

Laundering of Proceeds of Corruption

Background paper submitted by

Mr. Muhammad Kamran Shehzad
Director, Banking Policy Department
State Bank of Pakistan

The United Nations Convention against Corruption emphasizes the importance of tackling the menace of money laundering and requires a number of requirements on the state parties. A synopsis of these requirements is given below:

Article 14: Measures To Prevent Money-Laundering

The Article emphasizes the prevention of money laundering, with measures directed at both the public and private sectors. It enjoins each State Party to establish a comprehensive domestic regulatory and supervisory regime for banks and NBFIs as well as natural or legal person that provide formal and informal services for the transmission of money, in order to deter and detect all forms of money laundering through requirements of customers/beneficiaries identification, record keeping and the reporting of suspicious transactions. Also it requires to ensure cooperation and exchange of information at the national and international levels between the regulatory and law-enforcing agencies within the conditions prescribed by domestic law and, to that end, consider the establishment of Financial Intelligence Unit as a national center for the collection, analysis and dissemination of information regarding the subject matter.

State parties are also required to devise a mechanism for reporting and to detect and monitor the cross-border movement of cash. Further, it has been desired to make it mandatory upon the financial institutions and money remitters to obtain and maintain meaningful information on the originator.

Article 23: Laundering of Proceeds of Crime

Under this Article, each party should adopt legislative and other measures for making the Money Laundering a Criminal Offence. Further each party should seek to apply this provision to a comprehensive range of criminal offences.

Article 31: Freezing Seizure And Confiscation

Each State Party should take measures within its domestic legal system to enable identification, tracing, freezing, seizure and confiscation of the proceeds of crime or property or income derived from such proceeds.

Article 40: Bank Secrecy

Each State Party shall ensure that, in the case of domestic criminal investigations of offences established in accordance with this Convention, there are appropriate mechanisms available within



its domestic legal system to overcome obstacles that may arise out of the application of bank secrecy laws.

Article 52: Prevention and Detection of Transfers of Proceeds of Crime

Each State Party in accordance with fundamental principles of its domestic legal system shall require of financial institutions under its jurisdiction to verify the true identity of their customers and the bona fide of the beneficiaries of the funds deposited into accounts of high value customers with due cognizance of the fact that this enhanced scrutiny shall not harm legitimate businesses. For this purpose the State parties shall issue advisories regarding the types of accounts financial institutions will be expected to apply enhanced scrutiny. The advisory may also be issued on the request of another state party for a particular type of natural or legal person. Also, state party shall ensure by taking measures by which the financial institutions shall be required to maintain the relevant record over an adequate period of time.

State party shall take measures, with the help of its regulatory and oversight bodies, ensuring that no bank is established without having physical presence and that are not affiliated with a regulated financial group. State parties shall also require their financial institutions to refuse to enter into correspondent banking relationships with such institutions by putting in place procedures guarding against such relationships.

Article 58: Financial Intelligence Unit

States Parties shall cooperate with one another for the purpose of preventing and combating the transfer of proceeds of offences established in accordance with this Convention and of promoting ways and means of recovering such proceeds and, to that end, shall consider establishing a financial intelligence unit to be responsible for receiving, analyzing and disseminating to the competent authorities reports of suspicious financial transactions.

Being regulator of banks/ DFIs, State Bank of Pakistan is fully alive to its role in ensuring clean and transparent banking system in the country. In this context, State Bank of Pakistan has taken following steps to curb and control money laundering.

Issuance of Prudential Regulations

• Prudential Regulations No. M-1 (KYC/ CDD)

A comprehensive system of Know Your Customer (KYC) / Customer Due Diligence has been put in place in line with international best practices. The said PR requires banks to make all reasonable efforts to determine true identity of every prospective customer. Additionally, minimum set of documents to be obtained from new customers/ accounts holders of various types have been prescribed. Necessary requirements include the following.

- Ensure true identity of prospective account holders
- Ascertain nature of the business
- Determine beneficial ownership of accounts
- Requirement of introduction.
- Enhanced due diligence for high risk customers
- Training of staff.

