

# Combating Money Laundering in the Banking Industry: Malaysian Experience

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**Abstract**—Money laundering has been described by many as the lifeblood of crime and is a major threat to the economic and social well-being of societies. It has been recognized that the banking system has long been the central element of money laundering. This is in part due to the complexity and confidentiality of the banking system itself. It is generally accepted that effective anti-money laundering (AML) measures adopted by banks will make it tougher for criminals to get their 'dirty money' into the financial system. In fact, for law enforcement agencies, banks are considered to be an important source of valuable information for the detection of money laundering. However, from the banks' perspective, the main reason for their existence is to make as much profits as possible. Hence their cultural and commercial interests are totally distinct from that of the law enforcement authorities. Undoubtedly, AML laws create a major dilemma for banks as they produce a significant shift in the way banks interact with their customers. Furthermore, the implementation of the laws not only creates significant compliance problems for banks, but also has the potential to adversely affect the operations of banks. As such, it is legitimate to ask whether these laws are effective in preventing money launderers from using banks, or whether they simply put an unreasonable burden on banks and their customers. This paper attempts to address these issues and analyze them against the background of the Malaysian AML laws. It must be said that effective coordination between AML regulator and the banking industry is vital to minimize problems faced by the banks and thereby to ensure effective implementation of the laws in combating money laundering.

**Keywords**—Banking Industry, Bank Negara Money, Laundering, Malaysia.

## I. INTRODUCTION

MONEY laundering is not a new phenomenon and has existed for centuries. It is the process by which criminals try to disguise the true origins of the proceeds of crimes. In Malaysia, money laundering is considered a relatively new form of commercial crime that had just been codified as criminal offence. It can also be categorized as a form of white collar crime [1]. Although apparently no physical violence would be normally associated with the perpetration of money laundering, if left unchecked, it can pose devastating economic, social and political consequences for countries, especially for the developing countries and those countries with fragile financial systems.

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due to the complexity and confidentiality of the banking system itself. The Bank of Credit and Commerce International (BCCI) collapse in 1991, the Citibank and Bank of New York scandals in 1999 and the Riggs Bank scandal in 2002 have exposed the danger posed by money laundering to the banking system. As such, many of the efforts to combat money laundering have concentrated on the procedures adopted by banks and financial institutions. It is submitted that effective AML regime within the banking sector can make a significant contribution to the fight against money laundering [2]. More importantly, combating money laundering is not just a matter of fighting crime but also preserving the integrity of the banking industry from being abused by money launderers.

In recent years many countries have implemented laws to fight against money laundering and Malaysia is no exception. Malaysia passed the Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA) in 2001. AMLATFA is implemented by multi-law enforcement authorities led by the Central Bank of Malaysia i.e. Bank Negara Malaysia (BNM). As at July 2010, 94 money laundering cases are in various stages of prosecution in Malaysia with more than 3000 charges involving proceeds amounting to RM1.2 billion [3]. AMLATFA criminalizes money laundering and requires banks to put in place proper identifying, recording and reporting procedures; appoint money laundering reporting officer; make staff aware of the AML laws and provide proper training.

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## II. REPORTING OBLIGATIONS UNDER AMLATFA

This section will focus on the key reporting obligations imposed by AMLATFA on the banking industry. These obligations include the obligation to report cash and

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suspicious transactions, identify and verify customers, keep records and establish AML compliance program. They have been applied to the banking industry since 15 January 2002. In November 2006, BNM as the Malaysian AML regulator, issued two sets of guidelines, namely Standard Guidelines on Anti-Money Laundering and Counter Financing of Terrorism (Standard Guidelines) and Sectoral Guidelines 1 for Banking and Financial Institutions (Sectoral Guidelines). These Guidelines are in line with the international anti-money laundering standards issued by the Financial Action Task Force (FATF). FATF is the global standard-setter for measures to combat money laundering, terrorist financing, and the financing of proliferation of weapons of mass destruction. It is an inter-governmental body with 36 members and with the participation of over 180 countries through a global network of FATF-style regional bodies.

