Zamani Abdul Ghani: Strengthening governance to derive value

Keynote address by Dato' Zamani Abdul Ghani, Deputy Governor of the Central Bank of Malaysia, at the International Financial Crime and Terrorism Financing Conference 2010, Kuala Lumpur, 19 July 2010.

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It is my great pleasure to welcome all of you to this Second Annual International Conference on Financial Crime and Terrorism Financing. There has been an overwhelming response this year where participation, including international participation, has significantly increased from last year. I believe that this stems from the success of the first conference. There is also no doubt of increasing interest of the financial industry in preserving the integrity of the financial system, particularly from the threats of financial crime and terrorism financing. Let me begin by congratulating Malaysia's Compliance Officers Networking Group (or the CONG Group) for successfully organising this conference. The CONG Group has worked tirelessly in collaboration with the Institute of Bankers Malaysia, the Securities Industry Development Corporation, the Malaysian Insurance Institute and the Asian Institute of Finance. In the preparatory discussions with members of the CONG Group, I personally witnessed the dedication, hard work and commitment shown by the Group in bringing out the best of the industry through this Conference. Needless to say, we in Bank Negara Malaysia or the Central Bank of Malaysia, has given our specific support to this Conference. I also wish to register our special welcome to all participants and for the 60 international participants from 14 countries, including our special guest from CAMLMAC, i.e., the Financial Intelligence Unit of the People's Republic of China.

The presence of renowned experts amongst us today from domestic and international institutions in this Conference is testimony to the fact that the areas that we will be discussing during the next two days are not only domestic issues, but universal ones as well. These issues are indeed global issues faced by financial institutions worldwide. On this note, I wish to thank the speakers and moderators who have made their way to Kuala Lumpur, many of whom are from half-way around the world. It is indeed an honour for us to have all of you here to speak at this Conference.

The theme for the conference, i.e., "Strengthening Governance to Derive Value" is significantly relevant and timely. The increasing sophistication and the broadening of the reach and network of money laundering and terrorism financing (or ML/TF) globally have elevated the ML/TF threat to the next level. This calls for greater strategic action, more intensified efforts, and better coordination among key stakeholders, both domestically and internationally, to address this concern. Strong governance among the stakeholders, however, remains the key and integral component within the national AML/CFT framework, to prevent the escalation of ML/TF risks. More importantly, strong governance in financial institutions is and will remain a critical safeguard and is pertinent in the overall prevention of ML/TF activities. Striving to enhance the level of governance in this area will not only result in lowering the overall threat of ML/TF in Malaysia, but would also enable the financial institutions to derive greater value for themselves, and in the process, reduces the cost associated with the ML/TF prevention activities.

I will briefly share my thoughts today on this issue by covering three key items; firstly (a) the current emerging trends of ML/TF; secondly (b) policy and strategic response by the authorities in Malaysia on these emerging trends; and finally (c) our expectations on the financial institutions in response to these trends.

Emerging ML/TF trends

ML/TF is notable for the diversity of its forms, players, location and settings. While it is normally described in the sequential elements of placement, layering and integration, the real activities are very fluid. Recent global ML/TF trends indicate that the criminals, especially the professional launderers, will exploit every possible gap in the formal and informal financial system to launder the illegal proceeds. They are known to misuse the payment and fund transfer system, including wire transfer and remittance services, internet payments, mobile payment and stored value card, to channel the illegal proceeds within and across borders. The traditional laundering methods of cash smuggling, via casino, investment and insurance policies are increasingly being used together with other methods such as through the banking facilities to avoid detection. In March 2010, the Financial Action Task Force (or FATF) issued a report on Money Laundering Vulnerabilities of Free Trade Zones, indicating the rising threats of trade based money laundering. Apart from this report and the periodical typologies reports, the FATF has issued a number of reports relating to specific laundering methods; such as through securities, football and gaming sectors in 2009; vulnerabilities of internet payment system and commercial websites in 2008; and the real estate sector, VAT Carousel Fraud, and the misuse of corporate vehicles, such as trust and company service providers in the previous years.

For Malaysia, consistent with the global trend, the financial system continues to be one of the preferred modes of channelling proceeds of crime. In recent years, it is observed that there is a combination of three common methods. The first is the increasing use of repository accounts whereby immediate withdrawals are made once deposits have been received. The other two methods consist of fast movement of money across borders and involvement of third parties in laundering activities. While this is not peculiar to Malaysia, financial institutions are advised to ensure strong controls in place to deter and detect these activities.

An example of the modus operandi on the above involves the smuggling of dirty monies into Malaysia by the agents of a criminal ring. The agents will subsequently deposit cash into the accounts of various entities and individuals in the few bank branches operating at the border towns. The deposits remain in the accounts only for a limited period of time, where the runners or the agents will withdraw the cash to be further wire-transferred and/or smuggled to another neighbouring country, as instructed by the syndicates. Along with this example, it is also observed that transferring illicit fund overseas has evolved into another preferred laundering method. This is especially so for funds involving prominent personalities, and large value funds arising from illegal investment, illegal deposit taking and other fraudulent activities. All financial institutions are also urged to have adequate controls in place to manage the risks arising from these activities that could potentially affect their operation and reputation.