- **Prudential Regulations No. M-2 (Monitoring of activities)**

Prudential Regulation-M2 requires that specific procedures be established for ascertaining customer's status and his/her source of earnings, monitoring of accounts for identities and bonafides of remitters and beneficiaries. The transactions, which are out of character/ inconsistent with the history, pattern or normal operation of the account involving heavy deposits/ withdrawals are required to be properly investigated.

- **Prudential Regulation M3: (Record Keeping)**

Banks/ DFIs are required to maintain, for a minimum period of five years, all records on transactions, both domestic and international along with the records on the identification data obtained through KYC/ CDD (NIC, Driving license, passport etc.). Additionally, record of suspicious transactions has to be maintained for longer period and can be destroyed only with the prior permission of State Bank. The record so maintained, must be sufficient to permit reconstruction of individual transactions including the amounts and types of currency involved so as to provide, if necessary, to SBP or law enforcement agencies for investigation or as an evidence in legal proceedings.

- **Prudential Regulation M4: (Correspondent Banking Relationship)**

The said regulation sets out parameters for entering into correspondent banking relationship. Banks/ DFIs are prohibited to establish correspondent banking relationship where there are deficiencies in KYC/ CDD policies or where correspondent/ respondent has no physical presence. Particular attention has to be paid in continuing relationships with banks located in jurisdiction that have poor KYC standards or have been identified by FATF as "non-cooperative". Approval for establishing new correspondent relationship has to be taken from senior management.

- **Prudential Regulation M5: (Suspicious Transactions)**

Banks/ DFIs have been advised to pay special attention to all complex, unusually large transactions and all unusual patterns of transaction, which have no apparent economic or visible lawful purpose. Detailed examples of such transactions have been provided by outlining the basic ways in which money could be laundered. If there are reasonable grounds to suspect that funds are the proceeds of a criminal activity, such transactions are required to be reported to concerned authorities.

Implementation of Regulations:

Accordingly, implementation of these regulations is ensured through on-site examination and off-site surveillance. Our inspectors specifically verify the adequacy of KYC policies and other Anti-money laundering safeguards during their on-site inspections conducted regularly as well as through special inspections when need arises. The inspection report is then provided to Banking Supervision Department for enforcement actions. The banks/ DFIs found deficient in requirements are fined in addition to other administrative actions e.g removal of undesirable employees-executives.

Rupee Travellers Cheques (RTCs)

The banks in Pakistan started issuing Traveller Cheques in local currency called "Rupee Travellers Cheques" (RTCs) in exceptionally high denomination of up to Rs.500,000 which was not in line with the true spirit/purpose of Traveller Cheques. Instead of using RTCs to meet the needs of travellers, the holder of these instruments started using them as a mode of settlement of payment, primarily for those transactions, which were not documented, thereby, defeating the goal of

Government for documentation of the economy. SBP, therefore, prohibited the issuance of RTCs exceeding Rs.10,000/- in denomination vide BPD circular No. 12 dated 23rd May, 2002.

Bearer Instruments:

Various kinds of bear instruments were previously available in the market which have been gradually phased out in collaboration with the Federal Government. The measure has almost eliminated availability of bearer financial instruments in the market. The measure should augment the Government's efforts towards documentation of the economy.

Freezing of funds/ bank accounts.

State Bank of Pakistan has remained actively involved towards implementation of terrorism related sanctions by UNSC. The United Nations Security Council vide its Resolutions Nos, 1267 (1999), 1333(2000), 1390(2002) 1455(2003) has directed to freeze the funds and other resources of certain individuals and entities including those related to Al-Qaida and Taliban individuals and entities. The National law of the country viz. United Nations (Security Council) Act, 1948 enjoins upon the Federal Government to apply certain measures for giving effect to the decisions of the United Nations Security Council. Accordingly, the Federal Government has been issuing Gazette Notifications and instructions to freeze the bank accounts of the individuals and entities associated with terrorism. Accordingly, State Bank of Pakistan has issued directives to all banks to freeze the said accounts immediately and report the frozen accounts to State Bank of Pakistan.