In fulfilling their obligations under AMLATFA, banks and their officials are protected by various immunities. For example, section 20 overrides any obligation as to secrecy or other restriction on the disclosure of information imposed by written law. In addition to this, section 24 confers protection from civil, criminal and disciplinary proceedings in relation to the disclosure of information in a suspicious transaction report or in connection with such report, whether at the time the report is made or afterwards, except where the disclosure was done in bad faith.

Section 14 of AMLATFA requires the banks to submit two types of reports. The first type of report is the Cash Transaction Report (CTR). CTR reporting is designed to expose the laundering process at its most vulnerable 'choke' points, that is, the points when cash enters the financial system and when it is transferred between financial intermediaries. Under section 14(a) banks must report to the Financial Intelligence Unit (FIU) any transaction that exceeds the specified threshold amount. FIU is the competent authority established by the Central Bank of Malaysia and it also acts as the national AML regulator. The FIU set the specified threshold amount at RM50,000 per day. By virtue of section 13(4), banks are required to aggregate multiple cash transactions in a day that exceed the threshold amount as a single transaction if they are undertaken by, or on behalf of, one person. This is aimed at eradicating 'smurfing' or 'structuring' activities. 'Smurfing' is a typical money laundering technique used by criminals to avoid detection and it involves breaking large cash transactions into smaller transactions so that they fall below the CTR threshold.

The second type of report that banks have to submit is the Suspicious Transactions Report (STR). STR refers to a piece of information which alerts law enforcement that certain activity is in some way suspicious and might indicate money laundering [4]. Under section 14(b), a STR should be made when the identity of the persons involved, the transaction itself, or any other circumstances concerning the transaction, gives rise to suspicion. Here, the suspicious transaction does not have to be in form of cash and it applies to any amount of money. 'Suspicion' is not defined under AMLATFA. In *K Ltd v Natwest Bank* [2006] EWCA Civ 1039, the Court held that

the person must think there is a possibility, more than merely fanciful, that the relevant facts exist, and this suspicion must be of a settled nature.

It must be noted that unclear reasons for suspicion is among the main problems faced by the banking industry in implementing the STR. FIU provides examples of suspicious transactions in the AML Guidelines, for example transactions conducted are out of character with the usual conduct or profile of customers carrying out such transactions. However, since a suspicion is a subjective fact, it can be said that identifying suspicious transaction is not an easy task. Even if more examples were given, it is doubtful whether they can cover the entire range of suspicious transaction.

It is critical to have sufficiently clear examples of suspicious transactions to enable the banks to comply with the STR requirement effectively. It must be borne in mind that an ineffective STR regime will lead to mistaken reporting and defensive reporting. This would result in a flood of reporting and resources spent on irrelevant files may jeopardize the effectiveness of the STR regime.

Furthermore, while the STR regime is considered the key to detecting money laundering, the effectiveness of the system is still uncertain. According to Levi, the STR system could only be targeting the most unsophisticated cases of laundering but failed to lead to the conviction of sophisticated money launderers [5]. In the United Kingdom (UK), for example, it was found that only eleven percent of STRs contributed to a criminal justice outcome in the UK and therefore, the regime still need to be improved [6]. Indeed, this may explain why there is no significant relationship between the volume of STRs and the reduction in criminal activities.

AMLATFA also imposes obligations on the banks to identify and verify customers. Section 16(1) requires the banks to maintain accounts in the name of accounts holders and prohibits the opening of anonymous accounts or accounts which are in a fictitious, false or incorrect name. Sub-section (2) requires the banks to verify the identity of the account holder, the identity of the person in whose name the transaction is conducted as well as the identity of the beneficiary of the transaction, and to include the details in a record.

Section 5(1) of the Anti-Money Laundering and Anti-Terrorism Financing (Reporting Obligations) Regulations 2007 (AMLATF Regulations) specifies that customer due diligence measures must be conducted when there is a suspicion of money laundering or when there is a doubt about the veracity or adequacy of information on the identity of the account holder which it has obtained previously. Furthermore, section 5(2) (b) of the AMLATF Regulations requires the banks to identify and verify the identity of the beneficial owner of its customer. It must be noted that customer identification and verification requirements provide banks with important protection against the serious financial costs that can follow from imprudent operation [7].

