

Examining Anti-Bribery and Corruption Measures in a Single Framework to Combat Money Laundering and Terrorist Financing

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Corruption and money laundering are synergistic—not only do they tend to occur together, but also the presence of one tends to reinforce the other. The aim of this paper is to make a contribution to the existing audit framework by interrelating corruption and money laundering risks. This paper follows on recent regulatory developments to combat one type of financial crime that could be successfully employed in fighting the other. A more demanding regulatory landscape requires financial institutions to enhance existing controls and procedures of anti-money laundering (AML), anti-bribery and corruption programs. Understanding synergies between corruption and money laundering would enhance knowledge of each problem and would suggest a need for a continuous dialogue among audit teams covering financial crime compliance reviews. Ensuring holistic and consistent application of compliance with AML and ABC requirements is a challenging task facing internal audit function.

The U.S. government faced a similar challenge when the events of September 11, 2001 exposed serious flaws in national defense due to the failure of law enforcement agencies to share information. According to a U.S. Congressional report published in July, 2003, “The Sept. 11 attacks were preventable, but the plot went undetected because of communications lapses between the FBI and CIA, which failed to share intelligence related to two hijackers.” While they must remain separate agencies, the need for continuous dialogue between the FBI and the CIA to combat terrorism models the need for continuous dialogue between AML and ABC audit teams to combat financial crime.

Overview of Corruption and Money Laundering

In 2006, a number of international organizations including the World Bank and IMF agreed on a definition of corruption as “the offering, giving, receiving, soliciting directly or indirectly anything of value to influence improperly the actions of another party.” Offering and soliciting bribes is considered corruption. Even if the advances are rejected and no exchange takes place, the intention is what matters. There is a long history in every society demonstrating that if there is delegated power, this power may be abused for personal gain. National efforts to stop corruption have a long history as well. However, international efforts and campaigns against corruption became more prominent in recent years —led by

the U.S., the Organization for Economic Co-operation and Development (OECD), the World Bank and Transparency International. The United Nations Office on Drugs and Crime (UNODC) stated: “There are important links between corruption and money laundering. The ability to transfer and conceal funds is critical to the perpetrators of corruption, especially large-scale or ‘grand corruption.’ Money-laundering statutes can contribute significantly to the detection of corruption and related offences by providing the basis for financial investigations. It is therefore essential to establish corruption as the predicate offence for money laundering.” In 2010 the Bribery Act was introduced to update and enhance U.K. law on bribery including foreign bribery in order to address the requirements of the 1997 OECD anti-bribery convention. It is now among the strictest legislation internationally on bribery. It introduces a new corporate criminal offence that places a burden of proof on companies to show they have adequate procedures in place to prevent bribery.

Money laundering refers to the process of obscuring the illicit origin of money derived from crime. Increased activities in global banking and finance have created more opportunities for obscuring the true source of money. As a result, international AML efforts were expanded significantly especially after creation of Financial Action Task Force (FATF) in 1990, which issued 40 Recommendations and Special Recommendations on Terrorism Financing. These recommendations set the international standard for AML measures to combat the financing of terrorism and terrorist acts. The BSA/AML Examination Manual, issued by the Federal Financial Institution Examination Counsel (FFIEC), not only provides guidance on identifying and controlling risks associated with money laundering and terrorist financing, but also considers a comprehensive approach by bringing corruption and bribery risks into the overall risk management framework.

Framework for Anti-Money Laundering and Anti –Bribery and Corruption Measures

Because of increased regulatory focus and expectations for AML and ABC programs, they essentially demonstrate some key similar components: policies and procedures, periodic risk assessments and monitoring of the key risks, due diligence of high risk

accounts/transactions/parties, corporate commitment, enhanced training, periodic monitoring and reporting (refer to Figure 1: AMB and ABC compliance program).



The implementation of AML measures is vulnerable to corruption in several ways:

- Corruption is among the most significant contributors to proceeds of crime that become available for laundering.
- Because of its connection to money laundering, corruption can prevent the adoption of effective measures against money laundering, and may succeed in doing so if not detected and checked.
- Corruption impedes the effective implementation of AML measures that have been adopted by interfering with the capacity of mandated institutions to perform their duties, or corrupting the relevant officials.
- Institutions on whose cooperation the prevailing AML systems increasingly rely can, if corrupted, sabotage the effective implementation of AML measures by falsifying information or concealing information from the mandated institutions as to the true nature of questionable corruption-related transactions.

