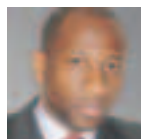


Fighting money laundering and terrorism finance





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In 2005 the EBRD launched an ambitious programme aimed at raising awareness of money laundering in its countries of operations. This article describes the work being undertaken by the Bank to promote anti-money laundering measures in the financial sector.

International efforts to combat money laundering began with the United Nations Vienna Convention in December 1988 and the Council of Europe Convention in 1990.¹ The Vienna Convention introduced an obligation to criminalise the laundering of profits from drug trafficking and initiated measures to improve international cooperation. Heavier penalties were introduced under the Council of Europe Convention including investigative assistance, search and seizure and the confiscation of earnings from all types of criminal activities.

These penal measures were introduced in tandem with further preventative work undertaken by the Basel Committee on Banking Supervision which issued its declaration against money laundering in 1988.² The Financial Action Task Force on Money Laundering (FATF) set up by the Group of Seven industrialised countries at its Economic Summit in Paris in July 1989 is following up these initiatives.³ The FATF thus remains the main international agency in this area and continues to make a significant contribution towards developing best practice and improving cooperation in combating global money laundering.

Its 40+9 recommendations have now become the global blueprint in anti-money laundering best practice.

Although in place for some time, such efforts have become even more important since 11 September 2001 as countries attempt to develop new global alliances to challenge significant criminal and terrorist threats. Financial institutions are thus subject to several separate criminal and regulatory requirements on anti-money laundering (AML) and the prevention of terrorist activities. The overall thrust of these rules is:

- to attempt to prevent financial institutions from being used as a cover for criminal purposes
- to use in-house banking information, systems and controls to detect such activity
- to allow separate prosecution and enforcement.

Strengthening transition economies also means promoting transparent financial markets. Therefore, promoting AML training is an integral part of the EBRD's activities and ultimately forms part of its transition mandate.

The EBRD's efforts towards AML have, of course, been guided by its institutional focus on private sector companies and in particular financial institutions. This has meant that in previous years the Bank's strategies have mainly concentrated on thorough internal due diligence in order to ensure the efficiency of their potential clients' AML policies, making sure none of them were involved in money laundering activities.

The Bank has developed its AML programme further, driven by the following questions:

- Why is AML a key priority for the Bank?
- What is the Bank's role, from an AML perspective, in its countries of operations?
- How can the EBRD help address the issue?

The purpose of this article is to describe the work of the EBRD in promoting AML in its countries of operations. It presents the outcome of three pilot projects, the overall project process and design, current implementation and early indications of the results of the programme itself.

In most of the EBRD's countries of operations, the authorities have made significant efforts to tackle money laundering. This has included adapting their legislation and setting up institutions with effective powers of enforcement.

Why should AML be a key priority for the EBRD?

Measuring the scale of money laundering worldwide is difficult. In several International Monetary Fund (IMF) and FATF publications, a "consensus range" of 2 to 5 per cent of the world gross domestic product is frequently reported. This range is said to be between €500 billion and €1.3 trillion per year.⁴ However, all experts agree that the real magnitude of money laundering is significantly underestimated.

AML is a key priority for a number of reasons. First, the Bank must adhere to international standards and promote the rule of law in its countries of operations.

Secondly, the Bank requires high ethical standards in all of its operations. Since the proceeds of illegal activities such as corruption, organised prostitution networks and drug trafficking are channelled into the financial system through laundering techniques, making anti-money laundering a priority indirectly helps to combat such activities.

Finally, money laundering poses great risks:

- at the country level, since it is a threat to any kind of sustainable development. Experience has shown that sustainable growth is impossible in situations where there is a high level of organised crime and corruption.
- at the financial sector level, because money laundering undermines financial soundness and stability. A financial centre needs a sound reputation to attract sound investment. When a country or place is reputed for its complacency it is likely to attract further financial

misdeemeanours and discourage legitimate investors fearing for their own reputation.⁵

- at the bank level, because being a victim of money laundering indicates a lack of research into the client rather than a deficiency of thorough risk assessment. Good business practice and AML provisions go hand in hand. Banks need to know who their clients are. Failure to meet these requirements exposes the institution to fraud, bad debt and all kinds of financial crime. The aftermath of money laundering and the ensuing regulatory sanctions would not only attract negative publicity, but would also incur costs from the upgrading of systems and procedures. There is also a possibility of legal costs if the Bank were to be prosecuted, or if it were to take legal action against its client.

