renewing their focus on ongoing programme enhancement in order to better mitigate old risks, while simultaneously managing new risks and regulatory requirements. Furthermore, a renewed focus is needed to look beyond simple name matching, peer-group analysis, link analysis and data matching. A new approach must be adopted by every individual working in a financial institution. Only then will a necessary level of compliance be achieved.

References

1. Speech by Zhou Xiaochuan, Governor of the People's Bank of China, at the first meeting of the Ministerial Joint Conference on AML on 27 August 2004, Beijing, China.
2. "Anti-Money Laundering: Challenges and Solutions", Celent report, Finsight Risk and Compliance Summit 2007, 9 March 2007, Mumbai, India.
3. Carol Wheatcroft, www.apgml.org.
4. www.pwc.com.