

## Measures to Strengthen the Financial Sector

### Customer identification

#### *Introduction*

FATF Recommendation 12 requires financial institutions to identify all customers when entering into business relationships or conducting significant transactions.

In those countries where there exists a national identity card system, that card can provide a clear basis for customer identification. However many Commonwealth countries do not have such a system, and in a number of countries the proportion of the population having some form of formal photographic documentation confirming their identity may be as low as 5 per cent. It is therefore necessary to devise an approach that will ensure that there is an adequate degree of customer identification, while not having the effect of denying access to the financial system to those who have no formal identification documents.

#### **Possible approaches**

As part of their financial and economic reforms some Commonwealth countries are seeking to increase the proportion of the population subject to some form of official identification, to combat electoral fraud and to improve the efficiency of tax collection. Where possible, other grounds for requiring identification – including tackling money laundering – should be taken into account in administering this identification process. Ideally this would extend to including a photograph, but failing that the signature of the person identified. If financial institutions were allowed access to a register of names and addresses, this would also assist in confirming that customers presenting such identification were who they claimed to be.

Where no system of identification extends over the bulk of the population it may be appropriate for identification procedures to be concentrated where there is the greatest risk of money laundering. At the most basic level this would be where the sums of money involved were large, or involved hard currency, or where there was movement of money in and out of the jurisdiction.

By and large, those individuals with large quantities of money are most likely to have formal identification documents – passports and driving licences in particular. The same is likely to be true of those customers who handle foreign currency or have transactions involving other countries. For those countries where wide-scale identification is not possible, it might be reasonable to require identification from customers conducting transactions over a certain size, or who hold accounts that may exceed a certain limit. Identification should also be required for all foreign currency accounts, and for all transactions over a certain amount involving the transmission of funds into or out of the country.

Clearly such an approach is less satisfactory than one involving comprehensive customer identification. It would therefore be necessary for financial supervisors and law enforcement agencies to monitor its effectiveness continuously, with a view to introducing tighter procedures if there was evidence of abuse by money launderers.

#### **Corporate customers**

One area that is particularly susceptible to abuse by money launderers is the use of corporate bank accounts, particularly those associated with international business companies and other offshore

corporate entities. Identification of corporate customers is more complex than identification of individuals, as it is desirable to identify both the beneficial ownership of the account, and those individuals who are able to use it.

With corporate customers, as with personal customers it is important that customer identification should amount to more than just verification of a company's legal standing and the identity of individual account signatories. It is good commercial sense for a bank or other financial institution to know as much as possible about the sort of business carried on by the customer. This will give the financial institution some idea of the likely cash flow through the customer's account, and the scale of operations that will be involved.

### Issues for discussion

To what extent can customer identification for anti-money laundering purposes be integrated with action to improve the efficiency of the economy, through the use of identity cards, publicly accessible registers and other similar measures? What processes can be used for the identification of corporate customers?

It also provides an implicit standard against which to measure the performance of the customer, which will provide a potential early warning system in case the customer gets into financial difficulties or if the customer is or becomes involved in money laundering. Unduly large or illogical flows through an account might reflect business expansion or a change in direction – potentially an opportunity for additional business by the financial institution – or they could point to illicit transactions being put through the account. A financial institution that really knows its customers will be in a better position to judge, and to act accordingly. A financial institution that has at best just gone through the

motions may well find itself involved in an unwelcome criminal investigation.

## Internal systems and controls

### Introduction

While legislation can specify the need for customer identification, record keeping and suspicions reporting, its implementation will be effective only if financial institutions develop internal systems and procedures to ensure that these tasks are carried out, and in particular to ensure that relevant staff know of their obligations under the legislation, and under any related guidance notes.

