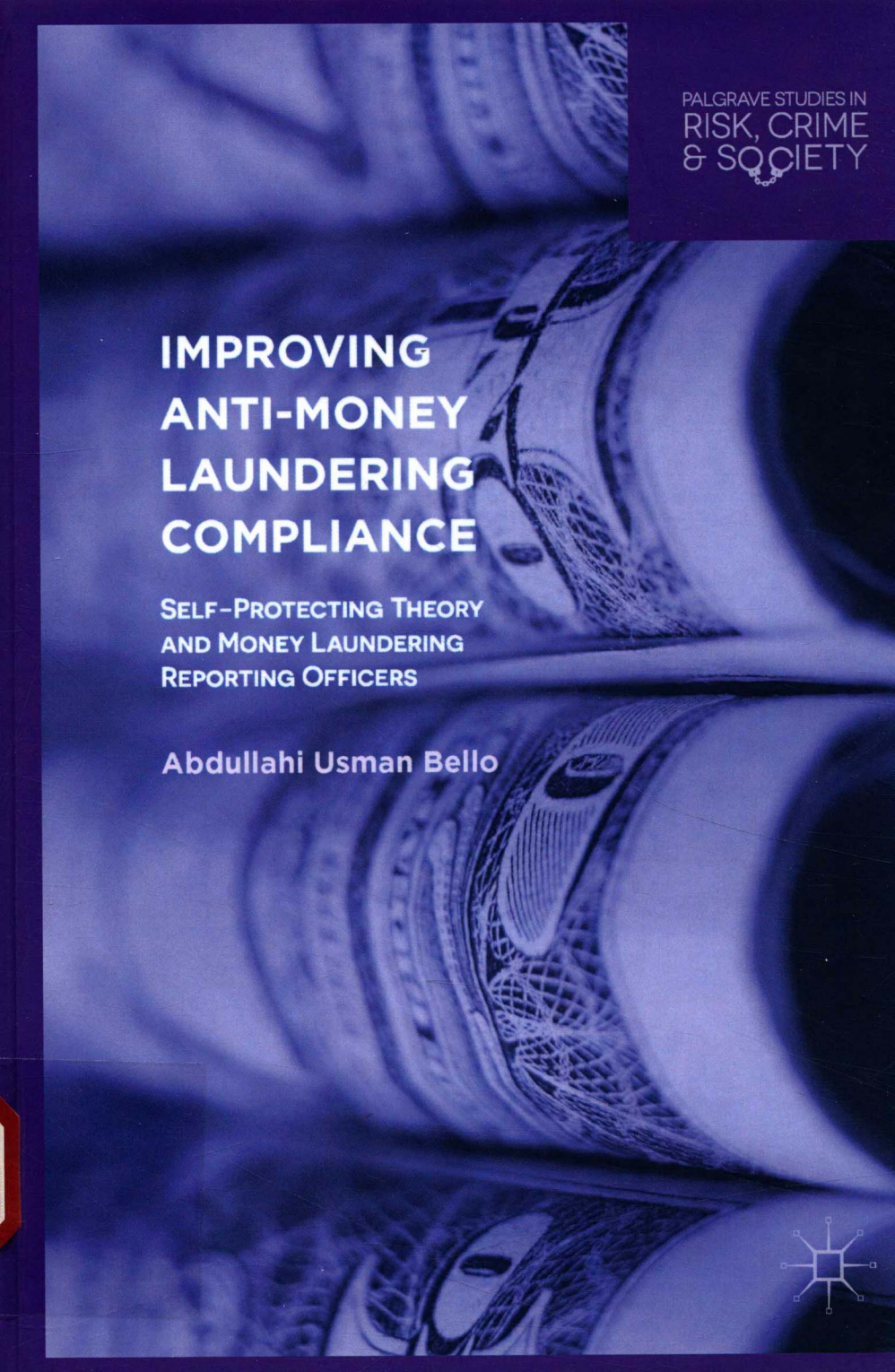
PALGRAVE STUDIES IN
RISK, CRIME
& SOCIETY
IMPROVING
ANTI-MONEY
LAUNDERING
COMPLIANCE
SELF-PROTECTING THEORY
AND MONEY LAUNDERING
REPORTING OFFICERS
Abdullahi Usman Bello

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Improving Anti-Money Laundering Compliance

Self-Protecting Theory and Money Laundering Reporting Officers

palgrave
macmillan

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Palgrave Studies in Risk, Crime and Society
ISBN 978-3-319-43263-2 ISBN 978-3-319-43264-9 (eBook)
DOI 10.1007/978-3-319-43264-9