Where do we stand in eastern Europe?

Overall, the situation is improving. In most of the EBRD's countries of operations, the authorities have made significant efforts to tackle money laundering. Countries that used to be on the FATF non-cooperative countries and territories blacklist have been removed: Hungary in June 2002, Russia in October 2002 and Ukraine in February 2004. These moves show that efforts from these countries, and several others that have never been on the list, to adapt their legislation and set up institutions with effective powers of enforcement have been successful (see Table 1). This is mainly the case of central European countries and, to a lesser extent, the Western Balkans. The central European countries have been driven by

the European Union (EU) accession process and the need to enforce EU anti-money laundering directives. Since October 2004 most countries in the Commonwealth of Independent States (CIS) have been charter members of the new Eurasian group on combating money laundering and financing of terrorism. This newly created group is a FATF-style regional body. Other countries have recently introduced AML laws that are under FATF assessment.

Government commitment and the proper legal framework is one thing, enforcement at the micro level is another. AML measures are only effective if financial institutions understand the risk involved and commit to their implementation. The EBRD's work provides a good view of what happens at the micro level. The EBRD, as the most important single financial investor in the region, has over 256 financial institutions as clients (of which 184 are banks).

Thus, in 2002, the Bank conducted a review of AML policies developed by its countries of operations and by its clients. Over a period of 12 months the Bank wrote to all its clients to raise awareness of AML and to gather information about their AML policies and procedures. The Bank also collated data on AML legislation and enforcement mechanisms for each country of operations. The purpose of this stocktaking exercise was twofold: first, to understand the AML policies of our clients and to develop, if needed, suitable training; and secondly, to engage the governments and AML authorities in policy dialogue. As a result of the review, the Bank's countries of operations fell into three broad categories:

- Group one: countries that have an AML system in place which works reasonably well. This group includes EU member states and accession countries.

- Group two: countries that employ an AML system which is more or less untested. This group includes mainly the Western Balkan countries and some CIS countries.
- Group three: countries that either do not have an AML system in place or have a distorted AML system (for example, the secret service is in charge of financial investigation). This group includes many Central Asian countries.

Two conclusions arose from the identification of these categories. First, as the AML systems of the first group of countries functioned well and, as the European Community (EC) was already engaged there, the Bank did not consider that its involvement would add considerable value.

How can the EBRD help address the issue?

The pilot seminars highlighted the need for anti-money laundering training in countries that had not yet benefited from commercially run courses. Even if such seminars were available their high costs would usually prohibit these countries' money laundering compliance officers from attending.

The main concerns expressed by delegates attending the seminars concerned legislation and how it affects banking. They also expressed concern about the different types of suspicious transaction reports that will need to be submitted to their respective Financial Intelligence Unit (FIU).

This second review found that the participating countries were at different stages of implementation in their AML and CTF requirements. In many countries – like Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Georgia, Moldova, Romania, Russia, Serbia and Montenegro (including Kosovo) and Ukraine – money laundering had, to varying degrees, already been the subject of conferences and other events, run by different international bodies and by the local regulatory agencies.⁷ Russia and Ukraine, for instance, had already been recipients of EU funds for large programmes such as MOLI-RU and MOLI-U.⁸ These programmes were institutional in focus, concentrating on the setting up of AML structures, such as the FIU, and the promulgation of internationally compliant legal frameworks.

In 2005 the Bank conducted training seminars in 15 countries, aimed at raising awareness and increasing knowledge of money laundering and terrorism financing risks.

Secondly, the potential clients (groups two and three) represented a broad spectrum. Therefore, a one-size-fits-all approach would not have addressed the different needs within these groups. For this reason the Bank has launched two pilot training courses: one for banks from countries in the second group and the other for banks and regulators from countries in the third group. The latter consisted of two separate initiatives:

- developing an action plan with the national regulator to introduce a suitable AML system
- training for banks and regulators to increase awareness of AML.

