

Money Laundering

The monthly briefing service for anti-laundering specialists

bulletin

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Policy accelerates

FSA plans extended probes of financial crime controls

"I've never prepared a slide-show peppered with so many question marks," Bob Ferguson, Head of Financial Crime & Intelligence, UK Financial Services Authority, observed in opening the Anti Money Laundering Professionals Forum Seventh Annual Seminar. It was a way, he said, to expand on the possible changes ahead rather than keeping strictly to settled arrangements. After reminding the audience that the "standing priority" which takes most of his department's resource is to act as gatekeeper to the financial services sector – assessing if individuals are fit and proper using the authorisation, change of control and approved person regimes – Ferguson turned to the FSA's added agenda. High on this list is transition towards its successor bodies by the end of 2012 – the Prudential Regulatory Authority (PRA), destined to sit in the Bank of England, and the Financial Conduct Authority (FCA), which will inherit the financial crime mantle, including anti-money laundering (AML). Margaret Cole, FSA Managing Director, Enforcement and Financial Crime won the battle for the FSA (and thence the FCA) to keep prosecution powers for insider dealing and money laundering (*Proceeds of Crime Act* and Money Laundering Regulations) offences, which will underpin continuation of the more intensive and intrusive approach to supervision and doctrine of credible deterrence of the last few years. In line with this philosophy, Ferguson's team is working on a rigorous 'financial crime core programme'; targeted at the highest impact firms, it is intended as a deep check on controls. The FSA had not, he said, been "bedazzled" by other issues, like data security, bribery and corruption or sanctions, at the expense of AML. Currently at conception stage, the new programme will be developed and piloted this year: "we think the core focus will be AML." It will operate on a rolling cycle but how long between inspections is unclear – "it may be two or three years, [at this stage] I don't know". Ferguson was equally tentative about the duration of inspections – "maybe six months, I don't know at this juncture."

MLROs and heads of financial crime nervous about the prospect of increased scrutiny may draw some comfort from Ferguson's announcement of a new 'regulatory guide on financial crime', which will set out guidance on FSA expectations. A version, incorporating elements from thematic reviews and internal and outside sources garnered over the years, is already in use by FSA supervisors. "We thought, why not adapt this and share it with the regulated community?" Currently the FSA approach is based on a couple of SYSC [Systems and Controls chapter of the FSA handbook] rules, characterised by a "high level of generality and abstraction" about firms' duties around combating financial crime, which are sometimes not easy for the regulator to translate into concrete requirements. So the new

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Institute of Money Laundering Professionals 8th Annual Conference

Marriott Forest of Arden Hotel and Country Club, Warwickshire
16-17 May 2011
www.implpo.com

7th Annual ACAMS Anti-Money Laundering & Counter Terrorist Financing Conference

Hilton Amsterdam,
The Netherlands
5-7 June 2011
www.amleurope.org

guidance should make expectations more explicit for both firms and supervision and promote a “greater briskness of dialogue about what FSA means by good and bad practice.” An official compendium will also save rooting around a library of documents to discover when and where a specific point was covered. The guide will be subject to full consultation and a cost-benefit analysis; a draft now in preparation should be “publicly visible before too many months.”

Findings from the latest thematic review of high risk areas (wire transfers, politically exposed persons [PEPs] and correspondent banking) will be captured in the consultation draft, said Ferguson. Not wishing to anticipate FSA’s own launch of the these findings at its Financial Crime Conference on 22 June, he did, however, note that “not all is rosy in the garden when it comes to systems and controls” in some of the 27 firms visited: one has already been referred to Enforcement and “may be joined by one or two others.”

Further thematic work is contemplated – “but no decisions have yet been taken” – on AML risk around PEPs and private banks; also, banks’ systems and controls against boiler rooms and investment scheme (eg, land banking) fraud; FSA is looking as well to extend the work it did on bribery and corruption risk in commercial insurance brokers [1] to other sectors.

Whitehall on expected standards

Financial Action Task Force (FATF) engagement with the private sector last year, during consultation on its review of the 40+9 Recommendations, opened the eyes of policy-makers in Paris to some of the complexities of working with the standards on the ground, according to David Lewis, Head of AML and Chair of the PEPs Strategic Group, HM Treasury; the consequence could well be a delay in final confirmation of any changes by three months, to February 2012. Domestic PEPs are likely to be included but internal inconsistencies may arise in international groups if the due diligence differs to that for foreign PEPs since individuals may be categorised differently across the business. Would it be tenable to operate a risk based approach for domestic but not foreign PEPs? FATF has not gone this far but appreciates that more work is needed in the area, said Lewis. Family and close associates are set to be treated the same as PEPs, he noted. The direction of travel is also clear for proliferation financing, which is likely to be incorporated into the standards, possibly in October

2011: text should be ready in time for the June 2011 plenary.

By contrast, distinguishing enhanced scrutiny of transactions as between the FATF ‘grey’ and ‘greyer’ lists of jurisdictions with material AML deficiencies [2] is a matter left for individual firms to resolve. There may be help though on equivalence. The current EU list of external jurisdictions with AML standards compatible to those in the EU Third Directive is set for revision: “The aim is [for the process] to be more credible, robust and transparent.” The UK is notably keen to see the list used as a basis for cross-border reliance on the customer due diligence (CDD) conducted by other credit and financial institutions, which would significantly reduce compliance costs.

UK supervisors will find the spotlight turned on their own performance later in 2011 when the Government expects to publish a report into how effective they are in overseeing AML in their respective parts of the regulated sector. The wise money is on it appearing before the Government’s long-delayed response to the Review of the Money Laundering Regulations 2007; that is sitting with the regulatory policy committee in the Department of Business, Innovation and Skills (BIS) and has several more internal hurdles to clear before a new consultation on any proposed changes is issued. Speaking at the LexisNexis Money Laundering and Financial Crime conference at the end of March, Tracey Guthrie of the UK Financial Intelligence Unit, Serious Organised Crime Agency noted that Chancellor George Osborne had mentioned reforming “our burdensome money laundering regime” in his Budget speech. HM Treasury, she said, was looking to remove “two dozen” provisions from the Money Laundering Regulations and contemplating an exemption from the Regs for small businesses.

Freezing in the Middle East

“I’ve been doing this job for five years and keep thinking it can’t get any busier,” Patrick Guthrie, Head of the Asset Freezing Unit, HM Treasury told delegates, “but in the last six to nine months, issues have risen to a peak.” The Supreme Court ruling at the start of last year, which curbed the asset freezing powers in secondary legislation, prompted a frantic move to reinstate a credible regime through durable statute by the end of 2010. The resulting *Terrorist Asset Freezing etc. Act 2010* raised the threshold before a freeze may be imposed from reasonable suspicion to reasonable

'belief' and requires more evidence to be presented than hitherto; the appeal process against asset freezes was also strengthened. In addition, David Anderson QC has been appointed as an independent reviewer of the regime and will make his first report on how it works in September/October this year. [3] "But for you [working in the field] there is very little difference otherwise for the way you see and implement the regime; it's business as usual: the regime is the same materially as it has been the last 10 years."