### The money laundering reporting officer

The key to effective internal controls is a clear system of accountability. This is best achieved by the nomination of a single, senior officer within each institution who should take responsibility for ensuring that all aspects of money laundering legislation and regulation are complied with. This officer, often referred to as the money laundering reporting officer, has a number of key roles:

- ❖ he/she should act as the point of contact between the financial institution and the authorities responsible for countering money laundering. By focusing on a single point of contact, the relationship between the two is likely to develop more smoothly, and with a higher degree of confidentiality;
- ❖ internally he/she should be the initial recipient of all suspicions disclosures. This will allow the officer to act as a filter, using his/her wider knowledge of the operations of the financial institution to judge whether the suspicions of more junior staff are justified, and should be passed on to the authorities, or whether they relate to legitimate business;
- ❖ the officer should be responsible for monitoring customer identification and record keeping procedures within the

institution, and should report to both the financial institution, at the highest level, and, in parallel to the regulators on their correct implementation;

- ❖ the officer should be responsible for training staff in their obligations and in the institution's internal procedures, and should in turn be fully trained in his/her own duties by the supervisory authorities.

Clearly in small financial institutions these requirements will be less onerous than in major banks and investment firms. Nonetheless it is important that the responsibilities of the money laundering reporting officer are clearly recognised by the directors, management and staff of the institution, so that the officer is given all the necessary support and co-operation in carrying out these duties.

### Issues for discussion

Are the responsibilities placed on the money laundering reporting officer manageable? What assistance might be necessary from the supervisory authorities to support this role?

## Suspicious transactions

### *Introduction*

**The idea that financial institutions should spontaneously report transactions that they have conducted to the authorities is perhaps the most radical element of the whole anti-money laundering package.** It runs contrary to the natural instincts of most financial institutions, which place a very strong emphasis on customer confidentiality.

However, with the development of sophisticated financial institutions able to move money rapidly around the world it is almost certainly

impossible to combat money laundering without the assistance of financial institutions in making such reports. It is therefore important to recognise that the responsibilities placed on financial institutions are not unreasonable.

### Why financial institutions should report suspicious transactions

There are two main reasons why financial institutions should co-operate in combating money laundering by disclosing details of suspicious transactions. The first is essentially a moral one. Given the growing importance of financial intermediaries across the whole economy, they are placed in a powerful and privileged position. It is because of this that financial institutions recognise a duty of confidentiality to their customers, which prevents them from abusing the power that their control over economic transactions grants them.

However their position also gives them a responsibility to the government not to abuse their power to commit criminal activities. Not only are financial institutions not above the law, but they have a duty to uphold the law more generally, and this duty may at times override the duty of confidentiality that they owe to their customers if there is legitimate suspicion of wrong-doing. This issue of confidentiality is discussed in more detail below.

The second reason for financial institutions to report suspicious transactions is simple self-interest. The basis of trust on which the financial system operates can easily be undermined by the involvement of financial institutions in criminal activity, even if the involvement was unwitting.

A financial institution that discovers that it is holding criminal proceeds may be subject to criminal penalties under the common law (as an aider or abettor), or civil suit for constructive trust, even in the absence of money laundering legislation. Given the ability to disclose its situation to the authorities, a financial institution will be able to put itself in a safe position.

## Factors that might make a transaction suspicious

Financial institutions should be suspicious of any transaction that they believe might relate to criminal proceeds. Recognition of such transactions is made easier when financial institutions have a clear understanding of the legitimate business of their customers. This is why it is so important for financial institutions to know their customers.

It is not possible to draw up a checklist of factors that would determine whether any given transaction should be treated as suspicious. In each case the context of the transaction is as important as details of the transaction itself. In practice it is for financial institutions to decide on a case by case basis whether the transaction “makes sense”. If it does not, then it may justify reporting.

In the absence of a checklist of features, it is still possible to identify some questions which an institution might ask itself in order to determine whether a transaction makes sense:

- ❖ is the **size** of the transaction consistent with the normal activities of the customer?
- ❖ is the transaction **rational** in the context of the customer’s business or personal activities?
- ❖ has the **pattern of transactions** conducted by the customer changed?
- ❖ where the transaction is **international** in nature, does the customer have any obvious reason for conducting business with the other country involved?

In many countries that have introduced money laundering legislation the financial sector trade associations, the financial regulators and the law enforcement authorities have worked together to produce guidance for financial institutions covering the issue of identifying and reporting suspicious transactions. This is discussed further below.