Library of Congress Control Number: 2016948409

Cover illustration: © Fly_Fast, Getty Images

Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Springer International Publishing AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

To my wife, Hadiza Abdullahi, the mother of my two lovely children; Muhammad and Usman

Foreword

As these words are crafted, money laundering is centre stage both in connection with the leaked Panama papers and the perceived risks posed by offshore finance centres (OFCs) and with its link to corruption. Public disquiet over foreign criminals using OFCs as a means of 'laundering' their criminal assets through the London property market[1] appears to be prompting more overt action on the part of the UK Government with a series of recent announcements: requiring disclosure of owners of all overseas companies purchasing property in the United Kingdom (UK); a new corporate money laundering offence that would hold employers responsible for failing to prevent money laundering by their employees;[2] and plans for introducing the offence of 'illicit' enrichment for UK public servants.[3]

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[1] Damien Gayle "Foreign criminals use London housing market to launder billions of pounds" The Guardian, 25th July, 2015. Available at: http://www.theguardian.com/uk-news/2015/jul/25/london-housing-market-launder-offshore-tax-havens.

[2] Patrick Wintour and Heather Stewart, The Guardian 12th May, 2016 "David Cameron to introduce new corporate money-laundering offence". Available at: http://www.theguardian.com/politics/2016/may/11/david-cameron-corporate-money-laundering-offence-anti-corruption-summit.

[3] BBC News "Money laundering: new law planned to target corrupt officials" 21st April, 2016. Available at: http://www.bbc.co.uk/news/uk-36098769.

If these proposals find their way onto the statute books, there will be yet more rules and regulations with which companies and institutions find themselves legally bound to comply. Of course public intervention within otherwise 'free markets' is predicated on the desire to correct some imperfection and indeed must be both justified and proportionate. This is especially the case when state intervention places burdens upon or intrudes into the lives of its citizens. Intervention in the financial market is more frequently justified because in its absence, the rest of the economy would fail to function. Writing almost thirty years ago, Lomax (1987) cited in Franks *et al.* (1998, p. 1548) makes a most salient observation *"the only major threat to the future health of the financial services industry is that of excessive or inappropriate legislation"*. For regulation is not cost neutral. Indeed in the UK each new law must be accompanied by a regulatory impact assessment (RIAs), a 'soft' cost-benefit assessment. 'Soft' because very often costs are only partially identified whilst claimed benefits are unquantifiable, presented in narrative terms. Thus, Harvey (2004) reviewed the RIAs for UK Money Laundering Regulations in 1993 and 2001 and demonstrated costs to be significantly understated and benefits unquantified merely promising sweeping protections for society from the global threat to the integrity of the financial system. Whilst no one would condone the activities of organised criminal gangs or of terrorists, they are very different both in objective and modus operandi but are within political discourse co-joined in creating the 'threat' giving absolute justification for the imposition of an extensive anti-money laundering (AML) regulatory framework.

Such burdens are not inconsequential. Harvey (2008) noted that the machinery of AML compliance had become self-generating with increasing cost implications. Those charged with their compliance within institutions can find themselves personally liable for failures within their organisation or by any of their employees to spot and report money laundering. Her respondents draw attention to their difficulties in coping and refer to a culture that is fear driven and risk avoiding. Those bearers of the poisoned chalice of AML compliance (Harvey, 2004) negotiate a tricky line between ensuring that they keep their employing firm on the right side of the law whilst ensuring that they

do not overly inhibit the activity of those employed by the same company to seek out and exploit profitable business opportunities. After all, 'risk taking' is the pursuit of profitable opportunity whereby the risk being taken is assessed, measured and managed.

Concerns about costs arising from and associated with what became termed the 'rules-based' approach, an approach that was proving overly prescriptive and burdensome, resulted in banks lobbying hard for a change in which they both managed to bend the ear of the regulator[4] and were consulted on implementation of the revised 'risk-based' approach to AML compliance. Risk and the appropriate way in which it is handled has its roots in the insurance industry, where it was a relatively straightforward affair to assess the probability of a set possible incidents or events that have occurred within a defined time span to a particular subject. Then calculate the loss (for it is usually a one-sided affair) arising from its occurrence. In simple terms, risk = probability × impact. This quantitative assessment to risk was long ago adopted by the Bank for International Settlements and promulgated through its various Basel Accords for the measurement and management of risk within the global banking sector. As the main complaint with the cost of compliance with the original rule-based approach to AML compliance emanated from the banking sector, it was understandable that they would have been more receptive to a 'risk-based approach' (RBA) as this was familiar language.

