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Corporate Governance and Anti-Money Laundering Measures 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. Malaysia passed the Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA) in 2001. AMLATFA not only criminalizes money laundering, but also emphasizes on good corporate governance and senior management accountability. Banks as the main reporting entities have borne the brunt of the measures introduced by the law. This paper will highlight the importance of corporate governance in anti-money laundering measures. As such, the discussion will focus on the roles and responsibilities of the board of directors and senior management to put in place relevant anti-money laundering (AML) measures as prescribed by AMLATFA. Undoubtedly, 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. More importantly, an efficient AML measure with good governance lower the pervasiveness of money laundering activities. At the end of the day this is the duty that the bank's board of directors owe to their stakeholders.

INTRODUCTION

Money laundering may be defined as 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 (Pendakwa Raya v Ong She Sen [2010]). 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.

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). AMLATFA criminalizes money laundering and requires the reporting institutions to put in place proper identifying, recording and reporting procedures; appoint money laundering reporting officer; make staff aware of the anti-money laundering (AML) laws and provide proper training. AMLATFA not only criminalizes money laundering, but also emphasizes on good corporate governance and senior management accountability. Banks as the main reporting entities have borne the brunt of the measures introduced by the law.

This paper will highlight the importance of corporate governance in AML measures. As such, the discussion will focus on the roles and responsibilities of the board of directors (BOD) and senior management to put in place relevant AML measures as prescribed by AMLATFA.

THE ROLES AND RESPONSIBILITIES OF THE BOD AND SENIOR MANAGER

It has been recognised 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. The 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 must be said that effective AML measures adopted by banks will make it tougher for criminals to get their 'dirty money' into the financial system. For this reason, Part IV of the AMLATFA imposes specific obligations on banks to counter money laundering activities. These obligations include the obligation to identify and verify customers, report cash and suspicious transactions, keep records and establish compliance program. They have been applied to the banking industry since 15 January 2002. Indeed, for law enforcement agencies, banks are considered to be an important source of valuable information for the detection of money laundering.

Given the complex nature of money laundering operations, BNM issued a new set of guidelines, namely the Anti-Money Laundering and Counter Financing of Terrorism- Banking and Deposit-Taking Institution (Sector 1) in 2012. This new guidelines supersede the Standard Guidelines on Anti-Money Laundering and Counter Financing of Terrorism and Sectoral Guidelines 1 for Banking and Financial Institutions which were issued in 2006. These Guidelines were issued under section 66E and 83 of AMLATFA. Section 66E empowers BNM to issue relevant guidelines in order to discharge any international obligations binding on Malaysia. Section 83 on the other hand specifically refers to power of BNM to issue relevant guidelines when exercising its function as Financial Intelligence Unit.

The Anti-Money Laundering and Counter Financing of Terrorism- Banking and Deposit-Taking Institution (Sector 1) 2012 prescribes the roles of BOD and senior management to put in place the relevant AML measures.

Para 28.2.1 states that the members of BOD must understand their roles and responsibilities in managing money laundering risks faced by the reporting institutions. Therefore, the BOD must be aware of the money laundering risks associated with business strategies, delivery channels and geographical coverage of its business products and services.

According to para 28.2.2, the BOD have the following roles and responsibilities:

(a) maintain accountability and oversight for establishing AML policies and minimum standards;
(b) approve policies regarding AML measures within the reporting institution, including those required for risk assessment, mitigation and profiling, customer due diligence, record keeping, on-going due diligence, reporting of suspicious transactions and combating the financing of terrorism;
(c) establish appropriate mechanisms to ensure the AML policies are periodically reviewed and assessed in line with changes and developments in the reporting institution's products and services, technology as well as trends in money laundering;
(d) establish an effective internal control system for AML and maintain adequate oversight of the overall AML measures undertaken by the reporting institution.
(e) define the lines of authority and responsibility for implementing the AML measures and ensure that there is a separation of duty between those implementing the policies and procedures and those enforcing the controls;
(f) ensure effective internal audit function in assessing and evaluating the robustness and adequacy of controls implemented to prevent money laundering;
(g) assess the implementation of the approved AML policies through regular reporting and updates by the Senior Management and Audit Committee; and
(h) establish management information system that is reflective of the nature of the reporting institution's operations, size of business, complexity of business operations and structure, risk profiles of products and services offered and geographical coverage.