Three pilot seminars were undertaken over two days in Bosnia and Herzegovina, FYR Macedonia and Kazakhstan.

Building on these pilot seminars, the Bank's consultant visited 15 countries from January to early April 2005.⁶ The aim was, once again, to gather detailed information on how each country addressed:

- the criminal definition of AML and counter terrorism financing (CTF)
- offences and penalties
- customer identification
- "know your customer" and due diligence requirements
- account monitoring
- suspicion reporting
- record-keeping
- the implementation of international recommendations
- staff training.

Although these programmes had been successful in producing high-level awareness of international requirements and setting the legal and political framework within which the AML regime operated, they, for the most part, had not penetrated to the second level (product typologies, suspicious transaction recognition examples and account analysis) which is instrumental in training bank staff.

Other countries like the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan had received hardly any, or no, attention at all. In some countries the subject was viewed as politically sensitive, although there was great interest from bankers and officials.

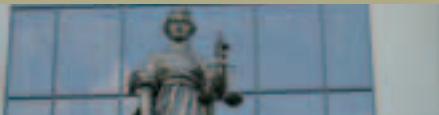
Table 1 Anti-money laundering measures in transition countries

	Specific legislation addressing money laundering
Albania	Law on the prevention of money laundering (no. 8610), dated 17 May 2000; amended (no. 9084), dated 19 June 2003.
Armenia	While there are provisions within different laws prohibiting money laundering, as of June 2005 there was no specific piece of legislation addressing money laundering. There is, however, a draft law on money laundering and terrorism financing currently being circulated by the government.
Azerbaijan	Law on banks, dated 16 January 2004; rules for professional participants of the securities market for the purpose of preventing money laundering and financing of terrorism, dated 9 March 2004.
Belarus	Law on measures against the legalisation of incomes received by criminal means, dated 19 July 2000.
Bosnia and Herzegovina	Law on money laundering, adopted in 2004 at the state level.
Bulgaria	Act on measures against money laundering, dated 24 July 1998.
Croatia	Act on anti-money laundering, as amended, adopted 18 June 1997.
Czech Republic	Act on measures against legalisation of proceeds from criminal activity (no. 61/1996).
Estonia	Act on money laundering and terrorist financing prevention, adopted 25 November 1998, as amended.
Georgia	Law on preventing the legalisation of illegal revenues, adopted 6 June 2003.
Hungary	Act XV of 2003 on the prevention and impeding of money laundering, effective 16 June 2003.
Kazakhstan	While there is no specific legislation addressing money laundering, Article 193 of the Criminal Code prevents the legalisation of money or other unlawfully acquired property.
Kyrgyz Republic	In 2004 the Kyrgyz legislature drafted a fairly comprehensive law on combating terrorism and illicit money laundering. On 9 December 2004 the bill passed its first reading in the parliament.
Latvia	Law on the prevention of laundering of proceeds derived from criminal activity, adopted 18 December 1997, as amended.
Lithuania	Law on the prevention of money laundering (no. VIII-275), adopted 19 June 1997; current version effective as of 1 May 2004.
FYR Macedonia	Law on the prevention of money laundering and other proceeds from crime, adopted July 2004.
Moldova	Law on the prevention and combating of money laundering (no. 633-XV), adopted 15 November 2001, as amended.
Poland	Act on counteracting the introduction into financial circulation of property values derived from illegal or undisclosed sources, approved June 2001, as amended.
Romania	Law on the prevention and sanctioning of money laundering (no. 656/2002), as amended.
Russia	Federal law on counteraction to the laundering of incomes derived by means of crime and terrorism financing (no. 115-FZ), dated 7 August 2001, as amended.
Serbia and Montenegro	
Serbia	Act on money laundering (Official Gazette of FRY, no. 53/2001), promulgated 27 September 2001.
Montenegro	Act on money laundering and terrorism financing prevention, dated 1 October 2003; amended 18 March 2005.
Slovak Republic	Act on the protection against the legalisation of proceeds from criminal activities (no. 367/2000 Coll.), adopted 5 October 2000, as amended; effective from 1 January 2001, as amended.
Slovenia	Act on the prevention of money laundering (Official Gazette of the Republic of Slovenia, no. 79/2001, 59/2002), as amended.
Tajikistan	A specific law on money laundering is currently being discussed. At present there is only a clause in the Criminal Code (Article 262).
Turkmenistan	Article 242 of the Criminal Code, dated 12 June 1997, covers the legalisation of illegally obtained funds or other property and prohibits money laundering. There is, however, no comprehensive legislation on money laundering in Turkmenistan.
Ukraine	Law on the prevention and counteraction to the legalisation (laundering) of the proceeds from crime, dated 28 November 2002.
Uzbekistan	The parliament passed a new law in August 2004 to combat money laundering and and terrorist financing. This law is scheduled to take effect in January 2006.