## The circumstances under which a financial institution should make disclosures

While money laundering legislation requires the co-operation of the financial sector in order to be effective, it is not the purpose of such legislation to turn financial institutions into detectives. Financial institutions cannot be expected to invest a large amount of time and resources in investigating their own customers’ affairs to ensure that they are not laundering money. On the other hand it is important that financial institutions do not wilfully turn a blind eye to what their customers are doing.

Striking the right balance is something that will only come with experience – although guidance notes of the type discussed below may be helpful here. However, the more that a financial institution knows about the activities of its customers, the better able it is to identify scope for potential new business. Where the relationship between institution and client is healthy there will be no problem in the two discussing the nature of the customer’s business. On the other hand, where the customer is acting suspiciously, it is important that the institution does not tip the customer off about its concerns.

### “Tipping off”

“Tipping off” is when a financial institution alerts its customer to the fact that it suspects the customer of being involved in criminal activities, and has made or is about to make a report to the authorities. Advance warning would allow the customer to move itself and its funds elsewhere, thus preventing the authorities from recovering the money.

While “tipping off” is an offence under most money laundering legislation, this should not prevent financial institutions from deciding to cease doing business with a customer whom they suspect of engaging in money laundering. Under such circumstances, however, it is important that the institution does not reveal to the customer why it is taking this decision. Where possible the authorities should be alerted to the situa-

tion, even if the financial institution has not actually conducted the transaction that has given rise to the suspicions.

### Issues for discussion

How can financial institutions in Commonwealth countries be encouraged to disclose suspicions? Can financial sector trade associations be encouraged to assist in this process?

- ❖ when the bank is required by law to breach confidence;
- ❖ when breach of confidence is necessary in the bank's own interests; and
- ❖ when breach of confidence is in the legitimate public interest.

Money laundering legislation normally defines circumstances under which a financial institution is required to disclose information to a designated authority, or else it makes it a defence against a possible charge of involvement in money laundering to make such a report. Under these two approaches the financial institution is protected from suit for breach of confidence by the first and second sets of circumstances respectively.

Where banking confidentiality is enshrined in statute it may be necessary to ensure that money laundering legislation provides adequate **gateways** with appropriate checks and balances through the confidentiality provisions to permit the disclosure of suspicions. Most confidentiality legislation permits financial institutions to pass on **knowledge** of criminal activity to the authorities. To be effective money laundering legislation must allow the passing on of **suspicions** as well as knowledge. This is discussed in more detail in Part 5.

[Despite the protection under the Common Law, however, most money laundering legislation gives explicit statutory protection to financial institutions that disclose suspicions of money laundering by their clients to the authorities in good faith.]

## Confidentiality

### Introduction

It is sometimes argued that action to combat money laundering can itself pose a threat to confidence in the financial system, particularly in respect of damage to the confidential relationship between financial institutions and their clients which is essential for the conduct of legitimate financial business.

Experience among those countries and territories that have introduced money laundering legislation has indicated that effective anti-money laundering legislation is fully compatible with a high degree of commercial and financial confidentiality, provided that the legislation is drafted and implemented in a way that respects the nature of financial business.

### The legal position

For those Common Law jurisdictions that have not introduced statutory provisions governing confidentiality, the legal position is effectively that set out in the *Tournier* decision (*Tournier v. National Provincial and Union Bank of England* [1924] 1 KB 461). This identifies a number of circumstances where the implied duty of confidentiality owed by a bank (or any other financial institution) to its client may be breached. The three most important in the context of money laundering are:

### Institutional arrangements

While the legal situation protects financial institutions from civil action by clients or criminal liability for breach of statute, it does not by itself defend them against the reputational damage that might arise if a disclosure, made in good faith but not relating to actual criminal activity, were to become known to the customer to whom it related, and that customer made the fact public.

This problem is best tackled by establishing appropriate institutional arrangements for the handling of suspicion disclosures. These arrangements should ensure that:

- ❖ suspicions disclosures are only handled by a small number of people, all of whom are well trained and aware of the sensitive nature of this information;
- ❖ when suspicions are passed on to investigators, they are only passed to known contacts within investigating authorities, who are themselves aware of the sensitivity of the information that they receive;
- ❖ all information that is not either relevant to ongoing investigations or might provide leads for future investigations is destroyed at the earliest possible opportunity;
- ❖ financial institutions are kept informed of developments relating to disclosures that they have made as quickly and as fully as possible.