This view has been proven correct when it was reported in 2006 that failure to identify and verify a customer can result in the dismissal of staff by a bank. This can be seen in the

Industrial Court case of *Southern Bank Berhad v. Yahya Talib* (Award No. 1692 of 2006 [Case No: 4/4-626/05] 25 September 2006). The claimant was dismissed from his service when he failed to comply with the requirement of the Know Your Customer Policy introduced by BNM as part of AML obligations. The court held that the claimant has been careless and acted perfunctory in introducing a prospective customer. He should have known the responsibilities that were attached when one introduces a customer to the bank in particular the requirement that they had to know the customer and be able to vouch for their integrity.

Sections 13 and 17 set out various record keeping requirements. Section 13(1) of AMLATFA requires banks to keep a record of any transaction involving domestic currency, or any foreign currency, exceeding the amount specified by BNM. Under section 17(1), banks are obliged to maintain all records for a period of not less than six years from the date an account has been closed or the transaction has been completed or terminated. It appears that banks are now required to record more information than they previously had to in order to comply with AMLATFA. Customer records must contain sufficient information to allow reconstruction of individual transactions. This might in turn require changes to the banks' existing file management and archiving arrangements.

To ensure compliance with the reporting obligations under AMLATFA, banks have to establish a compliance program. The compliance program must:

- Establish procedures to ensure high standards of integrity of its employees and a system to evaluate the personal, employment and financial history of the employees;
- Establish on-going employee training programs and instruct employees on their responsibilities; and
- Develop an independent audit function to check and test the effectiveness of the compliance program (s19(2) AMLATFA).

The issue concerning compliance program is the lack of AML training given to the staff. For example, the empirical evidence suggests that there is a serious deficiency of training programs conducted by the UK and Australian banks. In the UK, 13 percent of respondents admitted they had not received any training in money laundering identification or prevention. A further 20 percent had received very poor or unsatisfactory training [8]. In Australia, only 32.2 percent of respondents had received anti-money laundering training. The survey also suggested that training sessions typically were short and not up-to-date [9]. If the experience of the UK and Australian banks is anything to go by, there is a strong likelihood that Malaysian banks are no better than their overseas counterparts in respect of training programs. Given the complex and sophisticated nature of money laundering, this deficiency needs to be overcome.

Furthermore, AMLATFA also requires banks to designate a compliance officer, at management level in each branch and subsidiary to report suspicious transactions to FIU (s19(4) AMLATFA). The compliance officer is responsible for taking all reasonable steps to ensure that the banks comply with their reporting obligations under AMLATFA (s22(1) AMLATFA).

Additionally, AMLATFA requires banks to develop audit functions to evaluate policies, procedures and controls to test compliance with the measures taken by banks and the effectiveness of the measures in combating money laundering activities. The board of directors is responsible for ensuring independent audit of the internal AML measures to determine their effectiveness and compliance with the AML laws (para 10.5.1 Standard Guidelines).

It is clear that the AML laws emphasize good corporate governance and senior management accountability. An empirical study of factors affecting money laundering in 88 developed and developing countries has shown that an efficient AML framework with good governance lower the pervasiveness of money laundering activities [10].

In fact, the failure of AML systems is often symptomatic of overall weaknesses in a bank's corporate governance framework as such systems cannot be expected to operate in isolation [11]. Clearly, effective AML measures significantly impact on the efficiency of a bank's corporate governance which is considered a key element in ensuring that the bank is operated in a safe and sound manner. At the end of the day this is the duty that the bank's officials and board of directors owe to their stakeholders.

It is submitted that the AML measures imposed on the Malaysian banks are subject to continuous change and development. As a result of the increased regulatory requirements, banks have to adopt new procedures to detect and deter money laundering which is not only time-consuming but also very costly. Although there are no statistics on how much have been spent by Malaysian banks in complying with their AML obligations, it appears that the amount could be very significant judging from the amounts spent by banks overseas. For example, a recent study estimated that the UK and the US banks have spent more than 100 million pounds and 600 million pounds respectively for AML compliance [12].

It seems that the benefits of the AML laws may not always be clear to individual institutions because potential AML benefits tend to benefit a country as a whole rather than to individual institutions [13]. The benefits include an improved reputation as a fair and law abiding place to do business and improved competitive conditions arising from the reduction of illegal and fraudulent behavior.