■ No ■ Yes na = no data available

Source: EBRD securities markets assessment 2005, based on legislation in place as of 31 May 2005.

Laws and procedures cannot combat money laundering single-handedly. The real challenge is for countries to continue conducting regular training seminars and maintain permanent policy dialogue with the authorities.



The need for practical training for banks was obvious, but needed to be aligned within a wider educational context. These fact-finding visits allowed the Bank to consider the perceived training needs in each country and develop an AML/CTF training and awareness programme with the support of the EU and the Swiss State Secretariat for Economic Affairs (SECO).

The programme

The workshop series started in May 2005 and was due for completion at the end of November 2005. Each seminar was conducted over two days and targeted 20 to 30 people from financial institutions and their respective regulators, such as national central banks, FIUs and ministries.

Each seminar met the core identified training requirements and followed a “trainer friendly” concept, adaptable to local content. It combined presentations from local and overseas presenters with discussion opportunities and “train-the-trainer” sessions. Primarily, the seminars provided an overview of money laundering risks, policies available to banks, detailed structures and terminology and legal requirements with a focus on suspicious transaction recognition and reporting systems.

Various training tools were developed and used in these seminars including:

- *Money laundering: who cares?*
A video introducing key AML/CTF risks and methods for combating them
- *Money laundering and terrorist financing*, a game-based exercise explaining the AML/CTF process

- *Money laundering: a country tale*, an audiovisual slide show of the processes and methods used by money launderers
- *Law quiz*, an audiovisual quiz resource providing foundation teaching on major legal and regulatory requirements about identification, “know your customer” (KYC), monitoring, suspicion reporting and record keeping
- *Identity fraud*, a set piece presentation on the massive growth of identity risk through the increase in use of credit cards, ATMs and the internet
- *KYC – mini scenarios*, a set of mini case studies covering suspicion recognition in a management context
- *Is it suspicious?* An account analysis exercise identifying patterns of suspicious transactions
- *The syndicate*, a video-based training exercise setting up money laundering typologies.

The translated audiovisual materials which were used gave local visual references such as cities, people, maps, currencies and economic data.

Programme results

Judging by delegates’ satisfaction scores, the workshops have been successful. So far, 210 bankers from 177 institutions in ten countries have been trained on the programme. Of these:

- 96 per cent either “strongly agreed” (77 per cent) or “agreed” (19 per cent) that the programme was useful to them and their organisation
- 97 per cent either “strongly agreed” (78 per cent) or “agreed” (19 per cent) that they would recommend the programme to other bankers in their countries

- 77 per cent either “strongly agreed” (38 per cent) or “agreed” (39 per cent) that the programme was well adapted to their local environment.

Scoring strongly were the sessions dealing with suspicious transaction recognition and reporting, in many ways the most important issue for banks, with 97 per cent of delegates rating these sessions as either “very useful” (74 per cent) or “useful” (23 per cent).