Regular and direct contact between financial institutions and the authorities responsible for handling suspicion disclosures should increase the confidence that financial institutions have in the handling of disclosures, and will also tend to help the investigators and central authorities to understand the concerns of financial institutions.

### International co-operation

There may be particular concerns about the transfer of information deriving from suspicious disclosures to other jurisdictions. It is not always possible for the originating jurisdiction to specify precisely what should or should not be done with the information. Where the handling of the information is not covered by a pre-existing agreement, such as a tax or mutual legal assistance treaty, it may be useful to negotiate a memorandum of understanding (MoU), which can place restrictions on the use or further transmission of the information.

### Issues for discussion

How can action against money laundering be publicly presented to maximise the recognition that confidentiality is not being undermined? Which existing institutions carry the greatest public trust, and thus are best placed to play leading roles in the anti-money laundering regime? How can their protection from political interference be enshrined in the constitution?

### Central units for handling suspicious transaction reports

#### Introduction

Under FATF Recommendation 16, financial institutions which suspect that funds that they are asked to handle derive from criminal activity should report their suspicions to “the competent authorities”. The FATF Recommendations do not define what “the competent authorities” should be, but it has been the experience of governments implementing the Recommendations that the most effective approach is to designate a single central unit to receive and process money laundering disclosures.

An effective money laundering regime will necessarily involve the law enforcement agencies, the financial sector regulators and, where the system is also used to address tax evasion, the revenue authorities. It would be possible to locate a specialised central unit in any one of these bodies, or to set it up as a free-standing agency. There are examples of most of the options among countries that have introduced money laundering legislation.

The choice of approach for each country will depend upon a range of factors. These include:

- ❖ **institutional capabilities and resources.** There is no point in establishing a central unit within an agency that lacks the resources, powers, motivation or

competence to carry out the required role. It is essential that the central unit be backed by clear political commitment to assist it in combating money laundering;

- ❖ **inter-agency relationships.** The central unit will need to work with all the other agencies with a role in combating money laundering. It should therefore be located where it is capable of commanding the respect of those agencies;
- ❖ **relationship with the financial sector.** The central unit will need to deal on a day-to-day basis with financial institutions, and achieve their co-operation rather than grudging enforced compliance;
- ❖ **international contacts.** Most laundering operations are international in nature. The central unit will need to use existing international channels of communication, or else have the powers to establish its own, in order to co-operate with money laundering investigations in other countries, and in order to obtain assistance from other countries in their own investigations.
- ❖ **public confidence.** It is essential not only that financial institutions have confidence in the capabilities of the central unit, but that there is general public trust in it. This unit will have access to confidential information about individuals, which could be used improperly to do political, financial or potentially physical harm to those individuals. Misuse of personal information would undermine public faith not only in the unit itself, but also in the financial institutions that made reports to it. Under these circumstances the system would do more harm than good.

This section sets out a range of possible structures for a central unit to receive suspicious transaction reports, giving examples where appropriate of countries where such structures are in place.

## A designated unit within the police force

This is the most basic approach, and has been adopted in the **Isle of Man**. The local fraud squad are the contact point for all disclosures by local financial institutions. They will either investigate the disclosures themselves, where it relates to local activity, or pass the information to other investigators where it relates to activities in other jurisdictions.

This approach works best for jurisdictions where most financial sector activity is offshore-related. The low level of local activity means that the fraud squad are not swamped by investigations or analysis arising out of suspicion disclosures.

To be effective, such an approach relies upon the active involvement of the financial supervisory authorities in educating local financial institutions about their responsibilities under money laundering legislation, and monitoring its implementation. It is also essential that the local law enforcement agencies can give quick and effective assistance in money laundering cases involving offshore businesses operating from the jurisdiction (which will be the majority of the investigations arising from suspicion disclosures).

The adaptation of such an approach to cover tax evasion could in theory be achieved through an MoU between the police and the revenue authorities.

