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Money Laundering Risk: From the Bankers' and Regulators Perspectives

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Abstract

With the vulnerability of banking institutions in terms of exposure to money laundering, satisfactory money laundering risk assessment is vital. In banking institutions, the frontline officers who are dealing with customers for banking activities such as opening an account, savings, withdrawal and remittance are the frontline of defense responsible to undertake money laundering risk assessment. A series of interviews conducted with compliance officers who supervise the assessment of money laundering risk and a central banker who supervise the regulation on anti-money laundering are analyzed in order to understand how frontline officers discharge their duties in assessing money laundering risk in Malaysian banking institutions. Interview findings suggest that money laundering risk is a real risk in the banking institutions, and the frontline officers should be adequately competent in discharging their duties. Even if the banking institutions are equipped with automated risk management solutions, manual (human expertise) is indispensable in assessing money laundering risk. Support provided by the compliance department is seen as complementary for the roles played by the frontline officers and monitoring ensued by the regulatory authority should have enhanced the compliance intensity in the banking institutions.

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Keywords: money laundering; risk assessment; banking institutions.

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1. Introduction

Money laundering is a crime, justified by the fact that whoever launders money is pursuing a way to legitimize their ill-gotten gains which is accumulated via illegal activities and it allows criminals to enjoy the proceeds of their crime (Baldwin, 2003). By looking at the modus operandi of money laundering, banking institutions are primarily the first-level contact points by money launderer due to several factors including multiple services provided by banking institutions such as deposits, loans, investments and foreign exchange. In the set-up of a banking institution, assessing money laundering risk has been largely focused on organization-based role, for instance money laundering policies and compliance with the supervisory requirements (Raghavan, 2006; Simwayi & Wang, 2011). Limited studies have been found on the individual-based role in assessing money laundering risk, in particular relating to the assessment of customer risk. Although banking institutions are exposed with choices of automated solutions in assessing money laundering risk, the human factor in assessing the risk is indispensable.

Money laundering is one of the immense risks in the banking institutions. Banking institutions are paying hefty fines for failing to properly assess money laundering risk, such as London-based HSBC Bank that has been fined by the United States regulator for almost USD$2 billion for failing to stop Mexican drug traffickers from using its banking system to launder money (Mclaughlin & Pavelka, 2013). Another example involving Standard Chartered Bank which was fined for USD$340 million to the United States regulator to settle the allegations that the bank broke the United States money laundering laws in handling transactions for Iranian customers (Mclaughlin & Pavelka, 2013). The big quantum of losses to the banking institutions has undoubtedly affected the financial system and questions were asked what has gone wrong with the banking institutions risk management system, in particular risk assessment for money laundering? Could the losses be avoided should the personnel of the banking institutions be more cautious in assessing the money laundering risk?

Commonly in an organization, internal and external auditors have always been viewed as the two parties who hold fundamental roles in the assessment of risks (Josiah & Samson, 2012). Nevertheless, the responsibility of conducting risk assessment shall not be surrogated to the internal and external auditors alone as the other organizational members shall bear the same degree of responsibilities, if not more, to assess risks in the organization. Past studies, however, proved that at times some personnel in an organization are not adequately competent to meet the demands of their positions (Simwayi & Wang, 2011). Apart from competency level, the ability of those personnel to assess risks in an organization may be influenced by internal and external factors such as the strength of the internal control systems or the application of technology that could assist them in exercising their duties.

In the context of banking institutions, frontline officers who are involved in dealing first-handedly with the customers shall possess the required competencies to assess the customers bearing any type of risks, in particular money laundering risk that will be covered in this study. To be an expert in assessing money laundering risk, one has to learn the money launderer’s twisted mentality (Favarel-Garrigues et al., 2007). The main issue regarding the ability of the frontline officers to assess money laundering risk is on how competent they are, given their existing knowledge and skills as well as the influence of external and internal factors such as regulatory requirements and other organizational factors such as internal control systems and compliance. This paper aims to explore the practices of banking institutions in assessing money laundering risk, focusing on the involvement of frontline officers as the first line of defense. It will also integrate discussion on some issues and challenges faced by the banking institutions in ensuring the frontline officers effectively discharge their duties in assessing money laundering risk.

2. Money Laundering Risk in Banking Institution

The Financial Action Task Force on Money Laundering (FATF), which is recognized as the international standard setter for anti-money laundering efforts, defines the term money laundering as “the processing of criminal proceeds to disguise their illegal origin” in order to legitimize the ill-gotten gains of crime. A number of activities, other than the sale of illegal drugs, feed the money laundering cycle. They include, but are not limited to, illegal arms sales, the illegal sale of wildlife, prostitution, fraud and embezzlement, insider trading and securities fraud, bribery and corruption, tax evasion, and siphoning off of aid funds (Johnson, 2001). Money laundering goes hand in hand with the activities of organized criminal gangs, ongoing political corruption and corrupt business practices (Johnson, 2001). In Malaysia, drug trafficking is noted by the authorities as the main source of illegal proceeds.

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