Money laundering - a problem in the NR circuit

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Money laundering is centred on the various opportunities the beneficial owner has to hide his/her identity. The author published an article about this in the December 2000 edition of *Bank- en effectenbedrijf*. In his article, he described the opportunities offered by the Offshore Financial Centres and offshore banks to beneficial owners to hide their identity. In this follow-up, he focuses on the money-laundering problems in the non-resident circuits (NR circuits), along which criminal money is routed to its destination. In this context, he makes a link with the initiative launched by eleven major private banks to protect the financial system from misuse for criminal purposes.

The first part of the article deals with the most recent important, international political developments in the area of money laundering, as recently expressed in the reports and press publications of a number of authoritative bodies. When looking more closely at the concepts Offshore Financial Centres (OFCs) and offshore banking, it becomes clear that problems identified by the US legislator are not limited to the Caribbean or Atlantic tax havens, but that they also extend as far as the non-resident circuits across the Western world. The recent press publications about the Bank of New York, Sani Abachi, Raul Salinas and Trans World have one thing in common: money laundering via NR circuits in countries in the West. The US legislative proposal HR3886 is, in the first instance, exemplary of the current fragmented approach to the money-laundering problem.

Instead of working towards joint international measures, the US legislative proposal is aimed exclusively at dollar transactions. As a result, the actual money-laundering problem is expected to shift to different currencies. For the purpose of this article, therefore, the legislative proposal will merely function as introduction to the actual problem: the various opportunities the beneficial owner has to hide and to conceal his/her identity. Not only by using the corporate law and banking facilities offered by the OFCs and offshore banks, but also by using NR circuits to route proceeds from crime to their destination. This article, therefore, highlights the problem of money laundering in the NR circuits, and explains the most relevant aspects of the problem. In the first instance, the nature of the problem in the NR circuits is described, including the registration and availability of data relating to the nature and scale of the NR circuits in the different countries. This is followed by a discussion of the stakes and interests of the authorities concerned (police, justice departments, tax authorities) and the potential use of the available data. The possible consequences for international funds transfers and the role of the dollar are also described in more detail. The effectiveness of the initiative of eleven international banks to cooperate with Transparency International (TI) in the introduction of the *Global Anti-Money Laundering Guidelines for Private Banking*, in short, the *Wolfsburg Principles*, will be assessed on the basis of the problems identified in the NR circuits.

Legislative proposal HR3886 On 9 March 2000, the legislative proposal HR3886 was submitted to the US Congress. The proposal, known as the *International Counter Money Laundering Act 2000*, is aimed at facilitating the identification of the beneficial owner of a foreign bank account; at present, it is still possible for the beneficial owner to hide behind a whole range of cover-ups.

The NR circuit

Switzerland, Luxemburg, the Netherlands, the US, France, the UK and many other countries have a stable political, economical and fiscal climate, a high-quality domestic financial system, including renowned, internationally-operating banks with a global network of branch offices, and a relatively hard currency in high demand. In addition, some well informed banking experts and investigating officers believe that these countries also function as turntables in both the legal and criminal international funds transfer. Precisely because of the considerable advantages the countries in question offer in the financial-economic area, there appears to be a need among internationally operating criminal organisations to settle in these countries and not to hang around in dubious or insignificant countries on the sidelines of the large playing field. To a large extent, this is prompted by the extensive financial resources these organisations have at their disposal. Based on personal experience and available literature, one can conclude that it is not only about the ownership of these resources, but, even more so, the influence, the power and, in some instances, the invincibility that go with this ownership.