Another notable global AML/CFT trend is the growing emphasis on the result and effectiveness of the implementation of AML/CFT measures. Measuring effectiveness has been a component in the current assessment of national AML/CFT framework undertaken by the FATF, FATF-Style Regional Bodies (FSRBs) and multilateral agencies, including the IMF and the World Bank. In fact, in the recent FATF initiative to identify jurisdictions with significant ML/TF strategic deficiencies, much emphasis has been given as to how well the jurisdiction implemented the AML/CFT measures. This is ultimately measured by the overall result of the implementation. The result is used to measure the effectiveness of every component of AML/CFT measures covering the aspect of legal, preventive measures, financial intelligence and law enforcement, as well as domestic and international cooperation.

For this, it is important that we are well prepared for the next round of evaluation on Malaysia, which may be scheduled from the next year onward. From our past experience, a national AML/CFT assessment demands the joint efforts of all stakeholders, including the financial institutions. Participation, contribution and cooperation by all stakeholders are very critical in ensuring that the result of the assessment truly reflect our strong commitment in not only meeting the international standards, but also in achieving the desired result in combating ML/TF. Therefore, I wish also to call upon all stakeholders of our AML/CFT regime at every level to make due preparation for the coming assessment on Malaysia, while continuing our concerted efforts in preventing for the interest of the country, against ML/TF risks.

Shifting gear of AML/CFT implementation action

Let me now touch on the second area in terms of policy and strategic response of authorities. The Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (or AMLATFA) has been in operation for the past eight years with the basic foundation of the required framework, such as legal, regulatory and institutional infrastructures, already in place. In the 2007 Mutual Evaluation exercise, Malaysia is recognised as having good AML/CFT framework through good ratings obtained in many areas, comparable to those jurisdictions with excellent AML/CFT framework. We have addressed, since then, most of the recommendations set out in the Mutual Evaluation Report (or MER), including the only Non-Compliant rating in terms of SR IX by implementing the cross border cash transportation declaration system since January 2010.

Moving forward, considering the rising threat of cross border money laundering and greater emphasis on the effectiveness of the AML/CFT framework, a more strategic approach is undertaken. This is also undertaken as a tool to support the Malaysia's National Key Result Areas (NKRAs), particularly the first and the second NKRAs, i.e., initiatives to reduce crime and combat corruption. For this, Malaysia has formulated (in 2009) a 3-year National AML/CFT Strategic Plan 2010–2012 as a strategic tool to achieve the desired results of AML/CFT regime. The Strategic Plan includes a set of strategies to achieve specific Desired Outcomes in four key areas; focused implementation; enhancement of the legal framework; improvement of the institutional framework; and capacity building. The Plan covers not only the aspect of preventive measures for financial institutions and designated non-financial businesses and professions (DNFBPs), but also the aspects of legal, financial intelligence and law enforcement, as well as domestic and international cooperation.

As the Strategic Plan will be officially rolled out soon, Bank Negara Malaysia and the relevant agencies have started to implement the action plan in stages. The ML/TF investigation and prosecution have been intensified. To date, there have been 94 money laundering cases at various stages of prosecution, with more than 3000 charges involving proceeds amounting to RM1.2 billion. Law enforcement agencies have also stepped up capacity and efforts to curb laundering of illegal proceeds. Three main law enforcement agencies for the AMLATFA investigations, i.e., the Royal Malaysian Police, the Malaysian Anti-Corruption Commission and the Royal Customs Malaysia have established dedicated AML/CFT units to give focus to ML/TF investigations and expedite overall enforcement actions. Other related enforcement agencies have also geared up to achieve the same progress.

For Bank Negara Malaysia, we will remain vigilant on the level of compliance of the financial institutions with the AML/CFT rules and measures. Thematic examination will continue to be carried out on AML/CFT compliance of the financial institutions, and other reporting institutions, when the need arises.

Non-compliance incidences will be dealt with based on the seriousness of the issue. We will not compromise on serious matters, such as tipping-off, as those are the foundation of the AML/CFT framework. Apart from that, we are fully aware of the concern of not to cause the "overshooting" of AML/CFT implementation so as to affect the financial inclusion agenda. For this, Malaysia will be involved, under the umbrella of the APG and jointly with the FATF on initiative related to financial inclusion, in particular to look at best practices to ensure that implementation of the AML/CFT measures is not a barrier to financial inclusion. In Malaysia, the subject of financial inclusion is actually embedded in the National agenda and implemented with the full participation of the financial sector. A snapshot on the implementation result currently shows that 80% of the population has some form of savings account. In term of penetration of deposit and loan accounts, Malaysia is currently among the highest in the world with ratio of 3,300 deposit accounts per 1,000 adults and 1,100 loan accounts per 1,000 adults. Malaysia has also been championing the structured advance of Islamic finance around the world. Such a structured advance of Islamic finance is in fact part and parcel of financial inclusion. In this regard, we believe that Malaysia is able to support the work of the FATF and the APG on initiative related to financial inclusion through the sharing of our experience.