## A specialised unit within the law enforcement system

This is the approach used in **Britain**. It is similar to the previous approach, but allows for jurisdictions where there is a higher level of reporting. The main function of the central unit is to allocate suspicion disclosures to the appropriate investigatory agency. With sufficient resources, the central unit would also be well placed to perform an analytical function, and might be able to generate information on trends in laundering techniques, and highlight sectors or individual institutions whose reporting patterns are anomalous.

As with the previous approach, this mechanism still requires the financial supervisors to

play an active part in monitoring compliance by financial institutions with appropriate legislation. Again the ability to co-operate in investigations from overseas, and the ability to exchange information is necessary here.

Such an approach could be extended to cover tax evasion as above, through an MoU between the central point and the revenue authorities, or else by making the central unit a joint revenue/law enforcement body.

This approach is best suited to jurisdictions where the existing supervisory regime is effective, and willing to co-operate with law enforcement agencies.

### A specialised unit within the regulatory authority

An alternative to establishing the special unit within the law enforcement framework would be to establish it within the regulatory structure (e.g. within the Central Bank). This would have a number of potential advantages, for instance:

- ❖ financial institutions would already have a close working relationship with the regulatory authority, and they would possibly be more willing to make disclosures to them than to a law enforcement agency;
- ❖ where the regulatory authority suspected that a financial institution was not following the requirements of the legislation properly, it would be able to step in directly and either tackle the problem, or, if the financial institution appeared to be involved in laundering, it could take regulatory action up to and including licence revocation;
- ❖ the regulatory authority would be well placed to advise financial institutions on how they might improve their systems and controls to combat money laundering.

On the other hand there would be some disadvantages:

- ❖ the unit would not be in a position to *investigate* suspicions itself, and would therefore

need to pass them on to the relevant law enforcement authorities. This could potentially introduce an element of delay;

- ❖ because it was not itself a criminal investigatory body, a unit within the regulatory system might find it difficult to exchange information and otherwise co-operate with central units in other countries;
- ❖ there might be no single regulator with responsibility for all institutions subject to the money laundering legislation. This might lead to uneven coverage of the financial sector (one possible way to tackle this where there are several regulators would be to establish a central unit shared by all the regulators, staffed by secondees).

This option might be appropriate where the Central Bank or other regulatory authority is well respected and both willing and able to take on this rôle. It would however require the regulatory authority to liaise effectively with the law enforcement agencies and, if the legislation is to be used to combat tax evasion as well, with the Revenue authorities.

### A freestanding specialised unit

Establishing the central unit as a stand-alone body, separate from both the financial regulators and the law enforcement agencies would avoid some of the problems associated with the two previous alternatives, but it would lose some of the advantages. As an independent body it would not be seen to be working to any other agencies' agendas. However a unit with no role other than receiving, analysing and distributing disclosures might in practice be too weak to be effective, particularly as it would have clearly measurable costs, but the benefits of its activities would accrue elsewhere.

### A freestanding specialised unit with regulatory powers

Under this approach a single freestanding body would be responsible for the handling of suspi-

cion disclosures and the monitoring of the implementation of money laundering legislation. For the former function it would act much as in the previous options, performing analysis on the disclosures received and distributing them to the relevant investigating agencies. For the latter function it would have the authority to inspect the systems and controls established by financial systems to enable them to make reports.

It would be necessary to consider the relationship between such a unit and existing financial regulators. Some aspects of supervision, such as solvency, would not be of direct concern to such a unit, and would be expected to remain with the Central Bank or with the insurance supervisor. There would however be a potential overlap in the areas of conduct of business regulation and investor protection. Where there is no effective body with such responsibilities it might be sensible to place these with the central money laundering unit, to minimise duplication of effort and the compliance burden on financial institutions.

A body along these lines is likely to be fairly large, and expensive to operate. That will increase the attractiveness of using it to address tax evasion. This might best be tackled by involving revenue officials in the analysis of disclosures.

Any effective **cash transaction reporting regime** would require a central unit with at least the powers set out here. The **Australian Transaction Reports and Analysis Centre (AUSTRAC)** is structured along these lines.