In various places in the world, particularly in important financial centres, such as London, Zurich, New York, Luxemburg and Amsterdam, there are internationally-operating banks that maintain so-called loro and nostro accounts with correspondent banks all over the world in order to process the international funds transfers of their clients effectively and efficiently, and to facilitate the mutual capital and money market transactions among the financial institutions themselves. Within this extensive system of correspondent banks, international funds transfers in all possible currencies are settled between residents and non-residents of most countries in the world. Due to the increasing mobility of people, the expansion of foreign ownership of, among other things, companies and real estate, and the globalisation of trade, there is a strongly growing need, from a fiscal, treasury, criminal or practical point of view, to have access to foreign bank accounts, preferably in accepted currencies. Pursuant to international agreements related to the IMF, those people with bank accounts abroad are deemed non-resident. In many of these instances, the relationship between the bank and the client is based on no more than the first, hopefully personal, contact at the time of opening the account, and some administration kept in the client file. This is sufficient to satisfy the legal requirement to identify the client, but offers very little in terms of the know-your-client principle.

By introducing a geographical split between people and their financial transactions, the clients make it more difficult for the bank to form an opinion about the background of these transactions based on other, usually scant information. Thus, the overall picture of the nature and scale of the personal or commercial activities and the income and financial position of the client is fragmented across the different financial institutions to such an extent that each institution is presented with only a small fraction. As a result, the bank will only be able to make a marginal, if not totally inadequate, assessment of the subsequent international funds transfers via the client's bank accounts.

In these cases, consideration should be given to the situation that the client uses the accounts for reasons different from those initially stated to the account manager, or allows other people to use the account without informing the bank. And, with the existing facilities in the field of electronic banking, the latter is not inconceivable.

Furthermore, it is usually difficult for correspondent banks to scrutinise the international funds transfers between non-residents. In these instances, there is no direct transfer between the sender and beneficiary; the client's individual transactions disappear into the extensive and obscure NR circuits between banks and their correspondent banks. The money flashes from one non-resident to another, whereby settlement with a client in the same resident country happens in a relatively small number of cases. For various reasons, it is impossible for the correspondent banks in question to gain proper insight into the nature and background of the individual transactions.

The most important reason for this impracticality is the total volume of the NR circuit: in the Netherlands alone, a total of NLG 12,500 billion a year is accounted for in favour of foreign countries. Considering the acceptance of the dollar in international funds transfers, the Dutch NR circuit will represent only a small fraction of the extensive NR circuit in dollars. Secondly, it is undesirable and unfeasible for a correspondent bank to independently obtain a picture of the background of all individual transactions of clients of different banks, since they only act as intermediaries in settling international banking transactions. A proper investigation is time consuming and, consequently, will lead to an increase in charges, which, in itself, will impede an efficient international funds transfer system. The primary responsibility for judging the integrity of the client lies with the bank where the foreign client has an NR account, but there is the rub!

The judicial interest

Part 1 of the article described the fact that many countries lack supervision of money flows in the NR circuits. In fact: there is even a lack of adequate figures. International money flows, in which the different countries operate as intermediary, are registered on the basis of the net method described in part 1. As a result, the competent domestic authorities have no insight into the nature and volume of the NR circuits in their respective countries and are, therefore, incapable of identifying problems and, if appropriate, introducing the necessary measures. This is also one of the most important causes that lead to the crises in countries in South America and Southeast Asia, and in Russia at the end of the nineties of the last century.

Many countries do have statutory requirements with respect to confirming the identity of the client and reporting unusual transactions to the police or administrative authorities. In accordance with statutory requirements, banks keep a considerable volume of information about their clients and their banking transactions, which investigating authorities can access. However, the fact remains that financial investigations in general, and seizure of criminal assets in particular, still do not receive the attention they deserve from police and justice departments. Let alone that, at international level, there is the legal and practical opportunity to respond properly and alertly to reports from banks of unusual transactions by non-residents. A detailed legal investigation into an unusual transfer of USD 1 million between the London NR account of a German residing in Belgium, to the Luxemburg NR account of a Spaniard residing in Canada, is frequently doomed to fail. Gathering the relevant police and banking information, and deciding the

legal question of competency, will frustrate the investigation to such an extent that, in the absence of a clear offence, the responsible court will refrain from the time-consuming aspect of drawing up and responding to international requests for legal assistance. Any request by a US investigation authority to the correspondent banks in question to submit underlying information is currently considered unfeasible for practical reasons; more so, if no direct US interest is involved. The HR3886 legislative proposal obligates financial institutions in the US to record and keep information of individual transactions (also if they form part of a combination of numerous individual transactions), and to make this available upon request to the Minister of Finances where laundering is suspected. This applies to cases where the bank accounts with these institutions:

– are used by non-residents or their representatives;
– are used for transferring money on behalf of foreign financial institutions;
– function as correspondent account for foreign financial institutions.