Exchange Companies.

Through an amendment in Foreign Exchange Regulation Act, 1947, money changers have been replaced with Exchange Companies. These companies are subject to proper monitoring and on-site inspection by SBP. With the powers to conduct on-site inspection of such companies, State Bank can keep eye on their activities. Banks/ DFIs and Exchange Companies are encouraged to provide competing services in the formal banking sector in order to remove any incentives being provided by Hawala operators. The effectiveness of these measures can be gauged by the pattern of home remittances, which have recorded gradual increase in recent years.

Liaison and cooperation with regional/ global bodies

Membership of Asia Pacific Group on Money Laundering: Pakistan is member of APGML, a regional organization engaged in combat against Money Laundering. Officials of State Bank have participated in APGML's conferences and workshop. The objective is to keep abreast with the global developments as well as to provide an opportunity to interact with the regional partners with regard to AML/CFT areas.

Training of Staff

In order to develop expertise in the areas of AML/CFT, adequate training (local and foreign) is being arranged to the concerned supervisory staff. In addition, banks are encouraged to impart suitable training to their staff in the context of money laundering and terrorist financing. State Bank keep close liaison with Institute of Bankers in Pakistan (IBP) to provide maximum opportunities of training to staff of banks. To this end, IBP has been able to organize 14 seminars on Anti-Money Laundering during the year 2004 throughout the country.

Challenges faced in Implementation of AML/ CFT Measures:

- Reporting of Suspicious Transactions: Although banks/ financial institutions are required to report STRs, they feel insecure against any legal action by customers. The proposed AML law provides protection to financial institutions for lawful disclosure of information. The impression of insecurity will disappear with the introduction of law but for the present, difficulty is being faced in persuading bankers to report suspicious transactions.
- Pakistan is mostly a cash based economy. With the process of financial deepening documentation of transactions is being achieved with the passage of time but low literacy rate and lack of financial services in remote areas of the country are the challenges in the way of documentation process. The overall approach and strategy has been to follow the necessary measures in phased manner keeping in view the specific needs and environment of the country.
- In case of terrorist financing, incomplete or partial information furnished by various countries and common names of proscribed persons/ entities create hurdles in identifying the persons/ entities associated with terrorism.

Road Ahead:

- **Draft Anti-Money Laundering Law:**

A comprehensive law on the subject is in its final stage of promulgation in which State Bank of Pakistan has participated by providing input and comments. The law includes the following provisions in accordance with the global standards.

- Criminalization of Money Laundering and Financing of Terrorism.
- Confiscation of proceeds of crime.
- Establishment of FIU and processing, analyzing and disseminating financial information and other intelligence at the domestic and international levels.
- Law enforcement and prosecution authorities, powers and duties.
- International Cooperation.

- **Establishment of FIU:**

With the introduction of AML law, an FIU will be established in State Bank of Pakistan. The said FIU will be established as an independent unit to receive, analyze and disseminate information necessary for investigation and prosecution of persons involved in money laundering and terrorist financing.

- **Seminar on Anti-Money Laundering and Terrorist Financing:**

The State Bank of Pakistan is organizing a two days International Seminar on 29-30 March 2005, at Islamabad, to create awareness and educate the bankers about the risks and issues facing the financial sector in the context of money laundering and terrorist financing. The Seminar is designed to address various key issues and challenges faced by the sector and develop recommendations and future course of action to address the issues. The seminar will go a long way in identifying other high-risk sectors and potential areas of money laundering and terrorist financing

- **Close Coordination with other Stakeholders:**

For effective enforcement actions, State Bank, in collaboration with other agencies/ bodies would adopt unified strategy to fight money laundering and terrorist financing. This will be achieved through regular meetings and close liaison with other stakeholders on issues relating to money laundering and terrorist financing.