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Overview international best practices on customer due diligence and related anti-money laundering measures

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Abstract

Purpose – The anti-money laundering (AML) frameworks of many countries were generally influenced by the international best practices of money laundering that were first established in 1988 through the Basel Committee on Banking Supervision (BCBS). The general belief is that these international best practices are applicable in all jurisdictions, although most countries are still affected by money laundering. The international best practices are universal measures that were developed as a yardstick to control and curb money laundering globally. Nonetheless, international best practices for money laundering are not tailor-made for specific jurisdictions and/or countries. Therefore, it remains the duty of respective jurisdictions and/or countries to develop their own context-sensitive AML measures in accordance with international best practices. An overview of the AML international best practices that were developed and adopted by several countries are analysed in this paper. These include customer due diligence measures established by the BCBS, the financial action task force (FATF) standards, as well as the ongoing monitoring and the risk-sensitive approach that were implemented to curb money laundering globally.

Design/methodology/approach – The article analyses the AML international best practices that were developed and adopted by several countries. These include customer due diligence measures established by the BCBS, the FATF standards, as well as the ongoing monitoring and the risk-sensitive approach that were implemented to curb money laundering globally.

Findings – It is hoped that policymakers and other relevant persons will use the recommendations provided in the paper to enhance the curbing of money laundering in financial institutions globally.

Research limitations/implications – The paper does not provide empirical research.

Practical implications – The study is useful to all policymakers, lawyers, law students and regulatory bodies globally.

Social implications – The study seeks to curb money laundering in the economy and society globally.

Originality/value – The study is original research on the use of AML/counter financing of terrorism international best practices to curb money laundering activities globally.

Keywords Customer due diligence, Anti-money laundering, International best practices, Measures

Paper type Research paper

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1. Introductory remarks

In South Africa, money laundering generally entails any practice, conduct or activity that has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest that anyone has in such proceeds and/or any activity that constitutes an offence relating to certain transactions that are conducted to avoid reporting duties as stipulated under Section 64 of the Financial Intelligence Centre Act 38 of 2001 as amended by the Financial Intelligence Centre Amendment Act 1 of 2017 (FICA) or an offence relating to money laundering under Section 4, or an offence relating to assisting another person to benefit from the proceeds of crime under Section 5, or an offence relating to acquisition, possession or use of proceeds of unlawful activities as stipulated in Section 6 of the Prevention of Organised Crime Act 121 of 1998 as amended ("POCA", see s 1 of the FICA). Money laundering is a global financial crime that has affected both developing and developed economies. International bodies and organisations convene from time to time to deliberate on measures that could be adopted by countries to effectively curb money laundering practices globally. As a result, several efforts have been made to curb money laundering by various national anti-money laundering (AML) regulatory bodies of many countries, including South Africa, as well as the international bodies and/or organisations such as the financial action task force (FATF), the Egmont Group of Financial Intelligence Units (EGFIU), the International Monetary Fund (IMF), the United Nations (UN), the Association of Certified Anti-Money Laundering Specialists (ACAMS) and the Basel Committee on Banking Supervision (BCBS). For instance, the FATF provides various recommendations and/or standards to curb money laundering and terrorist financing globally. The EGFIU facilitates cooperation and intelligence sharing between national financial intelligence units to investigate and combat money laundering and terrorist financing practices globally. The IMF has its own international measures to detect and curb money laundering and terrorist financing practices. It emphasises that money laundering and terrorist financing practices are financial crimes that could give rise to negative economic effects on any affected country and/or jurisdiction. The UN Office on Drugs and Crime introduced the Global Programme Against Money Laundering, Proceeds of Crime and the Financing of Terrorism (GPMLPFT) in a bid to enhance the combating of money laundering and terrorist financing activities in its member states. This is a global programme providing assistance to UN member states to build and strengthen their AML and counter financing of terrorism (CFT) measures. The GPMLPFT empowers the UN to assist its member states through their legal and enforcement authorities to develop effective and comprehensive domestic AML/CFT regulatory frameworks. The GPMLPFT enables the UN to help its member states with institutional infrastructures and the relevant skills needed to enforce their AML/CFT regulatory frameworks in accordance with the UN instruments and international standards. The ACAMS is a global standard-setting body in AML certifications. It was founded in 2001 and is an international body that provides training and certification in AML measures to equip its members with adequate information on the detection, investigation and prevention of money laundering activities in their respective jurisdictions. The BCBS introduced customer due diligence measures and the know-your-customer (KYC) policy to curb money laundering. It was the establishment by bank governors of the signatory countries, which include the UK in 1974 (World Bank, 2009). The BCBS introduced its first international AML regulations in 1988 (World Bank, 2009). For example, the BCBS issued a statement on the "Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering" (BCBS AML Regulations 1988) which provided basic principles for customer identification (BCBS, 1988; Ahlosani, 2016). This statement provided some general ethical principles which obliged banks to adopt effective

measures to ensure that all their clients are properly identified. The same statement also stipulated that any transactions that do not appear legitimate should be prohibited and banks should co-operate with law enforcement agencies to detect, investigate and combat money laundering activities in their respective countries. This marked the first attempt by the BCBS to encourage banks to combat money laundering through customer identification and verification measures. However, the BCBS regulations are not legally binding (Alldridge, 2008). The signatory jurisdictions and/or countries of the BCBS are merely expected to transpose and give effect to its regulations into their domestic laws [1]. These regulations encourage its signatories to cooperatively combat money laundering and terrorist financing activities in their respective countries and jurisdictions (World Bank, 2009). Given this background, this article provides an overview analysis of the international best practices and AML/CFT measures that have been developed and adopted by many countries globally to effectively curb money laundering and terrorist financing activities in their respective financial institutions and/or financial markets to date. To this end, only the international best practices and AML/CFT measures that have been developed by the BCBS and the FATF will be discussed in this article.