The information to be recorded should include the identity of the sender(s), the beneficiary(ies) and other involved party(ies), as well as the legal background and description of the transaction. However, the legislative proposal cannot impose such an obligation to supply information on foreign banks without an international treaty being agreed. Nevertheless, it is logical that US investigating authorities, partly on the basis of this legislation, will tackle alleged excesses, such as the money laundering activities of the Russian mafia at the Bank of New York and those of Raul Salinas at the Citibank. But given the experience that such extreme practices are not everyday occurrences, the energy with which these investigating authorities will pursue unusual financial transactions will depend on their commitment and capacity. Despite these different developments, in the long term, it is likely that individuals and companies with criminal intent will, as a matter of precaution, choose other currencies as tender instead of the dollar. As reported in the introduction in part 1 of this article, this makes the identification of the beneficial owner in many cases difficult, if not impossible. The real problem has not been resolved; it has merely been converted into a different currency. Considering the international, economic importance of Europe, it is not inconceivable that people with criminal intent will increasingly take refuge in the euro, the Swiss franc and the pound Sterling at a European bank. In the absence of adequate counter measures by the EU, the governments of Switzerland and the UK, and the financial sector, therefore, there will soon be a significant flow of transferable money with a criminal origin towards European banks and the aforementioned currencies. This will force the European countries to follow the US example and introduce similar legislation in an attempt to gain insight into the beneficial owners in the NR circuits. However, it will take years before European directives are translated into specific domestic legislation. Therefore, European financial institutions will have to introduce procedural and organisational measures in the short term to stem this undesired influx of criminal money.

The fiscal interest

For the purposes of this article, criminal money concerns money earned through punishable non-serious crimes, such as the trade in drugs, weapons, women, child pornography and nuclear waste. Legally earned money not declared for tax purposes does not fall within the scope of this article. An inherent problem in this distinction is the fact that criminal money follows in the wake of fiscal flight capital, which means that it

becomes virtually impossible, and undesirable, for financial institutions to make a distinction between them. For the time being, a number of countries insists on making this bizarre distinction, accepting the calculated risk that criminal money also continues to find its way in the domestic and international financial circuits under the name of undeclared taxable money.

Given the fact that it is the personal duty of taxpayers to fill in tax returns, it is considered unlikely that the tax authorities in the different countries will and can independently and actively form a broader picture of the tax liabilities of their own subjects in NR circuits. Last year, the European Union Heads of Government reached an agreement about the introduction of a withholding tax or a uniform system for information exchange. Depending on the national interests, both plans have supporters and opponents in the European Union, making it unlikely that the different parties will converge in the near future. It will certainly not be a solution to the current problems of the NR circuits, because Switzerland lies as a haven of peace in the epicentre of the restless European waters. In this context, we must also be aware that, whatever final agreement the Heads of Government reach, it is still relatively easy and safe to reroute to other tax havens at present.

The Wolfsberg Principles

Recently, in cooperation with Transparency International (TI), eleven private banks that operate internationally established a new standard with the introduction of the Global Anti-Money Laundering Guidelines for Private Banking, known as the Wolfsberg Principles. The guidelines are mainly focused on curbing money laundering within the market sector of private banking. Other market sectors in the financial world might need a different approach. In the light of this article, it would be interesting to assess the effectiveness of these guidelines.