The two weeks in the run-up to the AMLP Forum event saw Guthrie and his team "working round the clock" in response to the revolt in Libya. The major lesson from the Middle East and North Africa crisis, he reflected, was the prominence now assigned to asset freezing as a policy tool. An asset freezing regime was implemented within two weeks of the departure of Zine al-Abidine Ben Ali, the former president of Tunisia. Progress has been slower in the case of Egypt in keeping with the less clear-cut transition to a new government - Mubarak property has now been frozen - and Libya has entered the sights, with asset freezes against Muammer Gaddafi, members of his family, close political and military associates and various entities that are a "potential source of funding for his regime", including the Central Bank of Libya and the Libyan Investment Authority. [4] "It's difficult: one minute they're an ally and the money's legitimate, the next minute not. We don't have a good answer [to this challenge]," Guthrie conceded, adding, "We're not saying London is closed for business to non-democratic regimes. It's a delicate balance undeniably." The UK moved swiftly on the Libyan issue - the Prime Minister and Chancellor had to see the Queen on Sunday 27 February to obtain the Order in Council enabling the Treasury to implement the freezes on the Monday morning. On 11 March, Prime Minister David Cameron said that Britain had frozen UK£12 billion of Libyan assets.

HMT believes the asset freezes apply "broadly" to ownership or control of state assets by the listed parties. The EU originally passed a Regulation extending the list of sanctions targets to further individuals without spelling out the entities over which they exercise control, leaving the scope of the measure unclear. The Treasury would like to see an "exhaustive list" so that firms could be clear on which entities are covered by the freeze and which are not but Guthrie said that, presently, as an iterative process, it "does not absolve you from judgement."

Similar uncertainty persists around Iranian sanctions. "All four Iranian banks in London are now frozen and there's an insurance ban." The EU regime against the Islamic Republic - much closer to the US approach than hitherto - requires UK entities to notify all transactions with listed Iranian individuals and entities exceeding €10,000 to HM Treasury, which must also authorise those over €40,000. Banks have complained especially of the practical difficulties in determining if a transaction is an indirect payment to a proscribed Iranian party. Guthrie appreciated the difficulty but said that the Iranians' use of front companies and intermediaries made it imperative to capture both direct and circuitous payments. He also acknowledged earlier problems in granting authorisation requests within the stipulated four weeks but reported that in the second half of January this year all 30 received had been answered in between 10 and 14 days. The Treasury had been flooded with questions on the regime and Guthrie appeared slightly piqued; the Government, he said, wasn't able to address every single issue: "We rightly need to provide more clarity on some but you [in the private sector] must exercise judgement; we can't do your job." The breakdown of talks on Iran's nuclear programme in January and more recent revelations that the country was supplying weapons to the Taliban meant that it "remains a very live issue". Further measures against Teheran are likely this year. "What and when, I'm not sure, but we're looking very closely at this so keep an eye out."

He described the MENA events, when taken together with the sanctions initiatives against Iran, as a "game-changer" in terms of resource allocation in HMT; but at the same time, the Treasury has to find 25% savings over the next four years. How to square that particular circle?

Notes

1. www.fsa.gov.uk/pubs/anti_bribery.pdf
2. www.fatf-gafi.org/pages/0,3417,en_32250379_32236992_1_1_1_1_1,00.html
3. <http://services.parliament.uk/hansard/Lords/bydate/20110228/writtenministerialstatements/part014.html>
4. www.hm-treasury.gov.uk/fin_sanctions_2011.htm

*For further information about the Anti Money Laundering Professionals Forum, visit www.amlpforum.com. Report by **Timon Molloy**, Editor.*

Kill or cure? – US prosecutors and moral hazard

“Financial regulation and prosecution and have effectively merged; it’s often hard to know where one stops and the other starts,” Andrew Hrushka, a partner with King & Spalding, observed, opening the first panel at the moneylaundering.com 16th Annual International Money Laundering Conference in Miami. Ten or 15 years ago, it was possible, he said, to talk about parallel proceedings but not anymore. “Agencies may be in the same room.” The whole push has been towards greater criminal liability for control failure. Compliance staff can no longer be sure whether they are merely assisting a regulator to better understand how their anti-money laundering programme works or straying into the grey zone of providing evidence that could subsequently be used against them in a prosecution. The “vaguely drawn” statutes certainly needed interpretation but in practice, said Hrushka, this means that an “extra-judicial and extra-regulatory body of law is growing piecemeal” as regulatory lawyers and prosecutors hammer out a position between them.

“Yes, we endeavour to work with regulators,” acknowledged Adam Kaufmann, Executive Assistant District Attorney (DA) and Chief of the Investigation Division, Manhattan, New York, “but as prosecutors we know the difference – where something has crossed the line from regulatory to prosecution.” Conduct that passed the threshold into potential criminality would need to be systemic and pervasive, he said. “But it’s hard for a bank to know what separates an ongoing course of conduct from a series of mistakes,” said Hrushka. Would failure to file a suspicious activity report be sufficient to trigger a criminal charge? So far not, if it was an innocent oversight, but “old ceilings are becoming new floors.”

Cases are not brought lightly, Evan Weitz, Assistant US Attorney for the Eastern District of New York insisted. Speaking in his personal capacity, he noted that in the event of a “close call”, the matter would generally be left with the regulator. “Given the money and energy [it costs], we only go for the worst of the worst.” All prosecutions need to be approved by the central Department of Justice office in Washington, DC, which acts as a control, said Weitz. Hrushka wasn’t impressed – oversight occurred mainly at the charging stage and he was concerned over exercise of

prosecutorial discretion much earlier, at the point when an investigation may or may not be launched.

Prosecutors had a habit of hanging on in serious matters, he added, which didn’t bother the regulators since it could be just the pressure needed to bring a firm to accept the lesser offence of having breached their rules. Kaufmann agreed that, having decided not to pursue a case, the prosecutor should withdraw and not “lurk as muscle in the background”. There are strict ethical requirements that govern the way prosecutors operate, Weitz pointed out: they wouldn’t, for example, be able to ask a regulator to obtain documents from an institution on their behalf that would otherwise necessitate a subpoena. “The lines are not actually that bright,” Hrushka noted, “In recent history prosecutors and regulators have been of sufficiently like mind that a line developed by regulators has subsequently been used in prosecution.” The “mindset” of regulators has changed, he said: in the past they saw themselves as coequal with the lawyers, as an independent agency that didn’t need their involvement but now they feel they “get more respect if there’s a prosecutor in the background and a better resolution.” In the current environment it was also very hard to make a regulatory self-report of a failing, say, to file a SAR, without also reporting to a criminal prosecutor as well.

Kaufmann thought the anxiety was overdone: “If I think of the cases where we’ve been involved, again and again it’s been a policy or course of conduct problem, way beyond the [non-]filing of a SAR. That’s where self-disclosure goes a long way to putting the institution in the best light possible.” In determining degree of culpability and knowledge, stupidity is not a defence, Weitz reminded delegates. “Financial institutions are required not to be stupid, that’s why they’re required to maintain an AML programme.” However, he said, there may be an ignorance defence for the individual, not the institution, if a failing could be attributed to cost-cutting in AML.