### **A specialised unit with regulatory and investigative powers**

This option would create a very powerful body with potentially wide-ranging powers. In addition to the considerations discussed above, it would be necessary to address the interface with law enforcement and, where appropriate, revenue authority investigators. It might be possible to establish such a body with the ability to investigate tax evasion, passing other cases to the police, but this could give rise to conflicts of interest between apprehension of criminals and recovery of revenue.

This single agency approach is probably too monolithic to be workable.

### **Issues for discussion**

Which of the existing agencies in each Commonwealth country currently command the trust and respect of the financial sector and the law enforcement agencies? Is any existing agency structured appropriately to take on responsibilities in this area, or would a new agency – perhaps drawing staff from a number of existing bodies – be a better option? What arrangements, such as interdepartmental arrangements, might be necessary to ensure a co-ordinated and co-operative approach to tackling money laundering?

## **Treatment of jurisdictions with inadequate money laundering regimes**

### *Introduction*

Given the international nature of both the global financial system and modern money laundering, there is a danger that domestic action to tackle the problem will be undermined by criminal proceeds that have been introduced into the financial system from other countries. Once the money is in the financial system it is harder to recognise its criminal origins, and thus to take action against it. A comprehensive approach to tackling money laundering must therefore include measures to deal with these flows.

### **The scale of the problem**

Identifying those countries that pose the greatest money laundering risk is not easy. Even in countries where there is no relevant legislation, only a small fraction of financial flows will involve the proceeds of crime. Other factors, such as the scale and sophistication of the local financial

sector, geographical location, or level of criminality, may attract money launderers, so that some countries with legislation in place may suffer from more money laundering than others without. Furthermore, within any country, some financial institutions are likely to be more effective at deterring or detecting criminal proceeds than others. In particular, branches and subsidiaries of financial institutions whose headquarters are subject to an effective anti-money laundering regime may be obliged to follow much tougher procedures than might be required under local legislation.

Under these circumstances attempts to draw up lists of countries with inadequate money laundering countermeasures, or alternatively lists of countries that do have countermeasures in place, are likely to be ineffective, as well as politically contentious. Clearly it is important to pay careful attention to transactions arising from countries with a poor reputation for taking action against money laundering, but it is equally important to identify particular institutions, from whatever country, that may have inadequate systems and controls.

### Identifying high risk transactions

This is best tackled through the exchange of information among financial supervisors, law enforcement agencies, and other bodies with a responsibility for tackling money laundering. While the exchange of mere suspicions may be inappropriate, information about convictions for money laundering, or regulatory action to tackle institutions failing to take adequate steps to guard against it, is likely to be of value to authorities in other countries, particularly where the financial institution involved has branches or subsidiaries in other countries, or conducts much of its business with residents of another country.

The exchange of such information is best handled through bilateral (or multilateral) agreements between the agencies involved, perhaps on the basis of MoUs. Such agreements would cover the basis upon which information might be exchanged, including any restrictions on further transmission of the information.

### Issues for discussion

What arrangements already exist for the exchange of information between national authorities? Can these be developed to encompass information regarding institutions and/or countries that pose a significant money laundering threat? To what extent would such a system affect the relationship between financial institutions and the relevant authorities?

## The role of the supervisory authorities

### Introduction

It is clear from what has already been said, and from consideration of the draft model law, that legislation on its own is not sufficient to construct an effective regime for tackling money laundering. It is absolutely crucial that there is an appropriate institutional structure within which the law operates.

Whether or not a single body is given responsibility for ensuring compliance with all aspects of money laundering legislation, it is crucial that a number of functions are carried out. These include the inspection of financial institutions to monitor compliance, the compilation of statistics and other reports and reviews of the effectiveness of the legislation, issuing guidance notes to assist financial institutions in meeting their obligations under the legislation, providing training for the staff of financial institutions in appropriate systems to forestall, prevent and detect money laundering, and ensuring that financial institutions do not come under the control of criminals or criminal organisations.

### Inspection of financial institutions

It is necessary to ensure that financial institutions have in place systems that address the requirements of Recommendations 12-18 and 20, that is to:

- ❖ identify their customers;

- ❖ keep records of all transactions;
  - ❖ report any suspicious transactions to the relevant authorities and co-operate with subsequent instructions from those authorities;
  - ❖ establish systems and controls to forestall and prevent money laundering, including the provision of appropriate training for staff.
- ❖ information on convictions obtained and assets confiscated, both domestically and as a result of international co-operation;
  - ❖ regular appraisals of the costs of the anti-money laundering regime to government and to the financial sector;
  - ❖ trends in laundering, both domestic and international.