The eleven banks involved want to protect the financial system from misuse for criminal purposes and, as such, aim to accept only those clients whose personal fortune and disposable financial means can be accounted for. This is, without doubt, a noble aim, which deserves all the praise and chances, and which should gain wide support within the financial world. As yet, however, experts from the financial world and law enforcement in many countries, including the US, have applied some scepticism and a sense of reality in their reception of the initiative. Sceptics consider the guidelines a ‘bad marketing stunt’ with the aim of calming remove international political anxiety about the issue of ‘money laundering’. In addition, the conflict between the commercial interest of the financial institutions on the one hand, and ethics and integrity on the other, is looming up. The guidelines imply real and far-reaching commitment for the banks involved so that they, in turn, are obliged to prevent these guidelines from becoming no more than dead letters. Within the framework of the new guidelines, the banks are required to adopt reasonable measures to establish the identity of the client and the beneficial owners. This is an implicit recognition by the banks that other people, as well as the known client, also use bank accounts. The banks’ duty of investigation thus goes further than the current practice in most countries where, pursuant to statutory requirements, such as the Financial Services Identification Act (Wif) in the Netherlands, it suffices to make and keep a copy of an identity document.

The bank is required to perform a due diligence investigation with respect to all

account holders in order to establish whether they are the beneficial owners of the accounts. In the case of natural persons, this means ascertaining whether the client acts for personal account and risk that, unfortunately, cannot be established at the time the account is opened. If there is any doubt, a more detailed investigation will be required. With respect to legal entities, banks will have to obtain – and maintain – insight into the company's proprietary and managerial relationships. If other service providers present new clients, the private bank also expects these service providers to carry out a due diligence investigation with respect to these clients. One-off clients and clients wishing to make use of electronic banking facilities require an even more meticulous due diligence investigation, because of the incidental or limited contact the account manager has with the client. In all the cases mentioned above, the client will have to supply information for the due diligence investigation, including details of the purpose and reasons for opening the bank account, the nature of the transactions that will take place via the bank account and the origin of the funds. The client will also have to provide the names of reliable references in order to verify the information supplied.

The banks will have to initiate an intensive investigation into clients who are dignitaries or senior civil servants, or who come from countries with an increased risk. An increased risk means clients who reside or who are based in countries '*(...) identified by credible sources as having inadequate anti-money-laundering standards or representing high risks and corruption*'. These countries run the risk of being internationally excluded from participating in the international funds transfer if they fail to take adequate measures.

Initiatives by the OECD
The Organisation for Economic Co-operation and Development (OECD) has introduced various initiatives to prevent tax evasion. The OECD initiatives are aimed at harmonising national tax systems, in which the first priority is examining the taxation principles. At present, these principles are so different to the extent that the current practices of the various countries form a threat to the allocation of capital and services, and the integrity of the tax systems. At international level, therefore, the OECD initiatives in the context of the identification and elimination of harmful tax practices contribute more to finding a proper solution, instead of combating undesired symptoms.

Transparency international (TI)
TI is a non-governmental organisation that aims for the improvement of responsible government action, and which takes on domestic and international corruption. TI publishes an annual summary of countries, listed according to the level of corruption found in the countries identified.

The Wolfsburg principles
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In addition, the risks associated with legal entities established in offshore jurisdictions must also be covered by means of due diligence procedures. To conclude the acceptance process, in addition to the account manager immediately involved, a second official should approve the acceptance of the new client or the opening of the new account. To ensure that the client does not implement material changes after the account

has been opened, the private banks in question have committed themselves to ensuring regular updates of the client files. The financial institution will have to assess the client's integrity on a regular basis, which could create a real problem in the case of non-residents.