“The question of stupidity is a good one,” Hrushka picked up. The problem for firms, he remarked, is that, even with the best compliance and training programmes, mistakes happen and institutions are unsure how far they need to dig when they recognise a breach. “There’s a reluctance to turn over the entire department to find out how far it goes; it’s expensive,

disruptive and may unnerve the regulator on the basis that ‘there’s no smoke without fire.’” He urged the agencies to keep in mind the “tremendous effects” of their actions and reiterated the worries of compliance staff in firms that they have no idea where they lie on the prosecutors’ spectrum of egregious behaviour when they arrive at the door. Weitz sought to allay this fear: “It’s very hard to bring a case against a financial institution and even harder to bring a Title 31 [of the US Code] action against an individual.” The doctrine of ‘collective knowledge’ means that a corporate may be held responsible for the sum of knowledge of all the individuals who work for it but if no one person was in possession of all the relevant facts, it would be far more difficult to demonstrate that they had the necessary knowledge to incur criminal liability. Other factors also point to corporate rather than individual prosecution, he said: investigations tend to be prolonged, and may run up against the statute of limitations, while evidence gathering, especially overseas, is often a significant challenge.

Corporates will tend not to fight a case when the prosecutors have achieved a sufficient quantum of evidence; instead, said Hrushka, they’ll likely enter into some sort of discussion to come up with a deal; “there’s really very little judicial oversight.” Individuals, with their liberty at stake, typically take a tougher stand and the level of proof needs to be higher accordingly. Hrushka also thought collective knowledge was widely misunderstood by prosecutors: at least one person in the institution should have the mens rea – “unless he can put the evidence in one person’s head the prosecutor should not go ahead [against the institution].”

The ‘stripping’ cases, in which some global institutions removed originator information from wires, in order to avoid OFAC (US Office of Foreign Assets Control) filters at US banks, provide a useful illustration of the issues that confront the DAs. “There were readily identifiable clerks deleting things and putting [wire instructions] back into the system,” said Kaufmann, “In theory we could have prosecuted the low-hanging fruit but to what end? They were implementing a process from above.” On drilling down to find who set up the process it turned out to be one of “organic growth”. “There was no ‘aha’ moment, ‘let’s do X to defeat all the OFAC filters.’” Rather, people gradually adopted the workarounds and then moved on, handing on the process to the next person, just showing them what had been done before; it was “not conspiratorial”, said Kaufmann, “and hard to identify

one individual and [type of] conduct that was ongoing and established.” His office also ran into the difficulty of securing evidence: “We needed individuals to volunteer to come in for interview. Many had long since left the institution. Practically and logistically, it was a nightmare.”

Reviewing the tools available, Kaufmann listed the choice to prosecute or not, the ability to indict individuals and to litigate. For a financial institution, an indictment is effectively a “death sentence”, he said. “The reality is these battles with financial institutions cannot be fought. We have to address the conduct at institutional level through a DPA [deferred prosecution agreement] without killing the financial institution.”

At the same time Hrushka noted that the “goal posts keep moving. Informal law dispositions have changed and raised the standards that financial institutions need to meet in dealings with prosecutors through DPAs, etc.” While an institution might be expected to assimilate all this disparate material scuttlebutt-fashion, the same duty of knowledge could not be readily imposed on an individual.

Prosecutors were chastised by the judge for reaching a ‘sweetheart deal’ in the Barclays case. [1] If anyone thought that criticism would rile the Manhattan DA’s office into more aggressive pursuit of individuals, they should think again: “I’ve been yelled at by judges,” said Kaufmann, “We listen and nod, say ‘Yes, your honour’, and go about our business. To believe that will change the way we do our calculations is not a knowledgeable position.”

The fact is that judges are not in a position to intervene in a DPA, Hrushka claimed: “They’re so complex, involve a big institution and the judge can’t do his own investigation.” Kaufmann noted that there had been talk of judicial involvement in reaching the DPA. “That would make matters even more complicated,” suggested Weitz. “We’re not going to bring cases just because the media or public are screaming for someone’s head, that’s just not what we do.” He did, however, concede that prosecutors should do a better job of elucidating why they had not brought a case against any individual, showing the steps taken, but the resource called for and the time might serve only to delay proceedings yet further.

“Are there likely to be any prosecutions of individuals in the next year?” Kieran Beer, Editor in Chief of moneylaundering.com enquired. “If I knew the answer to that question I don’t think I’d be allowed to tell you,” said Weitz.

“If you can’t bring cases against financial institutions

because it would be a 'death sentence', what then is the deterrent to those institutions not to commit crime – a high fine, reputational risk? The money laundering law was changed specifically to create the death sentence." Weitz addressed this question from the conference floor. Even a leak that an investigation is in prospect can be extremely damaging, he said. "The last thing we want to do is to seriously harm a financial institution for the acts of a small number of people." Kaufman confirmed that his office was also mindful of the need for total secrecy around investigations to avoid undue reputational and market risk. "Whenever we speak publicly about actions it is through the indictment or DPA with a very carefully negotiated statement of facts." He continued, "I think that within the legal framework that exists, use of DPA and NPA [non prosecution agreement] is a great tool; it helps us deal with serious criminality. Day in, day out we use our prosecutorial discretion to decide when to proceed and charge. DPAs are supposed to send a deterrent message."

In talking to delegates, *MLB* found general surprise that the prosecutors should so openly shrink from exercise of the ultimate sanction against a financial institution for a criminal violation of the money laundering legislation, namely take it through the courts and see the licence revoked. The challenges they enumerated in making a case against an employee for compliance failings likewise raised the collective spirits – "Did you hear the audible sigh of relief in the auditorium?" smiled one MLRO.

Notes

1. Barclays' settlement with OFAC: www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/08182010.pdf; see 'Barclays deal 'raises questions of fairness and justice' ', FT.com, 18 August 2010, for criticism by US district judge Emmet Sullivan.

Report by **Timon Molloy**, Editor

Derrick ponders... Sing's sorrows

*In his last article, **Derrick Paterson** discussed secondees. [1] Here he considers outsourcing, where one firm performs part of the business of another, which can also create difficulties for MLROs.*

This piece does not consider the subcontracting of one part of a project to another firm in an outsourcing arrangement, but similar considerations may give rise to similar concerns.

Consider the situation where 'Sing' outsources part of its business to 'Sor'. All customer relationships will be the responsibility of outsourcing business (Sing), even where employees of the business to which the work is outsourced (Sor) have direct connections with the customers, including where these employees perform the customer due diligence (CDD) ("onboarding") for the customers. Either or both Sing and Sor may see information about the businesses of customers. Both Sing and Sor will have other relevant relationships, including with other customers and suppliers.

For our purposes, there is no connection between Sing and Sor, except the contract for the outsourcing. In particular, Sing and Sor are not part of a group of companies. Note that UK Money Laundering

Regulation 15 requires that "A credit or financial institution must require its branches and subsidiary undertakings which are located in a non-EEA state to apply, to the extent permitted by the law of that state, measures at least equivalent to those set out in these Regulations with regard to customer due diligence measures, ongoing monitoring and record-keeping."