Whatever agency is responsible for fulfilling this responsibility, it will need to be able to inspect financial institutions' records, and if necessary to interview their staff. Financial supervisors and Central Banks will often have such powers. Even where these authorities do not have primary responsibility for tackling money laundering within the financial sector, they will have an interest in the findings of such inspections – a financial institution that is not taking adequate steps to guard against money laundering may be cause for concern in other contexts. In order to maximise the effectiveness of such inspections, while minimising the burdens imposed by the inspection process on financial institutions, where responsibilities lie with more than one agency it may be appropriate for one authority to conduct inspections on behalf of others. This will require close co-operation between all the agencies concerned.

### Compilation of statistics and reports

The effectiveness of money laundering legislation can best be maintained by ongoing assessment of its impact. Not only will governments wish to know what impact the legislation is having, but financial institutions will also benefit from feedback about the disclosures that they make, in aggregate as well as on a case by case basis. Reporting might usefully take a number of forms:

- ❖ statistical information detailing the number of disclosures made, the percentage which have been of value, and the classes of institution that made the disclosures;

### Guidance notes

It has been the experience of financial institutions in many countries where money laundering legislation has been introduced that compliance with the legislation is made easier by the provision of officially approved guidance notes.

It is important that such guidance is:

- accurate, reflecting the legal provisions in such a way that financial institutions can trust the guidance;
- comprehensible, so that it is easy to use; and
- kept up to date, so that it reflects any amendments to legislation or experience in using it.

For these reasons it is desirable for the drafting of guidance notes to involve not only the regulatory and law enforcement agencies responsible for supervising and operating the legislation, but also the financial institutions themselves.

The guidance notes should set out good practice in complying with the law in a more detailed way than is possible in the text of the legislation. They should also give examples of what might be considered suspicious transactions, and what elements might be appropriate for inclusion in staff training programmes. Examples of Commonwealth countries and territories that have produced guidance notes include Britain, the Isle of Man, Singapore and Australia.

### Training

While guidance notes form an invaluable adjunct to money laundering legislation, they operate

best when combined with training for the staff of financial institutions. While it is appropriate for financial institutions to train their own staff, it is vital that those officers who are responsible for making suspicions disclosures, and who liaise with the supervisory authorities, receive sufficient training in their specific responsibilities. Such training is best provided by, or in close association with, those agencies responsible for the operation of the legislation.

This training should cover a range of topics:

- ❖ the requirements placed on financial institutions under the legislation, including the duties to identify customers, keep records and train staff in the appropriate systems, as well as reporting suspicions;
- ❖ recognising transactions which might relate to money laundering, and determining to what extent “mild” suspicions might be “filtered out” and not passed on to the authorities;
- ❖ understanding the sort of information that would be of value to the authorities, and the extent to which follow-up information might be valuable, and what level of feedback might be expected in response to disclosures;
- ❖ handling requests from law enforcement investigators for confidential information.

### Issues for discussion

What institutional arrangements are needed to ensure that the authorities responsible for combatting money laundering are in a position to carry out all their responsibilities, or alternatively to ensure that they are carried out by other bodies?

In some Commonwealth countries the provision of training has been arranged in association

with the financial sector trade associations, who have been able to devise appropriate manuals and materials for training staff at all levels within financial institutions. This approach has helped to develop mutual understanding between the authorities and the trade associations, which has allowed the effectiveness of the legislation to be monitored informally, and possible improvements to it to be identified at an early stage.

### Preventing criminal control of financial institutions

The effectiveness of the measures outlined above depends critically upon the assumption that financial institutions themselves recognise the desirability of co-operating with the authorities to ensure that they do not find themselves inadvertently doing business with criminals. In almost all cases this assumption is justified, and financial institutions genuinely do want to “keep the crooks off the books”. However this is not the case where financial institutions have been set up, or subsequently fall, under the control of criminals or criminal organisations.

