Corruption and Money Laundering: What’s the Connection?

Sal Jadavji, ERM Officer and CAMLO
Agenda

- Why Is It Important to Protect Organizations from Corruption & Money Laundering (ML)?
- Money Laundering Risk vs. Credit Risk
- The Connection Between Corruption and Money Laundering
- Methods of Corruption
- Corruption Risks for Financial Entities
- How to Detect PEP/PEFPs
- How to Launder the Proceeds of Corruption
- Red Flags for Corruption
- Key Components of an Anti-Money Laundering (AML) Program
- Key Components of an Anti-Bribery/Corruption (ABC) Program
- Anti-Corruption and AML Groups Working Together
Why Is It Important to Protect Organizations from Corruption & ML?

1. Manage reputational risks faced by organizations

2. Limit financial losses - Failure to implement any of the 5 elements of the compliance regime = $100,000 fine

3. Comply with regulatory requirements
   a. Office of the Superintendent of Financial Institutions (OSFI)
   b. Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)
   c. Financial Action Task Force (FATF)/OECD/G20
      • The G20 Leaders statement, Pittsburgh, September 2009: “We ask the FATF to help detect and deter the proceeds of corruption by prioritizing work to strengthen standards on customer due diligence, beneficial ownership and transparency”.
   d. OECD Convention on Combating Bribery of Foreign Public Officials
   
e. Corruption of Foreign Public Officials Act (CFPOA) – Canada/Foreign Corrupt Practices Act (FCPA) – USA/UK Bribery Act (UKBA)

4. Social and political costs of corruption and money laundering

5. Promotes stability of the financial system and the economy
Money Laundering & Corruption in the Headlines…

“FINTRAC issues $40,000 fine against Sharons Credit Union”

“RCMP search SNC-Lavalin headquarters, shares fall 28%”

“Standard Chartered Denies Money Laundering Allegation, Shares Drop 17%”

“J.P. Morgan Chase Pays $88.3 Million To Settle Sanctions Violations”

“Army Lieutenant Colonel Gets 41 Months In Bribery Case”

“HSBC’s AML Penalty Likely to Approach $1 Billion”

“Niko Resources pleads guilty to Bangladeshi bribe; agrees to $9.5M fine”
Money Laundering Risk vs. Credit Risk

Credit Risk

- Protect the organization against financial losses
- Key question - Is the money there?

Money Laundering Risk

- Protect the organization against criminals using the organization to launder proceeds of crime
- Key question - Where did the money come from?
Case Study #1: The Travelling Property Developer

- Customer had a credit card account with a limit of $2,000; current balance outstanding was zero
- Only one person listed on the credit card account
- Client was self-employed and working as a property developer making $250,000/year
- The client made a large cheque payment of $20,000 via a bank machine deposit
- This created a credit balance of $20,000, which is highly unusual for a credit card account because normally you owe the bank money, not the other way around
- Fraud/credit risk flag triggered = will the cheque bounce?
Case Study #1: The Travelling Property Developer (Continued)

- Asked to see the account transactions for the past year and we were shocked
  - High velocity of transactions on the account; over 75,000 attempted credit card transactions throughout the year
  - Multiple transactions on the same day using different channels (phone, web, in-person) and made from different locations
  - ATM withdrawals attempted from foreign locations (higher risk locations for ML/TF)

- Why was this unusual?
Money Laundering Risk vs. Credit Risk (3/4)

Case Study #1: The Travelling Property Developer (Continued)

Found account unusual because:

– A large credit balance for a credit card is not normal for this type of product
– The foreign transactions from a high-risk country for ML/TF
– The high velocity of transactions—which suggested more than one user for the credit card—that could be used by a terrorist group to fund their operations overseas
– Client’s profile did not fit with the activity
Don’t close the case by answering the question *Is the money there?* with the response “no risk of financial loss.” You should also ask *Where did the money come from?*
How is corruption connected to money laundering?

- Criminal activity related to corruption generates money that needs to be laundered—so where there is corruption, there is money laundering.

- Corruption is a crime and is a predicate offence (these crimes are the underlying source of the money laundering) for money laundering as defined under the *Criminal Code of Canada*.