Sing

If Sing is within an anti-money laundering (AML) regime, it is responsible for its own and its employees compliance with that regime. It is not responsible for Sor's compliance with its obligations.

Sing is responsible for providing appropriate training to its employees. It is not responsible for providing training to the employees of Sor.

Since it has the customer relationship, it is responsible for the initial customer due diligence and the ongoing due diligence. The customer due diligence must be completed before either Sing or Sor does anything for the customer on Sing's behalf. Even where the due diligence is performed by Sor, Sing is responsible for the risk analysis, the appropriateness of the process and the correct operation of the process (including ongoing customer due diligence).

Sing is responsible for making Suspicious Activity Reports (SARs) based on knowledge or suspicion that comes to it and its employees from its business activities with its customers. Knowledge and suspicion that come to Sor (or its employees) as a result of Sing's relationship with its customer (even if they come from the outsource contract) cannot form part of a SAR submitted by Sing, unless it is passed on to Sing.

Sor

Where Sor is within an AML regime, it is responsible for its own and its employees' compliance with that regime. It is not responsible for Sing's compliance with its legal obligations.

Sor is responsible for providing appropriate training to its employees.

Sor's customer relationship is with Sing, so it must perform CDD on Sing. It must complete this before it starts work for Sing (and keep it up to date).

Sor is responsible for making SARs that come to it and its employees from its business activities with its customers, including the work it performs on behalf of Sing for Sing's customers.

Points for consideration

Since Sing has the client relationship, the media and the public are likely to see it as responsible for a failure to see or prevent money laundering under a contract that Sing has with its customer, even where the processing is done by Sor. For this reason, Sing may wish to encourage the provision of appropriate training to Sor's employees (even if Sor is not within an AML regime). Sing may also wish to ensure that appropriate information is passed by Sor to Sing's MLRO.

Sor may be concerned about reputational issues arising from its association with individuals or entities with which it has no connection other than through the outsourcing contract with Sing.

If Sing knows or suspects that one of its customers is in possession of the proceeds of crime, it is possible that Sing's contract with the customer and Sor's contract with Sing may result in Sor running the risk of committing a *Proceeds of Crime Act* (POCA) 327 (Concealing, etc), POCA 328 (Arrangements) or POCA 329 (Acquisition, use and possession) offence. If Sing suspects money laundering but Sor does not, Sor will not commit an offence but the relationship

between the two may be soured if Sor sees that Sing has allowed it to continue in such a high risk situation. Similarly, if Sor knows or suspects that Sing's customer is in possession of the proceeds of crime, there will be an awkward situation if Sor does not take steps to prevent Sing running the risk of committing a money laundering offence.

If Sor's knowledge or suspicion arises in part from information arising from its work under its contract with Sing and in part from a contract with another business for which it does work, there will be issues of confidentiality (similar to those for secondees [1]). It is likely that Sor will outsource for several businesses (benefiting from economies of scale). This will make its duties of confidentiality complex.

If Sor maintains the customer due diligence records for different businesses (for instance, Sing and its competitor Ping), to what extent can it use the records held for one business in deciding how it performs its work for another business. For example, what should Sor do in the following situation?

- Sing assesses a customer as high risk and, as a result, Sor holds extensive information about the customer;
- Because Ping assesses the same customer as low risk it intends to collect only limited information;
- Sor knows that Ping would assess the customer as high risk if it knew the information that Sor knows because of Sing's assessment.

As with secondees, it is important that both firms consider the possible situations and that they are transparent with each other on how they will react. Where both Sing and Sor are within the same regime, there will be scope for cooperation. Where they are within different regimes, there will be scope for misunderstanding and jurisdictional conflict, particularly where there are confidentiality considerations.

Notes

1. See 'Derrick ponders... Sally's secondment', *MLB* March 2011

The purpose of this article is to pose questions and instigate discussion. It does not represent advice. Derrick Paterson Dip (AML) FCA MICA is an independent AML consultant. He may be reached on +44 (0) 7732 744 56, derrick.paterson@hotmail.co.uk

With friends like these...

Due diligence is not only for only for customers and business prospects. Edward Jones decides to do some digging in his bank's staff files while Sue Grossey notes the findings.

Edward Jones shook his head, then put his hands flat over his eyes and took a deep breath. After a few seconds, he took the slim file that was on his desk, turned back to the first page in it, and started reading again. When he reached the end, which took only a very few minutes, he picked up the phone and called his deputy MLRO.

"I hope you've had your Weetabix," he said, "It's worse than we thought."

Liz finished reading the folder and looked up at Edward. "That's it? That's all the information we have on file for John Augustus Greenway? Augustus? What were his parents thinking? No wonder he insisted on Jack. Anyway, a part-completed..." she looked down at the folder again, "A barely-completed application form and something to do with the pension scheme? Oh, and a signed slip for his security pass."

Edward nodded.

"And Jack Greenway was one of our most senior account managers, entrusted with sensitive client relationships and take-on sign-off?"

Edward nodded again.

"Who used that sign-off to recruit our Peruvian friend, hand him UK£23 million and then skip off into the night with him?" [1]

"That's him – and I think we can agree that we now know more about John Augustus than our colleagues in HR ever did."

Liz handed the folder back to Edward. "What's brought all this up, Edward? It's not your responsibility to handle recruitment, you know. We have cuddly Jenny in HR for that."

"I know it's not – but if that's the level of the checking that's currently being done... Look, we had friends round to dinner last night – well, they're not my friends, but Jane and the wife went to antenatal classes – anyway, long story short, her ghastly braying lawyer of a husband was telling me about the defence agency in New Zealand. Apparently they took on a new chap to run the place – claimed he'd been a Royal Marine, flown helicopters with Prince Andrew, competed in the Olympics and played rugby for Wales – real he-man stuff. And the New Zealanders

swallowed the lot. Didn't check any of it – although you'd think that security checks might be their thing. I was laughing along until I suddenly thought about us. I know we're not a defence agency, but some of our staff have a lot of power – and even the babies have access to useful information. So I went down to HR this morning, said I was looking into the Paddyngton Baer thing again, and asked for Greenway's file. And this is it. All of it. No documentary proof of anything, no copies of qualifications, no certified copies of ID. For heaven's sake, we do more checks on the girl who delivers the sandwiches than we did on Greenway."

"Played rugby for Wales?" asked Liz. "That would be the easiest thing in the world to check. Ask any beefy-looking man aged between fifteen and fifty."

"I was thinking that we might consider a more rigorous, scientific approach than asking round the pub," frowned Edward. "Of course, things might have improved since Greenway joined the bank – and particularly since he did a runner – so we need to find out what's happening now, and I thought we could ask George. He joined, what, eight months ago?"

"Nine," corrected Liz. "We had the nine-month celebratory cakes last week. I've never known anyone so happy to be a compliance officer – rather touching, really."

"Well, there was the application form, of course," said George, ticking items off on his fingers, "And the bank secrecy undertaking. And the personnel record – where I had to put the name of an emergency contact. I put my mum in the end, which was a bit embarrassing, but it's either her or my sister, and she's not home..." His voice trailed off.