A financial institution that knowingly launders criminal proceeds, and which conceals this behaviour from the authorities poses a severe threat to the financial system, and offers criminal organisations the best prospect of accessing the financial system without detection.

Unsurprisingly this situation has attracted criminal organisations in some countries to make active efforts to acquire control of financial institutions. There have also been banking crises in some jurisdictions that had set out to establish themselves as offshore centres through a combination of tax advantages and slack regulation. Even today, there is evidence that financial institutions in countries such as Russia are being established by criminal organisations.

It is essential that financial regulators and other authorities responsible for combatting money laundering take steps to ensure that criminal organisations cannot take control of, or set up, banks or other financial regulations. The key to this is to ensure that applicants for

licences to run financial institutions are adequately scrutinised to ensure that they are “fit and proper” to conduct the business that they propose.

## International co-operation

### *Introduction*

It has already been pointed out that money laundering is an international problem, and that effective measures to tackle it require international co-operation. This co-operation is necessary at a number of levels, and between a number of different agencies.

### Co-operation between governments

Co-operation between governments is important to ensure that a legal and administrative framework exists for cross-border investigations into money laundering. At the most basic level it is important that the legal and constitutional definitions of money laundering adopted by different governments are compatible, so that a crime committed in one jurisdiction will be recognised as such by others. The widespread adoption of the 40 FATF Recommendations, together with the 1988 United Nations Convention (and, increasingly, the 1990 Council of Europe Convention), has greatly assisted in this process. For those Commonwealth countries that have yet to introduce their own money laundering legislation, the draft model law produced by the Secretariat will provide a legal framework that is fully compatible with the FATF Recommendations, and hence with the approach adopted in the majority of other countries.

At the intergovernmental level the processing of requests for international co-operation in money laundering cases is greatly eased by the negotiation of bilateral or multilateral treaties or agreements. In particular Mutual Legal Assistance Treaties, covering asset tracing, freezing and confiscation, the production of evidence and the questioning of witnesses, are extremely valuable tools in pursuing investigations across national boundaries.

### Co-operation between government agencies

Within the framework of a common legal approach and a network of international agreements, most practical co-operation will take place on an agency to agency basis. This will tend to develop at both the formal and informal level. Formal arrangements for the exchange of information under international agreements will frequently, and rightly, be channelled through formal channels, involving nominated central authorities within Justice Ministries or the Attorney General’s Department. These formal exchanges can be greatly strengthened, and frequently speeded up, by more informal, direct contact between investigatory and supervisory agencies.

Apart from contacts relating to specific cases, informal communication can develop national authorities’ understanding of the nature of the information available to their counterparts in other jurisdictions, and the exchange of information about previous cases, and approaches that have been more or less successful, can help propagate good practice. Fora for exchanges of experience already exist for law enforcement bodies<sup>1</sup> and are developing among financial supervisors<sup>2</sup>.

With individual cases, informal bilateral discussions may clarify the likely value of information that might be obtained through formal requests for information. It might also allow the authorities in different countries to identify common targets, and develop a mutually supportive approach to their investigations.

Just as co-operation between governments is assisted by formal treaties and agreements, specifying how requests for information should be made, and to whom they should be addressed, agency to agency co-operation can be assisted by the drawing up of MoUs, setting out clearly how information should be exchanged. MoUs are particularly valuable where there is a regular two-way flow of requests between the two parties to the agreement.

1 Interpol’s FOPAC group, the Customs Co-operation Council

2 Through the International Organisation of Securities Commissions (IOSCO) and the Offshore Group of Banking Supervisors

### Co-operation on best practice

The exchange of information between supervisory authorities need not only relate to suspected cases of money laundering. Those countries with longer experience of tackling money laundering will often be willing and able to offer advise and assistance to other countries that are establishing legislation, procedures and institutional structures for the first time.

### Issues for discussion

Is the existing level of bilateral co-operation adequate? What are the shortcomings in existing arrangements? How can Commonwealth governments maximise the scope for international co-operation in combating money laundering? Is there a case for the establishment of a dedicated structure within the Commonwealth to assist in this process, or does Commonwealth participation in existing fora offer sufficient scope?