In addition, given that ML/TF activities often involve predicate offences under the purview of more than one enforcement agencies, there is an increase of collaborative initiative among the law enforcement agencies. This is manifested in the establishment of collaborative platform at management and working levels of relevant agencies. Again, these are aimed at coordinating collective actions at domestic and regional level against ML/TF and other related predicate crimes. Within the platform, several working level task forces have been set-up to facilitate joint investigations and enforcement actions.

Expectation on financial institutions to strengthen AML/CFT governance and capability

Let me now move to the third and final area for my remarks today, that is on our expectation on how financial institutions should respond to these developments. Given the significance of the new developments highlighted earlier, it is our expectation to see the Board of Directors and Senior Management of reporting institutions (RIs) to be the key drivers in AML/CFT initiatives. The Board and senior management are responsible to ensure that the financial institutions stand ready, in terms of controls and resources, to face the upcoming developments and challenges.

For this purpose, it is pertinent that, in implementing an AML/CFT internal programme, the board of directors and senior management ensure that it is in compliance with the AMLATFA and the related regulatory guidelines, in particular, the three important aspects of an AML/CFT internal programme.

The first aspect, i.e., customer due diligence or CDD, is the foundation to effectively prevent criminals from accessing the financial system. In today's internet environment and technologically savvy society, cross border transactions can be executed within seconds. It is for this speed in which transactions can be carried out that we need to be vigilant to ensure that the provisions of such excellent systems are not abused for illegitimate purposes. We just like to emphasize on ways to look out for false identity, complex structure with the intention to hide the true beneficial owner and the use of gatekeepers as proxies.

The second important element of the AML/CFT programme, is the submission of suspicious transactions reports or STRs and Cash Threshold Reports or CTRs to the Financial Intelligence Unit of Bank Negara Malaysia. Such reports do not in any way implicate the customers of any unlawful activity or that investigation will commence as soon as the STRs or CTRs are lodged. Let me reiterate that the submission of these reports is to facilitate the gathering of financial intelligence for analysis purposes. Then, it is equally important to establish a range of red flags to enable detection of suspicious transactions. One important area is to be alert on high risk jurisdictions. Bank Negara Malaysia has, from time to time, provided information on this area such as circulars on countries that are deficient in their AML/CFT regime as identified by the FATF. In addition, please do keep yourself updated on sanctions from the United Nations as well as reports from multilateral organisations, such as the UNODC, which report on AML/CFT matters for a number of countries. Information from various sources would support the STRs and CTRs mechanism.

The effective implementation of internal AML/CFT programme relies strongly on the capacity and capability of the resources supporting the programme. This is translated into the third key aspect of the AML/CFT programme, that is the provision of adequate and applicable resources to the compliance section of your institution. It is the responsibility of your Board and management to ensure that the compliance section is given due consideration and importance in terms of resources.

It is within this context that I see the financial institutions corporate social responsibility (CSR) should be undertaken. The financial institutions can continue to play a bigger role in contributing towards reducing crime and corruption, especially through the reporting of Suspicious Transaction Reports (STRs). To date, the STR received from reporting institutions have contributed to about 300 ML/TF investigations. The STRs, which is "trigger alert" for any ML/TF activities going through the institutions, has steadily increased (52% annually) due the overall improvement in compliance practice among reporting institutions.

I wish to stress that having strong AML/CFT practice is not only pertinent to ensure the country's AML/CFT risks are carefully managed, but it is also important for the financial institutions to lower the cost of doing business arising from AML/CFT investigations and cases. Concerted effort by law enforcement agencies has resulted in an average annual increase of 86% in cases under prosecution and forfeiture without prosecution. Without having adequate controls and system in place, financial institution will face challenges in responding to the increasing demand from law enforcement agencies. In addition, it is also observed that international financial institutions have strengthened AML/CFT monitoring of their counterparts, and are taking actions, such as enhanced due diligence or cease correspondent relationship, if the need arises. These would not only affect the cost of doing business, but also has an impact on the level of competitiveness at both domestic and international levels.

Concluding remarks

To conclude, I believe that the sharing of new trends and developments would tremendously benefit all of us today to have a better perspective of this global issue. I am also glad to note that some of the CEOs of our financial institutions will be sharing their insights on this issue and how they drive AML/CFT issue in their institutions. I hope that this sharing of insight will be an annual event, with better participation from other institutions. More importantly, I hope that this event will be the catalyst for more robust and comprehensive AML/CFT measures in each of the financial institution in Malaysia. We are to internalise the theme "*Strengthening Governance to Derive Value*" in our institution.