"The application form," asked Edward. "Was it like this one?" He handed a blank version to George, who scanned it and nodded. "So you filled in all your qualifications – A levels, degree?" George nodded again. "Do you have certificates for those?"

"Of course," said George proudly. "I keep the originals in a safety deposit box, and then I have copies at my place and my mum's."

"Were you asked to send in certified copies with your application?"

"No, but I thought that was probably an oversight, so I sent them anyway. I included my GCSEs as well, just to be safe. And my CRB check..."

"Your criminal records check?" interrupted Liz. "Does the bank ask for that?"

“Oh no, but I’d had it done anyway, so that I can help with the local scouts, and I thought it might be helpful. And then when I read the bit about an emergency contact, I thought it might be handy for them to know my blood group and allergies, so I put together a medical summary, with permission for them to contact my GP should I fall ill at work. You know, the usual stuff.”

“The usual stuff...” echoed Edward and Liz together.

“So that’s my concern,” concluded Edward, “We are so careful about doing all sorts of checks and verification on clients, but we don’t seem to take the same precautions with our staff. Who, as you know, are our real riches.”

Jenny Fenwick, Head of Human Resources, nodded vigorously. “You are so right,” she agreed enthusiastically – apparently having forgotten the poster behind her head. A rainbow stretched across an improbable country scene, with a pot of gold coins gleaming at the end of it and the legend ‘People are our real riches’ emblazoned along it. “Muffin?”

Edward was rather taken aback at her familiarity, until he realised that she was holding out a plate of cakes. He shook his head and leaned forwards. “So ideally, Jenny – I may call you Jenny?”

“I wish you would,” she said with a slight blush, “It makes things so much more friendly.”

Edward cleared his throat. “So, ideally, Jenny, we in Compliance would like to introduce the same level of checking – perhaps even a higher level of checking – for our staff as for our clients. We would like all pertinent elements of applications to be independently verified – using one document to verify name and another to verify address.” He saw Jenny’s eyes widen a little. “Don’t worry: we’ve been doing this for years for clients, and we can easily tell you which documents to ask for. In fact, I have a specific member of staff that I can second to your department to help with it all – he’s very thorough, and a big muffin fan. He’ll fit right in. You probably remember recruiting him – George Swanson?”

“George Swanson? With the police record checks?” Jenny chuckled. “Oh yes, we remember him!” Her laughter faded. “Good heavens: are you planning to ask for that for everyone? Blood groups and DNA swabs?”

Edward tried not to smile. “Granted, George can be a bit, well, over-enthusiastic. I think it highly unlikely that things will get to that stage. Although some banks have been talking about random drug tests for key

employees...” He saw the colour drain from Jenny’s face, doubtless as she had visions of having to perform blood tests on the directors. “But not this bank, Jenny – not us. But you might remember that George also submitted copies of his certificates with his application, and I think that this is a good idea – so that we can be sure that people have the experience and qualifications that they claim to have. Any professional memberships too – we should see evidence of those.”

Edward stopped talking as he realised that Jenny Fenwick was sitting at her desk with what his son called a definite look of the stunned mullet about her. Should he mention his last request, he wondered – pull off the plaster in one swift movement? “And I’d like to do these checks retrospectively as well, Jenny – current staff as well as new ones as they join. So we’ll need to go back through everyone’s file and see what we need to verify.” Jenny blinked once, very slowly. Edward stood. “Righty-ho. So I’ll send George down to you this afternoon, and you and he can get started.” Jenny was still sitting motionless in front of her rainbow as Edward left her office and went to break the good news to George.

“Excellent cakes, George,” said David through a mouthful of crumbs, “You’ve really pushed the boat out this time.”

“Well, my mum said that ten months was a milestone, double figures and all that, so she made a special effort. Cakes are her thing – she says she finds these little ones relaxing after the big fancy ones for weddings. Tiers before bedtime, she calls those.”

“Well, I think she’s right,” said Edward, “Ten months is something to mark – and I must say we’re glad to have you back in the fold. We thought you might be seduced by Jenny’s muffins into staying with HR.”

“Shop-bought,” sniffed George, “She took off the wrappers and roughed up the edges a bit, but you can tell mass manufacture. No attention to detail. A bit of a metaphor for HR, actually – rough at the edges and lack of detail.” He smiled shyly. “But I think we’ve made some progress. May I?” And he walked to the flip-chart.

“Every new recruit will have to complete the application form in full, and then another similar form at take-on – the purpose being to check for any anomalies,” George outlined, pointing to each statement on the flip-chart. “These two forms have been rewritten to a much higher standard: applicants now have to sign to say that there is nothing about them that would preclude them from joining the bank,

and that they do not have an unspent criminal conviction, and that they do not object to our undertaking our own checks on them. Certified copies of documents to verify name and address must also be supplied – as for clients. All claims to education, qualification and membership will have to be supported by documentary proof. And on the first day at work, the new recruit must bring with them original photographic proof of ID – passport or photo driving licence.”

“Gun licence?” suggested Ravi with a smile.

“Anyone offering a gun licence as proof of ID will have their application triple-checked,” countered George, “Compliance staff will conduct periodic spot-checking of HR files to ensure that these new procedures are being followed.”

Edward beamed. “Good work, George – I knew that you were the man for the job. This is exactly what I wanted. Just let a Jack Greenway try to get his grubby mitts on a job with us now!”

Liz held up a hand as though halting him. “I agree: this is excellent for new recruits. But what about the Jack Greenways we already have? How is HR coping with the retrospective review, George?”

“Not well, to be perfectly honest. In fact, they were so unhappy about doing it – didn’t want to ruin their fluffy image – that I said I would do it for them. I’m quite enjoying it, actually – gives me an excuse to go to all the departments, meet everyone, really see how the whole place fits together. And I’m making some useful friends – particularly the ones whose files are not quite, well, not a clear reflection of reality.”

Edward sat up straight. “You mean that there are people working for us who aren’t who they say they are?”

George shook his head. “No, not that bad – but take that chap you’re not keen on, Giles Ferguson, for instance. His application form says that he was head boy at his school, leaving with fistfuls of A levels, and that he went to Balliol College, Oxford.”

“He’s always going on about his leadership qualities being spotted early, and the halcyon days he spent on the Isis,” agreed Edward. A slow smile spread across his face. “Are you telling me that it’s not true?”

George went to his briefcase and took out a slim folder. “Well, he did go to that school, but he wasn’t head boy – he confessed that when he thought we might find it out. He was, however, chief fag. And when I asked about a degree certificate from Oxford, he went very quiet. Apparently he was thrown out – rusticated, I think the posh boys call it – after the first year, for failing his exams.” He handed the folder to Edward, who took it reverently. “Says even his father-in-law doesn’t know that.”

Edward’s smile spread even wider and he clutched the folder to his chest. “Tell me, team: does this make Giles the original unqualified success?”