The banks formed part of a group asked to develop guidance in relation to the RBA to foster a common understanding of what the term actually meant. Although the best this group could offer was that it *"... encompasses recognising the existence of the risk(s), undertaking an assessment of the risk(s) and developing strategies to manage and mitigate the identified risks"* (FATF, 2007[5] p. 2). This inability to capture what is meant by 'risk' within the arena of AML remains outstanding. Guidance

[4] See Financial Services Authority (FSA) "DP22: Reducing money laundering risk: know your customer and AML monitoring".

[5] FATF (2007), 'Guidance on the Risk-Based Approach to combating money laundering and terrorist financing' FATF/OECD, Paris.

notes on the RBA set out in the FATF 2013[6] (p. 4) methodology state that *"Once ML/TF risks are properly understood, country authorities may apply AML/CFT measures in a way that ensures they are commensurate with those risks—i.e., the risk-based approach (RBA)".* Although there was no attempt to inform supervisors how they should set about assessing risk that being set out in the nine sectoral RBA guidance papers. The guidance for the banking sector,[7] however, lacks specificity making application of the approach even more challenging, adding a new dimension of 'interpretation risk' when the assessment of the bank fails to accord with that of the regulator (see also Demetis & Angell, 2007).

In a perfect world, banks should be able to objectively assess the probability that for the total number of transactions passing across their books 'x%' will likely be associated with criminal activity. Of course in and of themselves these will not necessarily be loss making, so will not be observable from any historic loss database, and so indicators and red flags have to be built up in more interpretative ways, hence the criticism that banks can only truly observe what is unusual (Favarel-Garrigues *et al.* 2008). Unfortunately, unlike 'risk taking', 'being at risk' lacks any objective rod of measurement. What is evident here is that despite application of common vocabulary, the interpretation of 'risk' within AML is fundamentally different[8].

It is this fundamental difference that Abdullahi Bello carefully lays out before us in this book. He is, of course, not the first to centre a PhD study on compliance officers, Antoinette Verhage conducted hers with Belgian compliance officials noting (2011, p. viii) that *'once they are*

[6] FATF (2013) Methodology For Assessing Technical Compliance With The FATF Recommendations And The Effectiveness of AML/CFT Systems, FATF/OECD, Paris, February.

[7] FATF (2014) 'Guidance For A Risk-Based Approach; The Banking Sector', FATF/OECD, Paris, October.

[8] For an elaboration of the general discussion about proportionality and the risk-based approach, see Van Duyne, Harvey and Gelemerova (forthcoming) 'The Monty Python Flying Circus of Money Laundering and the Question of Proportionality' Chapter in ' Illegal Entrepreneurship, 'Organised Crime' and Social Control: Essays in Honour of Professor Dick Hobbs' (ed) G. Antonopolous Springer, Studies in Organised Crime.

found, they are very interesting and intriguing conversation partners'. Research in this field is not to be undertaken lightly; compliance professionals are often reluctant to talk publically, being anxious not to express views that differ from those of their employers. So it is less usual for empirical work to focus on the personal challenges faced by this group of people. By employing a grounded theory methodology, Bello was able to hear first-hand about their concerns. Data collection was carried out just by listening, no recording or note taking to disturb the conversation flow with his respondents feeling able to talk more freely.

Through this approach he has been able to uncover the very personal narrative of their daily lives and work pressures—the criticisms of compliance officers as being seen as cost centres and profit inhibiting, squeezed between two masters—their employer on the one hand and the regulator on the other. They feel underappreciated, the object of opprobrium for their trading-based colleagues. He further clearly demonstrates how the move from a rules based to a risk-based approach far from improving matters has actually increased levels of uncertainty. This leads him to derive what he refers to as 'self-protecting theory'. This states that the more there is unfair pressures on compliance officers, the more they protect themselves rather than assist in regulation. However, rather than leaving things at this juncture he goes on to carefully construct an alternative approach to compliance that gives greater involvement to money laundering reporting officers as co-constructors of an AML framework in which they have control of their decision making.

This book makes an excellent contribution to literature on AML compliance, and as we enter the Fourth Round of FATF Mutual Evaluation, I recommend it as essential reading to policy makers.

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Professor Jackie Harvey

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Acknowledgements

I wish to start by thanking Allah, the most gracious and the most merciful, for his blessings and my parents Usman Bello Akko and Fatima Muhammad for their love and prayers.