### III. NON-COMPLIANCE WITH THE AML LAWS

AMLATFA provides various penalties for non-compliance with the AML obligations set out under AMLATFA, its regulations and the relevant guidelines. Section 22(1) of AMLATFA requires the banks' management to take all reasonable steps to ensure compliance with the reporting obligation under Part IV of AMLATFA. Sub-section (2) empowers FIU to obtain an order from the High Court against any or all of the officers or employees of the banks on terms that the Court deems necessary to enforce compliance.

It is interesting to note that notwithstanding any Court order, FIU may direct or enter into an agreement with the banks to implement any action plan to ensure compliance with

Part IV of AMLATFA. This may suggest that the Malaysian government believes that a coordinated approach between the law enforcement authorities and the banks will result in effective implementation of the AML laws. This is welcome especially in view of the complex nature of the AML measures and the compliance burden faced by the regulated institutions.

Section 22 (4) of AMLATFA explicitly provides that failure of an officer to take reasonable steps to ensure compliance with Part IV of AMLATFA, or failure of the bank to implement any urgent action plan to ensure compliance, will result in the officer or officers being personally liable to a fine not exceeding RM100, 000 or to imprisonment for a term not exceeding six months or to both. In the case of continuing offence, a further fine may be imposed on the banks not exceeding RM1,000 for each day during which the offence continues after conviction.

To make matters worse, section 21(2) of AMLATFA provides that upon the recommendation of FIU, BNM may revoke or suspend the bank's licence if it has been convicted under AMLATFA. Clearly, this is a very serious matter and banks cannot turn a blind eye to the AML obligations.

Section 86 of AMLATFA provides a general penalty for non-compliance with any provisions of AMLATFA or regulations made under AMLATFA, or any specification or requirement made, or any order in writing, direction, instruction, or notice given, or any limit, term, condition or restriction imposed, in the exercise of any power conferred pursuant to any provision of AMLATFA. Upon conviction, a person shall be liable to a fine not exceeding RM250,000.

Section 92 of AMLATFA further empowers BNM to compound, with the consent of the Public Prosecutor, any offence under AMLATFA or its regulation by accepting from the person reasonably suspected of having committed the offence such amount not exceeding 50 percent of the amount of the maximum fine for that offence, including the daily fine, if any, in the case of a continuing offence.

It must be borne in mind that apart from the potential significant penalties from FIU and BNM, non-compliance with the AML obligations may also affect a bank's reputation. There are few prominent cases involving large and multinational banks from the United States and the United Kingdom. For example, in 2004, Riggs Bank was fined \$25 million by the US Office of the Comptroller of the Currency for willfully violating its legal obligations to implement adequate anti-money laundering measures [14].

In 2003, Abbey National was fined £2.3 million by the UK Financial Services Authority for serious AML compliance failure [15]. Both cases attracted significant adverse publicity for the banks. Once a bank's reputation is tarnished, it can have serious implications on its business. In the case of Riggs Bank, for instance, the bank was taken over by another bank. Therefore, to avoid these risks, banks have incurred high compliance costs. The resources spent on preventing the reputational risks may be greater than the cost of the money laundering risk itself [16].

#### IV. CONCLUSION

The past few years have seen a fundamental change in the legal and regulatory environment relating to anti-money laundering measures in Malaysia. With the implementation of AML laws, Malaysian banks have found themselves having to comply with an increasing number of regulations and guidelines. More importantly, the laws have put legal and administrative burdens on banks which are onerous and may involve serious legal and other liabilities for deficient compliance.

It is believed that Malaysian banks have spent considerable sums of money on AML compliance. Given the increased costs incurred by banks, it is likely to see these costs being passed along to the customers. Unfortunately, it is still unclear at this stage whether the benefits of AML compliance outweigh its cost.

It is undeniable finding a right balance between the benefits of the AML laws and the costs to the banks and their customers is not easy. However, it must be borne in mind that failure to find the right balance will not only create significant compliance problems for the banks, but also has the potential to adversely affect the stability, competitive and proper function of the commercial system. Indeed, it is unreasonable if the toughness of the laws seems to fall on the law abiding and conscientious banks and their customers rather than on the criminals. As such, effective coordination between AML regulator and the banking industry is vital to minimize problems faced by the banks and thereby to ensure effective implementation of the laws in combating money laundering.

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