Money Laundering – Problems and Challenges for Banks

ÅSA ARFFMAN*

The Stockholm Centre for Commercial Law held a conference on Money Laundering in December 2010. As an employee of the Swedish Bankers' Association, I was asked to elaborate on the problems and challenges faced by banks when implementing the anti-money laundering regulations. This paper is a brief summary of my perspective on some of the problems and challenges the anti-money laundering regulations have presented or may present for the banking industry.

What is the purpose of the anti-money laundering regulations?

Pursuant to the European Parliament and Council directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, Member States must ensure that money laundering and terrorist financing are prohibited. The objectives of the directive have been implemented in the Swedish Money Laundering and Terrorist Financing (Prevention) Act (from now on the Act) by the words "The purpose of this Act is to prevent financial activity and other commercial activity from being used for money laundering or terrorist financing".

The Swedish Act applies to certain listed businesses and companies. The Act designates the Financial Intelligence Unit (FIU) as the recipient of reports on suspicious transactions. In addition, the Act designates the Swedish Financial Supervisory Authority (*Finansinspektionen*) as one of the supervisory authorities that must ensure that the banking industry fulfils the requirements of the Act.

* Senior Legal Adviser, Swedish Bankers' Association.

One could say that the Act has given the industry the task of fulfilling the purpose of the law and, for that matter, the directive. The industry must consequently prevent financial activity and other commercial activity from being used for money laundering or terrorist financing. This task includes crime prevention and, one could say, that the industry, to some extent, has become an extension of the governmental authorities.

This is a huge task to perform. I believe it is of great importance that lawmakers, governmental authorities and the industry maintain an open and close dialogue and that they cooperate to some degree in order to achieve this purpose.

Other obligations for the banking industry to consider

In addition to the Anti-Money Laundering Directive, the industry must consider the EU regulations on measures against certain listed natural and legal persons, entities and bodies.

The requirements imposed by the Anti-Money Laundering Directive and the EU regulations are not the same. The directive is founded on a risk-based approach, while the EU regulations are strictly regulatory. The directive and EU regulations are to be applied to all customers. This could create some confusion as the directive has a risk-based approach, but not the regulation, while the purpose for both is the same, i.e. to prevent the system from being used for money laundering, terrorist financing, etc. For banks engaged in cross-border activities, different interpretations of the directive and of the regulations in the different Member States are causing problems.

With respect to the EU regulation on measures against Iran, the industry must also consider the US sanctions. Under US law, a foreign financial institution may be subject to US sanctions for facilitating significant transactions, or offering significant financial services, to the banks and entities listed in the US statute. This could even apply to transactions carried out and required under contracts entered into force prior to the enactment of the US law.

In order to achieve the purpose of the regulations, it would have been very helpful if the Commission had provided some guidelines as to how to interpret the EU regulations and how to act in light of the US law. The absence of guidelines creates considerable uncertainty about how banks must act.

Day-to-day business

In regard to day-to-day activities, the Act creates a number of questions concerning how to act.

"Know your customer" is one difficult area. First of all, a bank must inform its customer as to why it must ask the customer certain questions, of which some could be perceived as intrusive.

In Sweden, the Banking Association has, in cooperation with *Finansinspektionen*, published an information sheet for customers on why banks must ask these questions. The information is available for customers at our member banks and on our website.

Although the information can be found there, the association and banks frequently receive telephone calls from upset customers who feel offended. The conclusion must be that there has not been enough information disseminated to the public about the new Act and the effects it has on individuals. More could certainly have been done.

The "Know your customer" requirement also means that banks must identify the beneficial owner. According to *Finansinspektionen's* regulations, a beneficial owner of legal entities is: i) a natural person who owns, directly or indirectly, 25 per cent of the entity, and ii) a natural person that exercises a decisive influence over the entity. Since there are no public registers of beneficial owners, a bank normally must rely on information from the customer. This creates uncertainty as to whether the information received is reliable and sufficient and in accordance with the Act. The authorities have not provided any guidelines on this issue and have not offered any advice in this regard to the industry.

With respect to EU regulations and beneficial owners, the regulations do not stipulate a target level. This could mean that a natural person who owns less than 25 per cent of an entity should be considered a beneficial owner. For example, if a natural person indirectly owns 10 % of an entity, should that owner be considered a beneficial owner, and consequently, does the bank have to freeze the account or transaction for the entire entity?