I also acknowledge the support of Professor Jackie Harvey, Abubakar Usman Bello and Nuhu Bello Akko among others.

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Introduction

There has been a lot of discussion about the level of effectiveness of anti-money laundering (AML) within the United Kingdom (UK) and even globally. Some have attributed the problem with AML to weak regulatory and compliance framework, others lay the blame on the regulated sector for not doing enough to prevent money laundering, while some have attributed the problem to the cost of compliance imposed by the regulators. This book looks at the problem of AML from the perspective of one of the most important stakeholders, the money laundering reporting officers (MLROs), because their voice is often not heard in the debate despite the critical role they play in AML.

Consequently, the chapter introduces the problem with AML from the perspective of MLROs. The aims and objectives of the book, the justification for the writing of the book and a brief discussion on the philosophy and methodology adopted for the research that underpinned the book are also included in the chapter.

A.U. Bello, *Improving Anti-Money Laundering Compliance,*
Palgrave Studies in Risk, Crime and Society,
DOI 10.1007/978-3-319-43264-9_1

Introduction

Money laundering is a global phenomenon that has been around for ages (Unger 2013a). In its basic form, it is the process of concealing of the source of illicit money. The problem with money laundering is that it encourages criminal activities, allow money launderers to benefit from the proceeds of their criminal activities and threatens the soundness of the financial system (Schott 2006).

As a result of these negative effects, the international community has introduced various initiatives to tackle the problem caused by money laundering. The main organisation that deals with the problem globally is the Financial Action Task Force (FATF), an institution formed by the Group of Seven most industrialised nations initially to deal with drug-related money laundering offences and later terrorist financing and other serious offences. The organisation developed 40 Recommendations in 1989 as a comprehensive measure to preventing money laundering. The recommendations were subjected to various amendments before the organisation finally adopted the Recommendations in 2012 for the prevention of money laundering, counter-terrorist financing and proliferation of weapons of mass destruction.

The United Nations (UN) was, however, the first to introduce a global measure to tackle the problem with the introduction of the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances in 1988. Later, the UN introduced other conventions, such as United Nations (2000) on Transnational Organized Crime and United Nations (2004) on Corruption, to widen the scope of predicate offences and adapt to changing money laundering schemes. Other institutions that are at the forefront of the fight against money laundering include the World Bank, IMF, Egmont Group and Wolfsberg Group.

The European Union (EU) is also active in combating money laundering. Countries in the EU are obliged to follow various Directives on money laundering that were passed mainly to implement the recommendations of the FATF. The first Directive was passed to give effect to the first forty Recommendations of the FATF, and when the recommendations were amended in 1996, a second Directive was issued. There is also the third

Directive that is more comprehensive, which broadened the scope of predicate offences, included other organisations as regulated entities and introduced a risk-based approach to AML. The Directive that is now in force is the fourth EU Directive, which was issued in 2015 to further address the threat of money laundering. Furthermore, member countries are required to comply with the Directive by June 2017 (European Union 2015).

The UK, being one of the major countries in the EU and a strong member of the FATF, is one of the most active countries in implementing various AML Directives and FATF recommendations (de Koker 2009), mainly through money laundering regulations (MLR). The first MLR was issued in 1993 to implement the first Directive, the second in 2003 to implement the second Directive and finally the MLR in force is the 2007 MLR regulation, which is essentially a regulation that gives effect to the third EU Directive (van den Broek 2011).

Several acts were enacted to support the fight against money laundering. These include the Proceed of Crime Act 2002 (PoCA 2002), which is the foremost legislation for dealing with money laundering. Before 2002 there were Drug Trafficking Act 1994 (DTA 1994), the Criminal Justice Act 1998 (CJA 1988) and the Terrorism Act 2000 (TA 2000) that were also related to the fight against money laundering. Several organisations were also created to enforce the provisions of the law. Some of the organisations include the Serious Organised Crime Agencies (SOCA) and the Financial Service Authority (FSA), which, though not mainly created for AML, had powers to implement AML regulations. These two organisations were replaced by the National Crimes Agency (NCA) and the Financial Conduct Authority (FCA), respectively, but they retain the same powers and responsibilities to prevent money laundering. The two agencies were created by the Crime and Courts Act 2013 and Financial Services Act 2012, respectively.

One industry that was subject to intense regulation regarding AML was the banking industry because of the belief that the majority of money laundering activities were conducted through the industry (Takats 2011). Banks were unwillingly recruited to support the fight against money laundering through requirements for them to implement systems and controls to deter the use of their system for the conduct of