Furthermore, para 28.3.2 sets out the roles and responsibilities of the senior management as follows:

(a) be aware of and understand the money laundering risks associated with business strategies, delivery channels and geographical coverage of its business products and services offered and to be offered including new products, new delivery channels and new geographical coverage;
(b) formulate AML policies to ensure that they are in line with the risks profiles, nature of business, complexity, volume of the transactions undertaken by the reporting institution and its geographical coverage;
(c) establish appropriate mechanisms and formulate procedures to effectively implement AML policies and internal controls approved by the BOD, including the mechanism and procedures to monitor and detect complex and unusual transactions;
(d) undertake review and propose to the BOD the necessary enhancements to the AML policies to reflect changes in the reporting institution's risk profiles, institutional and group business structure, delivery channels and geographical coverage;
(e) provide timely periodic reporting to the BOD on the level of money laundering risks facing the reporting institution, strength and adequacy of risk management and internal controls implemented to manage the risks and the latest development on AML which may have an impact on the reporting institution;
(f) allocate adequate resources to effectively implement and administer AML compliance programmes that are reflective of the size and complexity of the reporting institution's operations and risk profiles;
(g) appoint a compliance officer at management level at Head Office and designate a compliance officer at management level at each branch or subsidiary;
(h) provide appropriate levels of AML training for its employees at all levels throughout the organisation;
(i) ensure that there is a proper channel of communication in place to effectively communicate the AML policies and procedures to all levels of employees;
(j) ensure that AML issues raised are addressed in a timely manner; and
(k) ensure the integrity of its employees by establishing appropriate employee assessment system.

It is clear that the Guidelines emphasise on good corporate governance and senior management accountability. The BOD and senior management are being held too much higher standards of corporate governance and playing a greater role in managing money laundering risk (Nakajima, 2013). As such the BOD and senior management of the banks cannot turn a blind eye to these responsibilities. More importantly, failure to act may constitute a breach of the director's duty to act with care and diligence and could expose the directors and senior management to criminal liability. Indeed, 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.

It must be noted that AML compliance can no longer be subject to business decisions by the BOD. In fact, it must be addressed by the BOD and senior management as an integral part of their overall responsibility and they must accept accountability for their actions or lack of actions (Dunne, 2014). More importantly, compliance with AML laws requires diligence. Therefore, the BOD and senior management must be aware of the AML rules, understand the institution's money laundering risk and monitor the institution's customers and transactions (Brummer and Alper, 2013).

An empirical study of factors affecting money laundering in a 88 developed and developing countries has shown that an efficient AML framework with good governance lower the pervasiveness of money laundering activities (Santha Vaithilingan and Mahendran Nair, 2007). On the other hand, 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 (Johnston and Carrington, 2006).

A KPMG survey in 2014 showed that 88 percent of banks globally admitted that the BOD took an active interest in AML issues. Given the impact that AML compliance can have on the reputation, share price and economic viability of a bank, this is no surprise (KPMG International, 2014). This indicates a high degree of commitment by the financial industry to protect the integrity of the banking institutions, as well as to comply with their legal obligations.

Despite the increasing liabilities imposed on the BOD and senior management of banks in the fight against money laundering, it is still unclear at this stage whether the benefits of AML compliance outweigh its cost. 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 (Gill and Taylor, 2004).

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 behaviour (Yeandle, et al, 2005). Pricewaterhouse Coopers identified the potential benefits of compliance with AML laws as improvements to the level of regulatory compliance; commercial benefits through improved customers' database and an increase in the prevention of financial crime (Pricewaterhouse Coopers LLP, 2003). Therefore, it is important for the BOD and senior management of the banks to ensure what is spent in AML compliance can enhance the reputation of banks as law abiding institution.

NON-COMPLIANCE WITH AMLATFA

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 BNM 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, BNM 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 BNM may revoke or suspend the bank's licence if it has been convicted under AMLATFA. 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 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 wilfully violating its legal obligations to implement adequate anti-money laundering measures (US Senate Permanent Subcommittee on Investigations, 2004).

In 2003, Abbey National was fined £2.3 million by the UK Financial Services Authority for serious AML compliance failure (FSA Press Release, 2003). 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, the BOD and senior management of banks must ensure the effective AML measures with good governance are established.

CONCLUSION

It is generally accepted that an efficient AML measures with good governance lower the pervasiveness of money laundering activities. With the implementation of AMLATFA, the BOD and senior management of banks have found themselves having to comply with an increasing number of AML regulations and guidelines.

More importantly, AMLATFA have put legal and administrative burdens on them which are onerous and may involve serious legal and other liabilities for deficient compliance.

Therefore the BOD and senior management must understand the institutions' AML's risk and ensure adequate compliance in their institutions. However, it is unreasonable if the toughness of the laws seems to fall on the law abiding and conscientious BOD and senior management rather than on the criminals. As such, at this time, effective coordination between the banking industry and the AML regulator is vital to minimize problems faced by the BOD and senior management and thereby to ensure effective implementation of the laws in combating money laundering.

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