The Bank will conduct a more detailed assessment of the programme in 2006 when all of the seminars have been completed. Each workshop had a final session entitled “Potential action for advancing the national AML effort” which invited delegates to express the priorities facing the banking sector. From the discussions, it is possible to identify the following distinctive, almost pan-regional, pattern of priorities from the workshops held so far:

- training – the need for more training of the kind delivered by this programme, dealing with practical day-to-day issues confronted by bankers while continuously adapting the programme to the local environment
- legal rationalisation and amendment – amending existing and draft laws to address the perceived lack of clarity and occasional inconsistencies with other areas of national law
- technology – the creation of suspicious transaction software, blacklist software and software to assist with compulsory reporting of large numbers of transactions to the authorities
- better liaison between agencies and commercial banks – in relation to such areas as expected best practice, clarification of circulars and official letters, consultation on proposed legislative amendments and agreements on mutual assistance.

Conclusion

The feedback forms and comments made during and after the seminars have demonstrated the value and importance of this programme in achieving the key objective of raising awareness and increasing knowledge of money laundering and terrorism financing risks in the Bank's countries of operations.

The overall success of the programme should be viewed in the context of existing legislation, levels of awareness and the current situation in most of the countries, which are not yet equipped to tackle the issue effectively. A distinction between the accession countries (in group one) and the Western Balkans and some CIS countries (in groups two and three) can be highlighted. Although the former have put in place the entire legal framework, effective enforcement remains very weak.⁹ In the latter, particularly in most Central Asian countries, international standard money laundering frameworks have to be put in place before focusing on implementation and enforcement.

Hence, should this programme continue, it would focus more on the institution-building capacity of the Western Balkans and most CIS countries. In advanced countries driven by the *acquis communautaire* of the EU the priority will be enforcement. Targeting local legal professionals and enforcement agencies would considerably improve the situation.

In conclusion, laws and procedures cannot combat money laundering single-handedly nor can they protect any country, financial centre or bank from the serious repercussions of money laundering. To ensure that this matter remains uppermost in the minds of those on the ground, AML actions should continue to be promoted through regular training seminars and the maintenance of a permanent policy dialogue with the authorities. This is the real challenge in the transition countries with regard to money laundering. This ambitious programme is an important and welcome milestone towards this objective.

Notes

- ¹ See United Nations, Convention against illicit trafficking in narcotic drugs and psychotropic substances (Vienna, 19 December 1988) and Council of Europe, Convention (Strasbourg, 8 November 1990), respectively.
- ² Basel Committee, "Statement on the prevention of criminal use of the banking system for the purpose of money laundering", 12 December 1988.
- ³ Money laundering has been defined by the FATF as "the conversion or transfer of property, the concealment or disguise of its true nature or source, or the acquisition, possession or use of property knowing it to be criminally derived". The FATF stated that money laundering involves three general stages or phases of operation: placement, layering and integration of funds. While placement involves the physical disposal of bulk cash proceeds from their location of acquisition to avoid detection, layering is the separation of illicit proceeds from their source with complex financial transactions to disguise their audit trail. Integration then involves the conversion of the proceeds into apparently legitimate business earnings through normal financial or commercial operations in the real economy. For more information on the work of the FATF, see www.fatf-gafi.org.
- ⁴ How much of this can be accounted for by the proceeds of organised crime – as opposed to individual crimes and tax evasion – is likewise hard to estimate. Recently, the FATF established the Ad Hoc Group for estimating the magnitude of money laundering. An effort was made to develop a methodology to measure the sums involved, related to the production and trafficking of specific types of illegal drugs, from a global perspective. The effort was stopped mainly due to the lack of reliable data.
- ⁵ It is not surprising to see high numbers of potentially suspicious financial activities involving possible money laundering in some countries or "off-shore centres" that are praised for their competitiveness yet reprimanded for the opaqueness of the deals which can take place there.
- ⁶ Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Georgia, Kyrgyz Republic, Moldova, Romania, Russia, Serbia and Montenegro (including Kosovo), Tajikistan, Turkmenistan, Ukraine and Uzbekistan.
- ⁷ The EU funds workshops in Armenia, Georgia and Moldova.
- ⁸ Money Laundering in Russia and Money Laundering in Ukraine.
- ⁹ It is found that in most of the EBRD's countries of operations, including some EU member states and accession countries, there is still a general absence of law enforcement results in terms of money laundering prosecutions, convictions and asset recovery. Few prosecutions for money laundering or terrorist financing have been reported.

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