- Corruption proceeds “often follow patterns of behaviour common to money laundering associated with other criminal activities.” Wolfsberg Group (2011)
Corruption Risks for Financial Entities

Scenario A

- The financial entity, through an authorized employee or agent, engages directly in bribery to gain business advantage.
  - For example, an employee, an investment banker, provides a “bribe” to a government official to obtain an underwriting mandate, or a loan syndicate member provides a favour to facilitate the financing of a deal.
  - Potential liability to the entity under the FCPA or its foreign counterpart.
  - If the bank knowingly enables corrupt activity of its clients, it and its employees may face prosecutorial scrutiny related to FCPA and money laundering violations.
  - If you report STR, do you also voluntarily report to RCMP?

Scenario B

- The bank’s customer is engaged in corruption that touches the bank through payment or use of bank’s products/services. Potential AML reporting obligations.

Enforcement in both scenarios is rising significantly which makes the case stronger for integrating the ABC controls into the AML program or making them work better together.
Methods of Corruption

- Domestic or Foreign Corruption

- Bribery – promise, offer/acceptance or transfer of an advantage either directly or indirectly, in order to induce or reward the improper performance of a function or activity

- Functional – Use of public office for private gain

- Specific Offenses – Petty or Systemic – public officials or employees receive money to perform or refrain from performing official acts

- Grand Corruption – Use of public office to enrich themselves, their families and associates

- Politically Exposed Persons (PEP) – FATF

- Politically Exposed Foreign Persons (PEFP) – Canadian law
How to Detect PEP/PEFPs?

- Use name scanning services like World Check (includes database of lists and software to clear alerts or hits)

- Have two levels of reviews:
  - Level 1 looks at all hits and excludes the obvious ones that are not matches i.e. name, gender
  - Level 2 looks at all the hits that the level 1 review could not exclude. This person should be more experienced with AML and be able to conduct research to exclude or confirm the hit as a match.

- Written procedures in place for exclusion criteria i.e. the steps for how to decision hits generated by the name scanning software.

- Frequency of name scanning = best practice is daily but could be weekly for low volume account openings. Monthly scanning is no longer industry practice.

- OSFI Instruction Guide: Designated Persons Listings and Sanctions Laws = good source of information on this topic.
How to Launder the Proceeds of Corruption

1. Corporate Vehicles and Trusts
2. Gatekeepers
3. Offshore/Foreign Jurisdictions
4. Nominees
5. Cash
1. Corporate Vehicles, Shell Companies and Trusts

Risks

- Easily created
- Multi-jurisdictional structures
- Specialized intermediaries/professionals
- Nominees to disguise ownership

Case Studies

- Pinochet – corporations established in weak jurisdictions, listed as nominal owners of US bank accounts and other investment vehicles

- Study highlights how easy it is to set up untraceable companies: http://www.economist.com/node/21563286?fsrc=scn/Ln_ec/launderers_anonymous

Control Measures

- Determine who the beneficial owners are? If an entity, ask why is the client using such a complex structure? Know who you are dealing with.
Beneficial Ownership

- Who owns the entity? Getting to the names of the actual individuals, not entities
- How far do you go? Two or three levels? For complex structures, ask why so complicated?
- Document the steps you took to determine the beneficial owners.
- Request legal counsel or client to provide statement of who are the individuals behind the entire corporate structure.
- AML Officer should determine if there is anything unusual or suspicious with the transaction/client/corporate structure. Is the client using the complicated structure to hide the true owners and if so, why?
2. Gatekeepers (Lawyers/Accountants)

Risks

- Reputable professionals who can create corporate vehicles, open bank accounts, transfer proceeds, purchase property, courier cash. All under attorney/client privilege

Case Studies

- Deposit incoming funds into law office accounts, then transfer to newly created PEP accounts
- Hold accounts
- Government funds transferred to corporate accounts and then transferred to client accounts at law firms
- Withdrawals from client accounts disbursed directly to PEP as cash
- Shell corporations used to purchase property

Control Measures

- Monitoring transactions for unusual indicators and EDD on gatekeeper accounts
3. Offshore/Foreign Jurisdictions

Risk

- Most frequent method
- Investigation is more difficult/time intensive
- Easy access
- Ability to “stack jurisdictions”
-Multiplies the complexity of investigation
- From developing to developed countries

Case Studies

- Marcos, Abacha – money moved and disguised in a series of financial transactions involving accounts and corporate vehicles in BVI, Singapore, Cook Islands, Costa Rica

Control Measures

- CDD/EDD – Client lives in Africa but uses a corporate entity in Costa Rica???
4. Nominees

Risks

- Close, trusted associates or family members
- Used as “middlemen”
- Shelter or insulate the PEP from unwanted attention