Payment services providers are another group within the "know your customer" context causing trouble for the banking industry. Under Swedish law, a payment services provider must have a license or a registration to conduct payment services. A license or registration requires, among other things, that the provider fulfil the requirements in the Act.

Even if the provider has a registration or license, a bank must conduct its own investigation to determine whether the provider complies with the requirements of the Anti-Money Laundering Act. As far as I know, banks are not entitled to rely on the authority's licensing examination or on-going supervision.

Within the group of payment services providers there is also a significant lack of knowledge about the EU regulations. Obviously, there has not been enough specific information given to the payment services provider sector. This means that banks must also conduct an investigation to determine compliance with EU regulations.

Further, in accordance with the transitional provisions of the Payment Services Act, a certain group of providers may conduct payment services without registration or a license until the end of April 2011. Those providers are not registered or otherwise listed by the authority. It is therefore up to the banks to review whether the provider fulfils the requirements of the transitional provisions. The industry receives no help from the authorities to handle these issues.

To end a business relationship

If the business of a provider is in line with the criteria in the Anti-Money Laundering Act, but the provider does not have a license or a registration, is a bank then able to end the business relationship with the provider even if the identification criteria are fulfilled?

In line with the Anti-Money Laundering Act, a bank cannot enter into a business relationship unless the bank is able to identify the customer. However, if the customer is identified but still does not have a registration or a license, the Anti-Money Laundering Act does not indicate how the bank may or can act.

Pursuant to the Swedish Deposit Insurance Act, a bank is required to receive deposits from everyone unless special reasons against doing this exist. For example, a provider, without a license or registration, is identified in accordance with the Anti-Money Laundering Act. There are no other obstacles other than the lack of license or registration. Could one maintain that this situation constitutes a special reason to end the business relationship? There is no guidance on this issue in the legal framework or from the authorities.

The risk-based approach

Under the *Finansinspektionen's* regulations, the concept of a risk-based approach means that a bank must take measures aimed at preventing it from being used for money laundering and terrorist financing.

The measures must be adapted to the risk that the operations will be used for money laundering and terrorist financing. A risk-based approach means that a bank must have appropriate risk-based procedures for handling various situations, and to be prepared for the risk identified. Further, a bank must be able to provide evidence to the authority showing that the scope of the bank's procedures is appropriate to the risk for money laundering. As a result, it is essential that banks have sufficient information to be able to make correct risk-based assessments.

When it comes to gathering information, the Anti-Money Laundering Act and, for example, the Personal Data Act, are not compatible. To be able to gather information on criminal acts, which could be essential for a bank's risk-assessment, a bank must get a specific decision from the Data Inspection Board. The same problem arises with respect to a bank's use of commercial databases containing information about suspected crimes. The bank must obtain a decision from the Data Inspection Board. Alternatively, the bank could ask the data provider to clean the information, but then the information will not be as useful for the risk assessment as it could be.

A bank's reports on suspicious transactions could be another way to collect necessary information for a risk assessment. When a bank detects a suspicious transaction, information regarding the transaction must be provided to the FIU without delay. The current regime does not, however, provide the bank with any feedback as to whether a report actually led to further action by the police.

Solutions to solve the problems

As I mentioned above, one could say that the banks have become an extension of governmental authorities in the sense that they have been tasked with preventing certain crimes, but without any real power. This is an odd situation, but perhaps a necessary one.

To fulfill the purpose – preventing money laundering and terrorist financing – I believe it is of great importance to have an open dialogue between the authorities and the industry and, to a certain extent, that they have

some kind of co-operation. This openness should be the basis of the dialogue with the EU Commission, the Swedish government, the FIU, *Finansinspektionen* and other competent authorities.

I also believe it is essential that sufficient resources and powers are given to the authorities, for example the FIU and *Finansinspektionen*, so they are able to provide guidelines and to expand their supervision of certain groups of providers, for example, payment service providers and other registered entities.

I also believe that certain tasks can be usefully transferred to agencies. For example, allowing the Swedish Companies Registration Office to register beneficial owners and making it mandatory for entities to report their beneficial owners to that authority. The Companies Registration Office could also review beneficial owners and board members against sanction lists.

These are only some of the problems and challenges that the banking sector faces. There are surely other challenges and probably solutions to those problems.