- Corruption can take advantage of differences in levels of implementation of AML measures in different countries to frustrate transnational co-operation to investigate money laundering.

U.S. Federal Sentencing Guidelines require the financial institution shall take reasonable steps:

- To ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct; and
- To evaluate periodically the effectiveness of the organization's compliance and ethics program.

The organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify program requirements to reduce the risk of criminal conduct identified through this process.

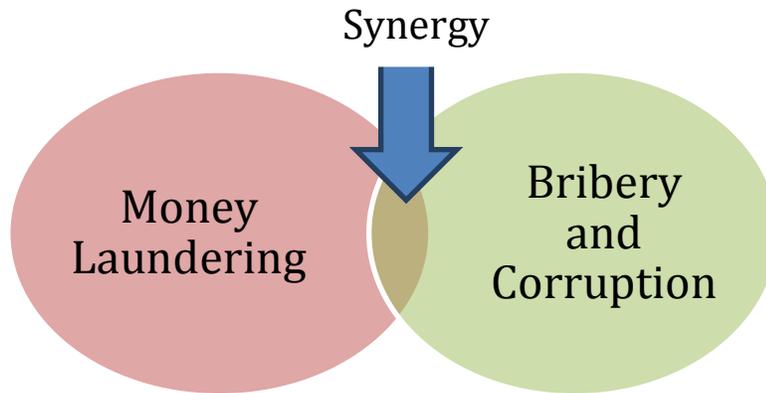
Synergies of Corruption and Money Laundering

The FATF is an intergovernmental body established in 1989 to set standards and promote measures to combat threats to the international financial system. Recognizing the interrelationship between corruption and money laundering, the FATF published "Specific Risk Factors in the Laundering of Proceeds of Corruption" in 2011. The report was written to assist financial institutions in analysis and understanding of specific risks. The FATF provided the following specific examples and typologies for heightened risk areas and methods used to launder corrupt money: use of corporate vehicle/trust, use of foreign offshore jurisdictions, identification and monitoring of politically exposed persons, etc. It is essential to examine some cases that provide strong evidence that corruption and money laundering will often occur together and reinforce each other. The case of Ferdinand Marcos, a former Philippines president, who used his position to become one of the world's biggest thieves, demonstrates a variety of forms of corruption, as well as various money laundering methods used to hide corrupt proceeds. Marcos and his family benefited from a slew of corruption activities including diversion of foreign economic and military aid, embezzlement, theft of official gold stocks, institutionalized and private sector extortions,

and kickbacks from private businesses. The method of receiving corrupt benefits relied on deception; the method of the laundering of illicit proceeds relied on secrecy. The placement of illicit proceeds into the banking system was done by smuggling funds out of the country, the layering of funds was carried out by intermediaries (lawyers and fiduciaries), and the integration of proceeds ensured that Marcos could protect and profit his ill-gotten gain through hidden investments. Both Marcos and his wife were high-risk senior public officials; however, they were allowed to open accounts in Switzerland and other countries without any consideration of the source of funds. The financial advisors of Marcos were able to find new ways of hiding his illicit wealth through a network of foreign corporate vehicles, foundations and private companies. In the 2004 Global Transparency Report, Marcos appeared in the list of the World's Most Corrupt Leaders having amassed between \$5 billion to \$10 billion in his 21 years as president of the Philippines.

Another example that illustrates conspiracy to launder the proceeds of extortions, bribery and fraud through various U.S. bank accounts is the case of Pavlo Lazarenko, former prime minister of Ukraine. Lazarenko was convicted of skimming and diverting \$72 million from Ukrainian government contracts, depositing the illicit money into Swiss banks, and then transferring most funds to accounts in Antigua and the Bahamas. He was also charged in the U.S. for money laundering and embezzlement of \$114 million by using his political status to extort money and then launder it through California banks.

The following diagram demonstrates commonalities between money laundering and corruption risks. As previously noted, there is a direct linkage between these two crimes. There are potential synergies, but also limitations in applying anti-corruption audit programs and techniques to the AML program assessment. This paper focuses on the commonalities of money laundering and corruption risks in light of heightened regulatory expectations globally.