Notes

1. Jack Greenway first appears in ‘A month in the life of the BFEO’, *MLB* April 2009

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An ugly side to the beautiful game

*The sporting ideal of fair play has long been sullied by the reality of corruption – from doping horses to athletes’ use of performance enhancing drugs. Football’s image is similarly besmirched by regular allegations of match-fixing, kickbacks and flawed governance while the antics of its stars fill the celebrity pages. Illegality in the world’s most popular and lucrative game runs very deep and wide as **Mark Rowe**, **Alan Osborn** and **Paul Cochrane** found when they took time away from the pitch to tackle the finances.*

It may be no coincidence that football (or soccer as it is known by North American readers) is generally regarded as corrupt by law enforcement agencies and has chosen to stage two of its next major spectacles –

the 2012 European championships, and the 2018 World Cup, in Ukraine and Russia. These two countries have of course been heavily criticised by the Financial Action Task Force (FATF) and MONEYVAL for dirty money flows, poor financial controls and fraud.

According to a senior UK-based tax expert, who specialises in money laundering in sport, the level and severity of criminal activity in football varies widely, but it is commonplace. “In the UK it’s generally greed and diversion, but elsewhere you do see some pretty sharp end stuff involved.”

According to reports published in *The Guardian*, international football federation FIFA demanded an exemption from a key element of UK money-

laundering legislation as part of government guarantees required in relation to the England 2018 bid. Entitled 'Section 5.B - Foreign Exchange Undertakings', this stated that the UK government should provide for "the unrestricted import and export of all foreign currencies to and from the UK, as well as the unrestricted exchange and conversion of these currencies into US dollars, euros or Swiss francs."

Via a formal 'freedom of information' request, *MLB* secured a British government legal statement, dated October 18, which was sent to Sepp Blatter, FIFA president by Ken Clarke, the Lord Chancellor. It said that "the government guarantees themselves are signed under a general expectation that they are intended to support the successful delivery of the competitions and events, and not to enable acts which could otherwise be construed as illegal, such as illegal immigration, tax evasion or money laundering."

However, money laundering experts are sceptical that such guarantees hold much water. "There's no doubt that FIFA's demands – such as that governments must allow FIFA employees to take unlimited funds out of the country unchallenged – breached UK money laundering laws," said the tax expert. He continued: "The largesse of FIFA executives is well documented. Members of the executive committee enjoy US\$150,000 per year honorarium, a US\$500 daily allowance, they have all flights and hotels paid for on official business and aren't required to submit receipts."

The problem, he said, is that sports federations start out as amateur organisations and while they become more professional as they gain wealth they still "don't have the controls and transparency."

One key area of concern for regulatory and enforcement authorities is players' agents' fees. "When a football club pays an agent a fee it is recorded in the club's books, but there is no requirement to follow up the destination of the fee beyond the initial recipient," said the tax expert, "Some of that will get diverted to parties involved in the transfer."

And while FIFA appears to turn a blind eye to tough matters, woe betide a government trying to meddle in football governance. This can hamper criminal probes into murky dealings within the so-called 'beautiful game'. FIFA was raided by Ghana's economic and serious crime unit last December. Its officers used a court-backed search warrant to remove mobile phones and computers from FIFA's building in the capital Accra and prevented staff from leaving or entering the premises. FIFA subsequently threatened the Ghanaian government with potential sanctions – like banning the

country from international football – should it continue to interfere with the association's operations.

"When money goes into some football associations in Africa the government says 'hang on, it's being diverted to people's pockets'," said the tax expert. "The local FA president bleats to FIFA about political interference as a ploy to stop the investigation and FIFA threatens to ban the FA from international football. What politician in those circumstances is going to risk the wrath of the public by effectively seeing his national football team unable to compete?"

Sylvia Schenk, senior advisor for sport for Transparency International, also highlights club ownership as a significant source of money laundering, enabling illegally obtained money to be invested in club infrastructure. "Prosecutors have found the mafia investing in football in Italy, and in eastern Europe it's a big issue," said Schenk, who says that money laundering can commonly be found in spot betting – where clients place money not only on scores, but on occurrences during matches, such as throw-ins, missed penalties or sendings-off. "Organised crime is involved in this, and we have reports of people being threatened, or being warned that their families will be hurt," said Schenk.

Football lends itself to money laundering through lucrative player transfer deals and the huge sums of money invested in the sport in the past 20 years. "You have a lot of money, a lack of transparency, there is no control over the clubs by their local national federation or by FIFA," said Schenk, "It makes it easy for people to launder money and make payments under the table. I always worry about transfers of players from South America to European clubs."

Such corruption also manifests itself in "image laundering", according to Schenk, whereby individuals, such as football chairmen or owners, are able to lead expansive, opulent lives on the back of ill-gotten gains. "You can be seen as a very important person. Politicians like you – they enjoy sitting in the VIP seats, and they get support from those football figures for their election campaigns."

Schenk also believes that radical change is required if football is to root out money laundering. "My feeling is you need change at the top of the administration if you want to tackle the problem. There are some people in FIFA who want to fight it and there are other administrators who would like things to stay as they are. But there is more awareness that things need to change."

The UK-based tax expert agrees, and argues that recent events may trigger the government of

Switzerland to look at making sports federations – of which there are 50 based in the country, including FIFA and the International Olympic Committee – subject to its corruption laws. “Incredibly that isn’t the case at the moment. I think after the [recent] World Cup bidding fiasco – especially the fact that Australia’s government paid for its own bid and got just one vote and England got just two votes – there’s a will to do something,” he said.

The problems were confirmed by Transparency International’s Swiss office, which said: “The legal status of associations, including sports associations based in Switzerland must be clarified; it is not clear to what extent these associations are subject to the Swiss law provisions on corruption.” A spokesman called for clarifications on whether associations may be prosecuted in Switzerland for any acts of corruption in relation to their activity: “The legislative changes and the international conventions which may be needed in this respect must be initiated without delay.”

Transparency International also wants the financial demands made of World Cup bidding countries to be investigated. The 2022 World Cup, which will be in the Gulf state of Qatar – not a known footballing centre, is a case in point. A source at a Middle Eastern central bank, who wanted anonymity, said: “The potential for money laundering, corruption and fraud is immense when it comes to building facilities [in Qatar].” He warned of the risk of kick-backs through the huge construction projects that will be required for this tiny desert country to host a World Cup: “The contractors are connected to the royal family and leading business individuals and families, so contracts may not be transparent and there is the possibility of over-the-top commissions being paid out and the whole process not being done by the book.” Merrill Lynch estimates that Qatar will spend US\$65 billion to host the World Cup in 2022, with some US\$40 billion to go on transport infrastructure alone, plus building nine stadiums, tens of thousands of hotel rooms and associated facilities.

The source noted that in the Middle East and north Africa “there is corruption at all levels, so of course financial wrongdoing in sports as well, whether the annual costs of facilities, construction costs, the wages paid to players, or sponsorship deals.” And with little tradition of financial transparency in the region, “financial crime is easy to do, including money laundering”. Banks needed to do more, he said – while they had been implementing international regulations, more was needed to drive dirty money out of deals

such as those involved in massive sporting projects: “The banks need to do more in terms of due diligence, KYC [know your customer] and compliance,” he said.