Case Studies

- Aleman – government funds to non-profit organizations and front companies set up by advisors
- Money to be paid to Treasury was diverted to foreign accounts held in the name of former wife and daughter

Control Measures

- Monitoring transactions – do the transactions make sense for the client’s profile? i.e. age, occupation, income, etc.
5. Cash – Placement Stage

Risks

- Anonymous, lack of paper trail
- Predicate crimes are cash intensive businesses
- Preferred method of choice

Case Studies

- Obiang – cash deposited directly into accounts controlled by PEP and/or his wife, million dollar amounts shrink wrapped
- Pinochet – Suitcases, Bank provided Cashier’s checks in the maiden name of wife
- Zambia – large cash withdrawals, cash used to purchase real estate
- Montesinos – cash couriers to transfer funds from Switzerland to Mexico and Bolivia
- West African PEP’s daughter – diplomatic pouch, non-declared Cross Border

Control Measures – CDD/EDD – where did the money come from? Reasonable?
Red Flags for Corruption

- Routing a transaction through a financial institution that is unaccustomed to doing business with foreign persons;

- Use, by a PEP, of accounts at a nation's central bank or other government-owned bank as the source of funds in a transaction;

- Frequent or excessive use of funds transfers or wire transfers in or out of an account;

- Wire transfers to or for the benefit of a PEP where the beneficial owner or originator info is not provided with the wire transfer;

- Large currency or bearer instrument transactions either in or out of an account of a PEP;

- High-value deposits or withdrawals, particularly irregular ones, not commensurate with the type of account or what is known and documented regarding the legitimate wealth or business of the client; and

- An inquiry by or on behalf of a PEP regarding exceptions to the reporting requirements of the AML regulations or other rules requiring the reporting of suspicious transactions.
Key Components of an Anti-Money Laundering (AML) Program

1. AML Officer appointed for the organization
2. AML Policies and Procedures
3. Risk assessment of the inherent ML/TF risks
4. Self-assessment of the controls
5. Independent testing of the AML Program
6. Training program
7. Transaction monitoring system in place to monitor customer transactions for unusual activity
8. Prescribed Reporting processes in place for Suspicious Transaction Reporting (STR), Large Cash Transaction Reporting (LCTR), Electronic Funds Transfer reporting (EFT), and terrorist reporting
9. Sanctions – Freezing Assets of Corrupt Foreign Official Act (Tunisia and Egypt regulations)
Key Components of an Anti-Bribery/Corruption (ABC) Program

1. Senior Manager appointed for the organization
2. ABC Policies and Procedures in place
3. Risk assessment of the inherent ABC risks
4. Self-assessment
5. Audit of the ABC Program
6. Monitoring
7. Training program
8. Sanctions – Freezing Assets of Corrupt Foreign Official Act (Tunisia and Egypt regulations)

- Compliance Programs for AML or Anti-Corruption are more than just having a policy = must prove that adequate procedures in place for AML/ABC
ABC and AML Groups Working Together (1/2)

- There are often separate groups that try to protect the organization from money laundering and corruption.

- AML groups often do work that is similar in nature to ABC groups, but their reasons for doing so can be quite different.

- Organizations can benefit by leveraging their ABC resources with their AML efforts.

- But how?
ABC and AML Groups Working Together (2/2)

- Have both groups report to the same senior executive team member.

- Provide ABC group with access to the AML case management system so that files can be easily shared between the two groups.

- When STRs related to corruption are filed with regulator, AML group should share this information with ABC group.

- Make decision together with business to de-market client and exit business relationship.

- Specialized training for the ABC group on AML and specialized training for AML group on corruption indicators (red flags).

- ABC group could do an annual AML self-assessment for its area and report this to the AML Officer.

- Have regular meetings between the two groups (at least monthly).
Sources of Information


Concluding Thoughts...

- Corruption and money laundering are similar and connected.
- Corruption and ML are emerging risks that organizations need to get better at mitigating.
- Opportunity to capitalize on potential benefits from collaboration between anti-corruption group and AML group including the following:
  - Cost savings
  - Enhanced intelligence
  - Leverage technology and expertise
  - Reduce the cost of burden on business (time and dollars)
Concluding Thoughts . . .
Questions?

Contact:
Sal Jadavji, CAMS, CFE
Enterprise Risk Management Officer & Chief AML Officer
MCAN Mortgage Corporation
416-591-2885
sjadavji@mcanmortgage.com