Present Day–Corruption and Money Laundering

Since their emergence in the early 1990s, and especially in the past decade, non-prosecution agreements (NPAs) and deferred prosecution agreements (DPAs) (collectively, agreements) have become embedded in the toolbox of U.S. federal prosecutors to address allegations of corporate misconduct. Table 1 below shows the 2013 agreements broken down by the primary legal allegations they resolved.

Primary Legal Allegation	Number
Bank Secrecy Act	1
Conflict of Interest	1
Foreign Corrupt Practices Act	8
Public Corruption (domestic)	1

A survey by Deloitte also indicated elevated levels of AB&C risk. In their 2010 due diligence survey, 63percent of respondents indicated they had abandoned or renegotiated a deal after finding evidence of AB&C issues during the diligence process. U.S. Financial Industry Regulatory Authority (FINRA) Regulatory Notice 11-12 (March 2011) reminded FINRA-regulated firms of their obligations under the [FCPA]. FINRA recommended that firms review their business practices to ensure that they are complying with all of their

obligations under the FCPA. It is therefore safe to say that increased FINRA oversight of FCPA/AB&C topics is now a reality. It is clear that the environment for anti-corruption enforcement is highly risky for banks and increasing in multiple jurisdictions. Practices which might once not have triggered investigation and prosecution, such as provision of recreational opportunities within business travel to clients, have been the subject of major actions. Authorities have signaled that exemplary punishments may be pursued as warnings to industry. In addition, industry experts agree that effective implementation of FATF recommendations would help fight both money laundering and corruption. However, AML/CFT and anti-corruption efforts are not always brought together effectively. The G20 Leaders' Declaration from the St. Petersburg Summit highlights that leveraging AML/CFT measures to fight corruption will remain a significant area of growing cooperation between the G20 anti-corruption experts and the FATF.

Audit of AML and ABC Compliance Programs

It is evident by recent regulatory focus, international cooperation of regulatory agencies, and increased regulatory scrutiny that AML and corruption risks should be managed and assessed holistically. As a result, the audit approach of independent assessment of these risks should be conducted on a convergent basis.

It is a regulatory requirement that AML and anti-corruption compliance programs have to be independently assessed and tested. Audit of AML and ABC compliance programs have to include all elements starting with risk assessment and extending through policies and procedures, appointment of the designated compliance officers, ongoing monitoring, due diligence, training, and reporting. The AML risk assessment has already been embedded and remains in place in financial institutions. However, the AML risk assessment could be broadened by incorporating bribery and corruption risks specific to the institution. Audit has to assess effectiveness of its risk assessment approach by analyzing data used for assessment—taking into account FCPA/U.K. Bribery Act recommendations, issues and trends. The AML/ABC risk assessment framework should be comprehensive to include key risk factors such as increasing regulatory focus on corruption matters and money laundering matters. The framework should also take into account the attractiveness of

certain banking products, especially in investment banking, to public sector customers, and the many countries having a high perceived corruption risk in which the bank has a branch presence or does business. For example, the product set in investment banking could be attractive to private sector customers, particularly with respect to high-risk scenarios involving traders influencing clients to increase trade volume. In Asia (e.g., China), there are frequent dealings between mixed public-private institutional clients (hybrid of socialist-capitalist economies), which should be rated as heightened risk. Investment banking advices on privatizations, could underwrite government bond issues and securities for state-owned firms. Consultants may be used to assist in deal “pitches,” which could raise third-party vendor risk. In addition to bidding for the business against other banks, investment banking transactions often involve a “roadshow” to help sell the securities. Even though such sales practices are generally acceptable, they could lead to cases of non-compliance with the Bank’s Travel and Entertainment policy. Therefore, these events must be closely monitored and risk ranked high. Additional special factors include the bank presence on the ground in many challenging geographies and the need to engage third parties to assist in business transactions around the globe. Audit should apply a holistic view while assessing the bank’s risk assessment framework to ensure that various types of risks are being considered and sought (e.g., sectorial risk). Even though financial services pose low sectorial risk when compared to those military, engineering and natural resources industries, which contributed to many of the historic anti-bribery prosecutions, a major financial services firm seems to share many of the objective risk factors of those industries. There is growing evidence of increasing issues involving financial services firms. As a result, banks’ sectorial risk could be rated as high and increasing. Individual product or transaction risks vary from low to high and it is not particularly useful to reduce these to an overall aggregate value. If pushed to do so, a medium product or transaction overall rating would seem appropriate. Business opportunity risk must be determined project by project and cannot meaningfully be rated from an overall perspective. Special activity risk, inclusive of business partnership risk and franchise management risk should be measured based on a bank’s global presence. Audit has consistently identified anti-bribery and corruption as a key emerging risk facing the bank. The anti-bribery and corruption risk

assessment should complement the bank's AML assessment and from the audit perspective, these risks should be managed and assessed in their totality.

