

BOARDROOM INSIGHT | BY DICK BROOME, DUNCAN DEVILLE AND SEAMUS MCMAHON

The money laundering landscape

Last month's \$65m penalty against AMEX Bank International and \$31 million penalty against Union Bank of California were just the latest entries in a long list of financial institutions that have faced severe fines for money laundering law violations. In 2001 and 2002, FinCEN, the arm of the Treasury Department that enforces the Bank Secrecy Act, assessed only \$1m in civil penalties. Since the post-9/11 profusion of money laundering legislation, nearly \$200m in penalties have been levied.

Riggs Bank became the most infamous example of what can happen when in 2004 FinCEN imposed on it \$31m in civil and criminal penalties. Rigg's money laundering violations involving foreign political figures led to the ultimate demise of the institution once known as the 'Bank of Presidents'.

Other bank and non-bank financial institutions that have taken big hits in the post-9/11 period include Israeli Discount Bank (\$12m), Bank Atlantic (\$10m), ABN AmroBank (\$30m + an additional \$40m from state regulators), Oppenheimer Funds (\$2.8m), Banco de Chile (\$3m), Arab Bank (\$24m), and Western Union (\$3m). All were for money laundering law violations.

Money laundering is the hiding of financial assets so they can be used without detection of the crime that produced them. Through money laundering, a criminal converts the money derived from a crime into funds that now appear to have come from a legal source. It is an enormous problem (the IMF estimates that the aggregate size of the funds laundered worldwide is 2-5 percent of the world's gross domestic product) and it is the lynchpin of many criminal and terrorist activities.

After 9/11, anti-money laundering (AML) laws, once the sole province of narcotics agents, quickly became a favourite tool of agents tasked with combating terrorism. And special counter-terrorist financing (CTF) requirements were added to many nations' laws under pressure from the US and the Financial Actions Task Force (FATF), the international body policy-making body which promotes adoption of uniform AML/CTF laws and publishes 'blacklists' of non-complying countries. Additionally, in the US, the passage of the Patriot Act strengthened the Bank Secrecy Act, created 'clean house' requirements for banks, and established enhanced due diligence requirements for certain types of customers. It also greatly expanded the definition of 'financial institutions' covered under the law to include, among others, real estate agents, insurance companies, investment bankers, money transmitters, casinos, check cashers, issuers of travellers' cheques and money orders, and credit card companies.

All of these laws expose banks to legal scrutiny even where the bank had nothing to do with the original crime. Flush with cash, very often a criminal's trail makes a stop at a bank or non-bank financial institution. As a result, criminal investigations often encompass banks, because as Willie Sutton said (in a different context) "that's where the money is". Consequently, banks, particularly since 9/11, have been forced to de-

vote considerable resources to AML/CTF compliance efforts.

The risks and rising costs of AML/CTF compliance are frequent complaints heard around the world. In light of the growing penalties and money laundering compliance costs, we interviewed, off-the-record, several current and former senior officials at FinCEN, OFAC (Office of Foreign Assets Control), the Justice Department, and intelligence agencies, as well as several current bank compliance directors, to assess the state of AML/CTF compliance six years after 9/11.

The most encouraging thing learned was that large US banks' AML/CTF compliance programs are in far better shape than they were six years ago – a quick look at how little time it takes for banks to raid FinCEN of its directors gives one an idea of how much hiring banks are doing to bolster their compliance departments. There have been four heads of FinCEN since 9/11. That is not to say that there is no room for improvement in large US banks; clearly FinCEN is still finding fault with them.

Non-US banks are further behind the curve however. Those with branches in the US of course must comply with US AML/CTF laws and regulations. However, even foreign banks that indirectly operate in the US, for example through correspondent relationships, must follow these same laws for all practical purposes. Experts to whom we spoke said that foreign banks are generally five years behind the curve when it comes to AML/CTF compliance. China, for instance, only in June of this year gained coveted FATF membership. As a result its government has instituted a major push requiring the country's commercial banks to come up to international standards. Reports suggest that banks are having to establish AML/CTF compliance departments and internal financial intelligence units from scratch.

Similarly, small and mid-sized banks are facing great difficulties in meeting AML/CTF requirements. After persistent complaints that they do not have the compliance resources of their larger competitors and that they present a lesser risk of money laundering, Treasury Secretary Paulson in June of this year announced a plan to revise FinCEN's 2005 BSA/AML compliance rules manual. This allows for a more risk-based approach to compliance demands made of banks. In late August, the revised manual was released; whether this ultimately produces meaningful relief for small and mid-sized banks remains to be seen.

Given the advanced state AML/CTF compliance in American banks, cost is probably their biggest concern. US banks spend over \$3.6bn a year on AML/CTF compliance activities. The bulk goes to training, technology and reporting systems. The Wall Street Journal reported on 9 July 2007 that AML/CTF compliance costs have increased 60 percent in the last three years. Our research revealed that banks not only are spending large amounts on compliance but they have no way to make peer-to-peer comparisons of this spending, and so are in the dark as to its efficiency. ▶▶

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Another concern of large banks is finding qualified AML/CTF compliance staff. The Wall Street Journal reported on 6 February 2007 that large banks are currently offering \$500,000 or more a year to top compliance executives with anti-money-laundering experience, much more than the \$165,000 national median salary that salary.com says a regional retail bank president commands. Our research found numbers even higher.

According to those we interviewed, banks rightly feel that law enforcement has been delegated to them, placing them in the strange position of essentially informing on their clients. Yet there are measures that successful banks are taking to comply with AML/CTF rules and still maintain financial growth. The basics are well known: establishing effective customer due diligence systems and monitoring programs, including know-your-customer rules; regularly screening against OFAC lists; and establishing sufficient suspicious transaction reporting procedures throughout the bank. Beyond this however, there are specific areas that successful banks are targeting their limited compliance resources: private banking; electronic banking; international funds transfers; cor-

respondent accounts; funds from high-risk countries (e.g., those on FATF's list of non-cooperative countries and territories, and countries on the State Department's annual International Narcotics Control Strategy Report); and funds from high-risk businesses (e.g., cash intensive businesses, money services business, certain charities, offshore accounts and funds from tax-havens).

Closely monitoring these, and meeting basic requirements, does not come cheaply. But given the penalties for not doing so, and the damage suffered to reputation if, for example, terrorists fund an attack on the US using money sent through your bank, this is money well spent. ■

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