The bank is also responsible for producing a written policy, on the basis of which unusual or suspicious transactions are identified and dealt with. This policy also has to include a definition of the concepts 'unusual' and 'suspicious', including an example of each. The factual establishment of whether transactions are unusual or suspicious can performed by assessing the client's transactions, or as a result of contacts with the client, the political situation in the client's country or on the basis of third-party information, for example, the press. Pursuant to the statutory regulations, the bank has to inform the competent authorities of its suspicion and, if required, provide information to clarify it. As a consequence of the formulated policy, the bank has to set up an adequate system for monitoring client transactions, as well as for supervising compliance with specified procedures. The bank management will also be regularly required to account for its policy on money laundering. This may include aspects such as the number of reported unusual or suspicious transactions, measures taken to monitor the financial transactions of clients, and the design and implementation of training courses for staff to enable them to properly carry out the specified activities. Finally, the bank has to set up an independent and expert internal or external unit (a so-called *anti-money-laundering organisation*) that will be responsible for supervising the bank's compliance with the imposed obligations to combat money laundering.

Effectiveness of the Wolfsberg Principles

In recent years, supervisory bodies in a number of countries, led by the US and the UK, have launched various in-depth reviews into the adequacy of and compliance with internal procedures set up by financial institutions. They had well-founded grounds to suspect that the financial institutions were being misused for illegal activities, including the laundering of criminal money. For example, banks were being misused, among other things, for diverting funds embezzled by senior bank officials, or officials had refrained from carrying out a due diligence investigation into the background of their clients and the origin of their assets. In most cases, the financial institutions in question were forced to introduce adequate measures to avoid repetition, or the responsible officials were dismissed or even prosecuted, and the operations of banking subsidiaries in the countries in question were discontinued. In the coming years, the vigilance of the supervisory bodies and public opinion will result in sufficient pressure to enforce proper attention to this issue. Given the nature and complexity of the problem under discussion, it would be an illusion to think that it would be possible to achieve awareness and a critical eye for money-laundering transactions in the financial institutions without investment in the own organisation and without cooperation with other parties involved, e.g. law enforcement agencies. Likewise, police, justice and tax authorities cannot continue doing nothing and looking on from the sideline, passively waiting to see which unusual transactions the financial institutions will present on a platter; they will have to get their priorities right and recognise financial investigation as a fully-fledged function and task. The new normative framework for financial institutions, laid down in the Wolfsberg Principles, demands that permanent attention be paid to clients in general, and non-residents in

particular. The lack or relaxation of this attention can, unfortunately, have far-reaching consequences, as demonstrated by various infamous incidents in New York and London. As a result of the fact that the 'know-your-client' principle has to apply in full force and to all clients, there will be more pressure in the future on foreign account holders to supply additional information about his/her income and financial position, as well as the nature and origin of his/her financial assets. Financial institutions will also have to initiate independent investigative efforts in order to obtain a better picture of the client or to verify information supplied by the client. In view of the developments in the US and other countries to remind financial institutions of their responsibilities to comply with statutory regulations in this field, it is not inconceivable that the Wolfsberg Principles will have effect in the long term.

Finally

When reading the US legislative proposal and the various reports of prominent international organisations, the question arises of whether the introduction of legislative proposal HR3886 can make a substantial contribution to the identification of the beneficial owner in cases of obscure financial transactions. Unfortunately, for the time being, the answer to this must be negative if all the practical and legal problems surrounding the NR circuits are also taken into account. The opportunities to take refuge in other currencies and the lack of similar legislation in other Western countries are partly to blame for this. Should the US investigating authorities see themselves obliged to tackle unusual dollar transactions, in which US banks operate as correspondent bank, it could have far-reaching consequences in the long term for the set-up of the international funds transfer system, the routing of payment traffic between international banks and the role of the dollar as international tender in this context.

As a new normative framework for private banks, the introduction of the Wolfsberg Principles can only then function properly and uniquely as a dam to stem the tide of money laundering, provided financial institutions and other parties involved are prepared to invest in this dam. Otherwise, in the event of a dike break and floods in the future, supervisory bodies and the public will come and survey the damage, call the dike supervisors responsible to account for negligence, and demand stricter compliance with the rules.