Another element of an effective AML and ABC program is the appointment of the person responsible for compliance. Audit function is to ensure credentials, experience, seniority; and access to the senior management is adequate. In large financial institutions, the responsibility for assessment and managing of AML and ABC risks are assigned to different individuals or to a group of individuals reporting ultimately to the Board. The USA PATRIOT Act requires designating an AML compliance officer, as does the U.K. Bribery Act. Therefore, it is essential for audit to evaluate the effectiveness of communication means established between these responsible parties to ensure that the bank had a complete view of the extent of its bribery, corruption and money laundering risks. There should be an assessment of how to efficiently perform overlapping functions, coordinating and partnering in efforts to manage AML and ABC risks.

Audit testing should include review of management information to the board and senior management forums to ensure reporting is regular, substantive and inclusive of ABC and AML risks faced by the business, systems and controls to mitigate those risks.

Monitoring of policies and procedures is another regulatory requirement for AML and ABC programs. A mechanism has to be in place for gathering and analyzing feedback from business units about the implementation of policies and procedures and breaches. Periodic independent testing by first, second, and third lines of defense should be conducted to assess the effectiveness of existing controls and processes.

In order to perform their duties effectively, all employees have to complete periodic training on AML and ABC risks. The important factor for audit is to assess whether the training program is comprehensive, supported by typologies, case studies, red flags and tailored to perform specific functions. Understanding by staff of the regulatory requirements, policies and procedures and how to deal with real-life scenarios has to be measured; therefore, testing has to be implemented after completion of training.

So far, this discussion focuses on examination of potential synergies between AML and ABC elements of compliance programs. The next discussion will be devoted to exploring practical steps to demonstrate how integrated risk management could benefit AML and ABC audits. Let us first explore why senior public officials should be managed as part of AML and the obligations and vulnerabilities of institutions to politically exposed persons (PEPs). The FATF Typologies Report provides case studies demonstrating the linkage between corruption and money laundering. These studies show that the “techniques employed by PEPs to launder illegal proceeds are very similar to those of other criminal money launderers. PEPs may use distinctive banking arrangements to assist them in creating a complex or sophisticated network of transactions to protect illicit assets they may have generated. ” Even though there is no consistent definition of a senior public official, there are common elements in the definition of PEPs. For example, the FATF definition of PEPs states that it is not “intended to cover middle ranking or more junior individuals.” Under the Bribery Act a “foreign public official” is defined more narrowly than under the FCPA but still includes: (i) anyone who holds a foreign legislative or judicial position; (ii) individuals who exercise a public function for a foreign country, territory, public agency or public enterprise; or (iii) any official or agent of a public organization. FATF Recommendation 6 stipulates the following main requirements relating to senior public officials:

- Application of appropriate risk-based procedures in identification if the customer is a senior public figure
- Taking reasonable measures to establish the source of wealth and source of funds for business relationships and transactions
- Obtaining senior management approval for establishing relationships with senior public figures
- Conducting enhanced ongoing monitoring of business relationship and transaction

Audit should be able to conclude, given an adequately applied risk-based approach from AML perspective if in identification of PEPs all relevant information is taken into account (e.g., identification of beneficial ownership of the company and other legal entities). Also, a number of factors such as types of service, products, geography, sources of funds and level

of financial activity should be considered in evaluating overall PEP risk. A central internal database of all PEPs has to be in place or at a minimum PEPs should be flagged in product processors. Then PEPs lists could be used by ABC auditors to run against payment systems, procurement systems, and linkage to vendors and intermediaries, for review of details of product offering, and for any preferential treatments or kickbacks. If the PEP was not properly identified during the account opening or the status was changed over time, audit should focus on the established regular reviews of customer databases which could potentially uncover new PEPs. As a result, identification and monitoring of PEPs as part of AML program could be included in the framework for anti-corruption compliance programs audit coverage.