And it is not as if money laundering in football has gone unnoticed by the world’s AML bodies. A report published in July 2009 by FATF [1] identified “a lack of awareness amongst some key players about their responsibility in the process of fighting illicit activities” as one of the key features of money laundering in international and national football. “Creating an understanding of the money laundering risks associated with the football sector amongst government bodies and the private sector, including financial institutions, is critical,” said the report.

Nearly two years later, how far has the FATF succeeded in waking up the sport to its vulnerability in this area? Quite a lot, according to Vincent Schmoll, principal administrator at FATF. “We haven’t done any follow-up work but there are things going on and although I haven’t got any methodical view of what countries and people are doing about it, I do know that the report seems to have raised awareness to a new level,” he told *MLB*. “We didn’t really expect to have significant policy results from that report because it’s a little bit out of the area that FATF work in but we wanted to raise awareness. With these subjects that are relatively new, it takes a bit of time – usually a couple of years – before you start to see concrete things,” he said.

The 2009 FATF report said there was “more than anecdotal evidence indicating that a variety of money flows and /or financial transactions may increase the risk of money laundering through football.” These are related to “the ownership of football clubs or players, the transfer market, betting activities, image rights and sponsorship or advertising arrangements.”

Football has huge sums of money and uses often complex and devious means to avoid tax, it said, and employs a wide range of money laundering methods “from basic to complex techniques, including the use of cash, cross border transfers, tax havens, front companies, non-financial professionals and PEPs [politically exposed persons]”...trade-based ML, the use of non-financial professionals and NPOs [non-profit organisations]”. Security, real estate and gambling have all been involved in handling dirty money for football, said the report.

Notes

1. www.fatf-gafi.org/dataoecd/7/41/43216572.pdf

Country risk ratings: equivalence to countermeasures

The issue of equivalence – whether a jurisdiction operates to AML standards that accord with the EU Third Money Laundering Directive – remains highly contentious. Sue Thornhill of MHA suggests that when considering country risk and whether a country can be regarded as “equivalent”, firms need to look through the Financial Action Task Force’s (FATF) political bias and take account of a range of comments drawn from the detail of its mutual evaluation reports, including a country’s political will to tackle terrorism and corruption. For its part, she says, FATF needs to put its own house in order.

In its January 2011 response to the consultation on the review of the FATF standards, the British Bankers’ Association (BBA) makes the following comment on the usefulness of mutual evaluations: “Our members have said that they find the FATF country assessments are of limited value. Our members suspect that the assessment system is so highly politically charged that the assessments could be seen as being deeply flawed. For example, there is very limited information indeed on the ownership of Russian corporate structures, but no comment is made about this. And with regard to the assessments of India and Pakistan, India should more realistically be rated as much less compliant with AML standards than Pakistan.”

While I would not disagree with the BBA that FATF is a political animal, it can be argued that BBA has missed the point in three principal respects. Firstly, that the political bias is, inexcusably, in favour of FATF members in the way that FATF responds to countries with serious deficiencies; secondly, that it is often necessary to read not only the executive summary but also the full Report in order to get to all of the facts; and thirdly, that political will to implement both the letter and spirit of all the FATF Recommendations is one of the most important aspects of AML/CTF strategies, not least for FATF members themselves.

Back to the sheep and the goats

Back in 1995, I accused FATF of dividing countries into sheep and goats in respect of AML measures. All FATF members, regardless of the steps they had, or had not, taken to criminalise money laundering or to sensitise their financial sectors, were in the white

sheep pen. All were classed as being whiter than white regardless of the strategies they had in place. All other countries were herded into the same lower status goat pen. There was simply no mechanism for giving recognition to the AML measures taken by non-FATF members, many of whom had gone significantly further than some FATF members.

Having stunned the FATF members into silence – in its six years of existence no one before had had the audacity to criticise FATF in open plenary session – the FATF accepted the point that I had made on behalf of the Joint Money Laundering Steering Group (JMLSG). The result was the creation of the FATF-Style Regional Bodies (FSRBs) in 1996, and a mechanism for recognising FSRB peer-group evaluations.

While it is true that there is still a political element in the mutual evaluation reports, dependent on the ability of the country concerned to engage in political horse-trading, one needs look no further than the third mutual evaluation of Argentina, itself an FATF member, to demonstrate that strong criticism also extends to FATF members. Argentina’s mutual evaluation report is simply a catalogue of errors and omissions in respect of the FATF 40+9 Recommendations. The joint FATF/GAFISUD evaluators have not minced their words in their criticisms. Strong criticism and concern was also expressed, for example, in Japan’s 2008 mutual evaluation report, and Canada was allegedly badly stung by the conclusion from its 2007 evaluation that “the preventative system is generally insufficient to meet FATF Recommendations”. It must also be remembered that the UK did not emerge unscathed from its 2006 evaluation, in spite of the extensive political bargaining powers available to the UK government representatives.

However, fifteen years on, FATF has fallen back into the same ‘sheep and goats’ trap. Where the FATF consistently fails, and where it demonstrates its political bias, is in its reaction to a critical report in respect of one of its own members.

It is simply inexcusable on the part of the Argentinean authorities that, six years after an equally damning second evaluation in 2004, the 2010 report advises that: “Argentina has not made adequate

progress in addressing a number of deficiencies identified at that time and the legal and preventative measures that are in place lack effectiveness.”

FATF’s response to Argentina’s third mutual evaluation report has been equally inexcusable. Instead of merely putting the country on a programme of regular reporting back to Plenary on its progress, Argentina should have immediately been added to the list of countries with significant deficiencies at the October 2010 plenary meeting.

FATF’s black sheep pen

It is acknowledged that FATF does now have a pen for its black sheep. Greece (an FATF member) is already on the list of countries with serious deficiencies, and Turkey has now been moved from that list to the more serious list of jurisdictions not making sufficient progress. But Turkey’s misdemeanours are long-standing (having had counter-measures against it in the mid-1990s) and it can be argued that Turkey’s membership of FATF has been wholly political and unsustainable from the outset. In respect of Greece, the European Commission (also a FATF member) must take a significant proportion of the blame, in that failure to meet the FATF standards also means failure to meet the requirements of European Directives. We will now need to wait and see how long it is before FATF takes action to move Argentina into the black sheep pen.

Failure to meet the necessary requirements

MHA has undertaken AML/CFT risk assessments of a number of countries, including all 24 FATF members that have been assessed under the 3rd round of mutual evaluations to date. In our view only 13 of these 24 FATF members have adequately implemented the 40+9 Recommendations and can be regarded as having sufficient measures in place to satisfy the rating of an equivalent jurisdiction under the Third European Directive. In my view, this is indefensible.

Membership of FATF should not be viewed as providing access to a cosy club; it should bring with it significant responsibilities for setting an example of best practice to other jurisdictions. Lack of political will to implement FATF Recommendations is simply not an option that should be available to FATF members. However, there is no indication that any FATF member is ever likely to be expelled when it consistently and deliberately fails to meet the required standards.

BBA’s comments: a missed opportunity

Transparency of beneficial ownership in Russia

On account of the misuse of corporate vehicles, particularly by corrupt politicians, BBA is correct in highlighting that transparency of beneficial ownership is an essential requirement. BBA is again correct in highlighting that Russia has failed in this respect. However BBA is wrong in stating that this has not been commented on in Russia’s 2008 mutual evaluation report.