Noten

1. De schrijver bedankt Jelle Herrema en Ed Lute voor hun ondersteuning bij de totstandkoming van dit tweeluik.
2. De posities van personen als Sani Abacha, de voormalig Nigeriaanse dictator, Raul Salinas, de broer van de Mexicaanse president, Pavel Borodin, de naaste medewerker van de voormalige Russische president Jeltsin, voormalig Filippijnse president Marcos en de voormalig militaire machthebber Noriega in Nicaragua, spreken voor zich.
3. De twee artikelen over client due diligence in het januari/ februari nummer van DNB magazine spreken in dit kader voor zich.
4. In het rapport 'Recovering the proceeds of crime' van juni 2000 en opgesteld door de Performance and Innovation Unit van de Britse regering wordt erkend dat financieel rechercheren en het ontnemen van crimineel vermogen nog onvoldoende tot hun recht zijn gekomen. In het rapport worden de voornemens van de Britse regering beschreven om te investeren in opleiding, wetgeving en capaciteit.
5. De transactie kan in juridisch en onderzoekstechnisch opzicht nog complexer worden als de natuurlijke personen worden vervangen door buitenlandse rechtspersonen, waarbij het bestuur van de vennootschappen door een trustmaatschappij of een advocaat wordt uitgeoefend.

6. Deze situatie doet zich pas voor als het Meldpunt over voldoende feiten blijkt te beschikken om een vermoeden van een strafbaar feit te rechtvaardigen.
7. De analyse- en opslagcapaciteit van de computers van het Amerikaanse FINCEN dreigt al onder het huidige aanbod van Currency Monetairy Instrument Reports (CMIRs), Currency Transaction Reports (CTRs) en Suspicious Activity Reports (SARs) ten onder te gaan.
8. De Abache affaire in Groot-Brittannië alsmede de persberichten rondom de betrokkenheid van enkele grote Duitse banken bij het witwassen van criminele gelden van de Russische maffia zijn hiervan de eerste voortekenen.
9. Een Franse parlementaire commissie die het witwassen van zwart geld onderzoekt, heeft Zwitserland er onlangs nog van beschuldigd, dat door 'een gebrek aan politieke wil, die ons voorkomt als kwade trouw, (…) criminelen uit de hele wereld' hun kapitaal daar onderbrengen.
10. Transparancy International is een niet-gouvermentele organisatie die verbetering van verantwoord overheidsoptreden nastreeft en de strijd aanbindt met (inter)nationale corruptie (zie ook kader).
11. In het rapport Suspicious banking activities van de General Accounting Office, het onderzoeksbureau van het Amerikaanse Congres, wordt vastgesteld dat buitenlanders vrij gemakkelijk hun geld door tussenkomst van Amerikaanse banken kunnen witwassen door gebruik te maken van Amerikaanse vennootschappen en de identiteit van de beneficial owner te verhullen achter offshore vennootschappen.
12. De Amerikaanse banken zijn ingevolge The guidance on enhanced scrunity for transactions that may involve the proceeds of foreign official corruption al verplicht voorzichtigheid te betrachten bij de acceptatie van gelden van buitenlandse hoogwaardigheidsbeklеders en hun naasten.
13. De Wet identificatie bij financiële transacties is ingevoerd op 1 februari 1994 en recentelijk op 22 november 2000 aangepast.
14. Deze specifieke bepaling is ook van toepassing op vennootschappen met aandelen aan toonder, tenzij het een beursgenoteerde vennootschap betreft.
15. Deze bepaling is met name ingegeven door de goedgevulde bankrekeningen van vooraanstaande (corrupte) staatshoofden of hun naaste medewerkers, zoals Sani Abacha, de voormalige Nigeriaanse dictator, en Raul Salinas, de broer van de Mexicaanse president, die in westerse landen zijn aangetroffen.
16. In de eerste plaats kan hierbij gedacht worden aan de landen die voorkomen op de name-and-shame lists van de FATF en OECD. Ook de landen die in de lagere regionen van de lijst van Transparancy International voorkomen, zullen onder deze bepaling vallen. In deze laatstgenoemde landen is corruptie in toenemende mate gebruikelijk en geaccepteerd.
17.

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