Another element of convergence of AML and ABC risks is correspondent banking relationships. Per 2011 FSA report on Bank's Management of High Money-Laundering Risk Situations "correspondents often have no direct relationship with the underlying parties to a transaction and are therefore not in a position to verify their identities. They often have limited information regarding the nature or purpose of the underlying transactions, specifically when processing electronic payments or clearing checks." As a result, "correspondent banking is primarily non-face-to-face business and must be regarded as high risk from a money laundering, terrorist financing and corruption perspective." Internal audit has to ensure that all correspondent banking relationships are rated as high risk and EDD is performed for all entities. The risk assessment of correspondent relationships should be independently evaluated to ensure that "each respondent was allocated a risk score, determined by an overall assessment of six risk factors: country; ownership/management structure; products/operations; transaction volume; market segment; and the quality of its AML program." In addition, material adverse information known about the respondent should be taken into account. The clients' risk score essentially will drive the frequency of reviews. Regular assessments of correspondent banking risks taking into account various money laundering and corruption risk factors such as the country risk, management structure, possible political connection, transactions volume, adverse information, etc., should be a key focus of audit coverage.

Another potential benefit of holistic audit coverage of AML and ABC risks is around suspicious transactions monitoring and reporting. The AML audit focus is on review of high-risk accounts, including PEPs, to ensure that they are being monitored against the anticipated activity in their profile, evaluating the appropriateness and effectiveness of the criteria, rules and thresholds ("optimization"), adequacy of alerts investigation and reporting. The transaction monitoring systems can be enhanced by adding red flags associated with bribery and corruption risks. Also, adding new data and new scenarios of concern (from gifts, meals, entertainment, payable and general ledger systems). This could be an opportunity for the audit function to provide some value improvement suggestions and consultation to management. With respect to investigation of transactions monitoring alerts and review of suspicious transaction reports, they have to ensure that there is open and transparent communication between anti-corruption and AML investigative cases, that quality of SARs are in line with regulatory requirements and have enough details to help FIUs in identification and investigation potential AML and ABC cases.

In the end, the importance of compliance culture cannot be overlooked. Clarity of AML and ABC policies and procedures, zero tolerance to facilitation payments, tone on the top, well defined and documented risk appetite and code of conduct are all essential elements that should be assessed independently by the audit function. The financial institution risk appetite, which includes the compliance risk appetite, has to be approved by the board of directors. Risk appetite statements should cover all risks including AML and ABC across the business lines and functions. They should not only consider limits and risk weighted assets; they also need to consider the types of customers, products and geographies the institution is comfortable servicing. Finally, they should consider controls that are needed to effectively manage the risk. Specifically, clarity is required as to whether the financial institution operates outside its appetite because controls set forth in program policies and procedures are not fully implemented or complied with, or if the control design is not actually commensurate with the inherent risk. For example, if the financial institution continues to engage in high-risk operations such as politically exposed public figures and foreign correspondent banking, high-risk geographies, and products and services subject to varying laws and regulations, the audit function needs to be more effective in providing

independent assessment in identifying, monitoring, measuring and controlling the associated risks of these businesses.

Financial crime is a heightened issue for corporate directors and C-suite executives of financial services corporations as the risks they face of actual bribery and AML continue to accelerate. These risks are driven by tightening regulation, growing demands by customers for integrity in an institution's financial dealings and increasing criminal sophistication. In addition to regulatory enforcement and criminal prosecutions, global cooperation amongst enforcement agencies and regulators has never been greater, increasing the scrutiny that corporate officers and directors are under. The financial penalties faced by our corporate clients through financial crime losses, the conduct of internal investigations, fines, class action lawsuits, and other litigation are climbing.

Unfortunately, many large corporations do not completely understand the new challenges this environment poses to their organizations. Therefore, their systems to prevent and respond to incidents of financial crime may not be adequate in today's new world of criminal and technological sophistication. As a result, the role of internal audit is also changing and requires more active engagement in the design, implementation, and oversight of financial crime programs and controls, including:

- Assist in the development of anti-corruption and AML controls
- Detect and deter corruption and money laundering
- Proactive auditing to search for corruption, misappropriation of assets and financial statement fraud
- Evaluate effectiveness of anti-corruption controls and communicate deficiencies and weaknesses to management and audit committee

A holistic and centralized view of the control environment, consistent application of compliance framework to include AML and ABC, the leveraging of technology, and following up on past deficiencies are new ways of bringing the internal audit function up to date with regulatory expectations and will help organizations manage risk.

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