Russia is rated as only partially compliant against Recommendation 33 – Legal persons: beneficial ownership – for the reason that “None of the existing systems achieves adequate transparency regarding the beneficial ownership and control of legal persons.”

The body of the report contains three further comments in this respect:

- Paragraph 686 states that “Beneficial ownership (BO) as defined in the FATF Recommendations is not registered in the USRLE [Unified Central Registration System], nor is BO information required to be retained by legal entities”;
- Paragraph 689 advises that “Russia has taken no measures to facilitate access by FIs [financial institutions] to BO information. On the contrary, the little information on the beneficiaries that is available to the authorities is collected by FIs themselves, and is not available for other FIs”;
- Paragraph 691 contains the following recommendation – “The Russian authorities should implement a system that requires adequate transparency regarding the beneficial ownership and control of legal persons”.

Our own risk profile of Russia notes that it was criticised in its first and second MONEYVAL Mutual Evaluation Reports as vulnerable to criminal ownership. The first report concluded that organised crime might have penetrated the banking sector, and the second report explicitly mentioned the possibility that clandestine ownership of banks by organised crime was present despite statutory provisions. The 2008 Evaluation Report restated the concern that this issue had not been addressed and that some banks are still believed to be owned and controlled by suspected criminals and their front men.

Perhaps BBA’s point could have been that concern about criminal ownership of banks, and its link to the lack of transparency of beneficial ownership, should

have been expressed more prominently in the Summary evaluation rather than confining the issue to the more detailed report.

Pakistan's rating compared with that of India

BBA's comments in respect of India and Pakistan are correct in one respect, in that India and Pakistan (and indeed Bangladesh) share the same problems of cash-based societies, the extensive use of unregulated alternative remittance systems and systemic levels of bribery and corruption. However, BBA's comments fail to recognise that measures to combat terrorism are now vital to every country's strategy and that it is for this reason Pakistan is rated as having serious deficiencies.

MHA's risk assessments of India and Pakistan, which are set out below, bring out the perceived differences between the two countries and the basis for Pakistan's rating.

Risk assessment – India

"India is one of FATF's newest members and has needed to make a huge leap in legislative, cultural and compliance terms in order to qualify for this position. While the 2010 Mutual Evaluation Report only assesses India as non-compliant with requirements for the designated non-financial sector businesses and professions (DNFBPs), full compliance has only been achieved in respect of Recommendation 4 – Secrecy laws. This leaves aside the continuing cultural hurdles that need to be overcome, not least of which is the continuing extensive use of the informal Hawala sector. Bribery and corruption are still major issues with India having been ranked as one of the five highest bribe payers according to the TI Bribe Payers' index. Only time will tell how much influence the new Central Vigilance Commission will bring to bear on long-standing practices.

"Nevertheless, with all of the necessary building blocks in place, together with evidence of political will on the part of the government, India has more chance of succeeding than have some other FATF members. In the meantime, in MHA's view, it goes without saying that India cannot be regarded as having equivalence status. Any correspondent relationships and introduced business must continue to be treated with caution and assessed on a case by case basis."

Risk assessment – Pakistan

"Pakistan faces significant risks of money laundering

and to an even greater extent, terrorist financing. The importance of the informal sector and the cash-based nature of the economy provide particular challenges.

"Financial crimes relate to drugs trafficking, terrorism, smuggling, tax evasion, corruption, counterfeit goods and fraud. Pakistan is a major drug-transit country. The abuse of the charitable sector; trade-based money laundering; hawala/hundi and physical cross-border transfers are the common methods used to launder money and finance terrorism in Pakistan. Pakistan's real estate sector is also a popular destination for illicit funds as many real estate transactions are poorly documented.

"Money laundering and terrorist financing are often accomplished in Pakistan via the hundi/hawala alternative remittance systems. Most illicit funds are moved through these unlicensed operators. The State Bank of Pakistan requires all hawaladars to register as foreign exchange dealers and to meet minimum capital requirements. In spite of this, unlicensed hawaladars still operate illegally in parts of the country (particularly Peshawar and Karachi). Legitimate remittances from Pakistani expatriates resident abroad now flow mostly through the formal banking sector.

"Pakistan also faces pervasive corruption. In addition to constituting a significant money laundering risk, this situation creates structural weaknesses, which may impede the effectiveness of the AML/CFT regime.

"Pakistan has criminalised money laundering and terrorist financing and the financial sector has been required to adopt AML/CFT measures for a number of years. The preventative measures have continued to be enhanced following the World Bank's Mutual Evaluation in July 2009. Nevertheless, the Mutual Evaluation Report concluded that the results achieved were not commensurate with the risks and threats faced, and Pakistan was assessed as non-compliant with 12 of the FATF 40+9 Recommendations and only partially compliant with a further 22.

"In June 2010, Pakistan was placed on FATF's list of countries that have serious deficiencies and the government of Pakistan made a high-level political commitment to work with the FATF and APG [Asia Pacific Group] to address those deficiencies. Pakistan has taken steps to improve its AML/CFT regime, including issuing STR [suspicious transaction reporting] guidance to its financial institutions. However in February 2011, FATF determined that certain strategic AML/CFT deficiencies remained. Principally these are based on Pakistan's failure to

criminalise and counter terrorism and terrorist financing.

“In view of FATF’s published assessment and its endorsement by HM Treasury, UK financial sector firms have no alternative but to treat Pakistan as a higher risk country for AML/CTF purposes. Firms should be particularly cautious when conducting trade finance transactions or cash-based remittance business that involve Pakistan.

“Recent allegations against Pakistan’s Inter-Services Intelligence in respect of the sponsoring of terrorism and the large-scale counterfeiting of Indian currency mean that Pakistan is unlikely to be removed from the list of countries with strategic deficiencies until the international community is satisfied that Pakistan’s government truly has the political will to tackle the country’s terrorist-related activities.”

In summary

It is no longer sufficient for FATF members to fully

and effectively implement the FATF 40 Recommendations to guard against money laundering. Equal attention must be given to combating terrorist financing and to ensuring that measures are taken to eradicate domestic corruption. Only then can a country truly deserve its place as one of the FATF elite.

For its part, FATF must set aside the political and strategic reasons that lie behind the reason for a country’s membership, and demonstrate that it has the collective strength and will power to ensure that FATF membership brings with it significant obligations along with the status. Failure to meet those obligations should result in swift and sustained censure leading to eventual expulsion when significant deficiencies are not corrected.

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Diary

FSA Financial Crime Conference

22 June 2011
The Brewery, Chiswell St, London EC1
www.fsa.gov.uk

Law Society Anti-Money Laundering Annual Conference 2011

23 June 2011
St Pancras Renaissance Hotel, London NW1
www.lawsociety.org.uk

Anti-Money Laundering & Terrorist Financing Introductory Workshop

19 July 2011
Chartered Institute for Securities & Investment,
London EC3M
www.cisi.org

ACAMS 10th Annual International Anti-Money Laundering Conference

19-21 September 2011
Las Vegas
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