2. Customer due diligence under the Basel Committee on Banking Supervision

In October 2001, the BCBS issued detailed guidelines on effective banking supervision and the use of customer due diligence measures (BCBS, 2001, 2012). These guidelines focus mainly on customer due diligence measures for banks (World Bank, 2009; BCBS, 2001, 2012). The BCBS promotes sound customer due diligence by banks to combat the direct and indirect losses that are usually incurred by banks due to money laundering and related financial crimes in many countries (BCBS, 2001, 2012). Accordingly, the proper use of customer due diligence measures by banks may curb money laundering activities in any country (BCBS, 2001, 2012). The effective enforcement of customer due diligence measures by banks protects financial institutions from money laundering activities, and it also preserves the reputation of banks (Goldsmith *et al.*, 2007). Customer due diligence measures help to detect and deter unscrupulous persons from conducting their illegal money laundering activities through banks and other financial institutions (Spedding, 2004; Ping, 2008). The BCBS provides that effective customer due diligence measures should be complimented with risk management programmes, and the two should not be separated (BCBS, 2001, 2012). The BCBS provisions for customer due diligence measures are discussed below (Ahlosani, 2016) [2].

The BCBS AML Regulations 1988 outlined the basic principles and procedures to be implemented by financial institutions to combat money laundering in the global and international banking systems (BCBS, 1988). These regulations reinforced existing banking practices against the criminal use of financial institutions to perpetuate money laundering activities globally (BCBS, 1988). Therefore, banks were encouraged to determine the true identity of all their customers to ensure that they are not used to transfer dirty money through money laundering activities (Ahlosani, 2016). The BCBS AML Regulations 1988 stipulated that significant transactions should not be concluded between financial institutions and customers who fail to provide proof of their identity (Goldsmith *et al.*, 2007). These regulations and/or customer due diligence measures were probably the first AML measures to be used by banks and related financial institutions globally (Ping, 2008). During this period, the BCBS was comprising of developed countries only (Booth *et al.*, 2011; Mugarura, 2014). Consequently, it could be argued that the BCBS AML Regulations and customer due diligence measures were specifically designed to suit the needs of developed countries. This suggests that these measures could be incompatible with developing countries such as South Africa.

The BCBS Core Principles for Effective Banking Supervision were introduced in 1997 (BCBS, 1997) to enhance the enforcement and use of customer due diligence measures to curb money laundering in its member states (BCBS, 1997; Njotini, 2009). These principles obliged banks and related financial institutions of the signatory countries to use customer due diligence measures to effectively combat and discourage money laundering and terrorist financing activities (BCBS, 1988; Ahlosani, 2016; Ping, 2008). The BCBS Core Principles 1997 also introduced the use of risk management practices to compliment customer due diligence measures in the fight against money laundering and terrorist financing activities in all the member states (Ahlosani, 2016). Risk management practices were aimed at ensuring that banks and other financial institutions implement AML/CFT measures according to the level of money laundering risk posed by their clients' transactions (Ping, 2008; Williams, 2017). The BCBS Core Principles 1997 introduced further strict regulations to promote high standards of the prevention of intentional and unintentional use of banks for criminal activities such as money laundering and terrorist financing activities in the member states (BCBS, 1988; Njotini, 2009). Banks and related financial institutions were obliged to assess compliance and the effective implementation of customer due diligence measures to detect and prevent money laundering and terrorist financing activities in the member states (BCBS, 1988). However, this required robust implementation of customer due diligence measures by banks and other related financial institutions (World Bank, 2009).

The BCBS introduced the Core Principles Methodology of 1999 (BCBS Principles Methodology) (BCBS, 1999) to ensure that banks have relevant policies to prevent money laundering and terrorist financing activities in their respective countries (BCBS, 1999; Njotini, 2009). The BCBS Principles Methodology became a vital global and international standard for prudential regulation and supervision of banks. It provides that banks should keep records of all their clients' transactions and enforce customer identification policies and rules in all situations (BCBS, 1999). The BCBS principles methodology and other guidelines and principles are used to foster customer due diligence measures and AML/CFT measures in the member states globally (Ping, 2008; Williams, 2017). Although the BCBS guidelines and principles are mainly focused on banks, they are also applicable to other financial institutions (Ping, 2008; Njotini, 2009). To date, the BCBS plays an important role in the enforcement of customer due diligence measures by banks and related financial instruments to combat money laundering and terrorist financing activities in many countries globally (Njotini, 2000).

3. Customer due diligence under the Financial Action Task Force

It is imperative to discuss the mandate of the FATF regarding the combating of money laundering in its member states. The FATF is an inter-governmental body that was formed in 1989 by the collective input of Ministers of its member countries and jurisdictions FATF Recommendations (2012). It was founded on the initiative of the Group of Seven (G7) countries to develop AML policies. Notably, its mandate was expanded to include terrorism financing in 2001. The FATF sets the international standards to promote the effective enforcement of the regulatory and operational measures for combating money laundering, terrorist financing and other related illicit trading practices in its member states as well as the international financial institutions and financial markets. Put differently, the FATF is generally a policy-making body that helps its member states to have the necessary political will to adopt the relevant national legislative and regulatory reforms to enhance their AML/CFT measures. It monitors progress in the enforcement of its recommendations and/or standards through, inter alia, peer reviews of its member states' compliance levels. The FATF currently has 39 members, including South Africa. The FATF was mainly established to enable all countries and/or jurisdictions to effectively combat money laundering and terrorist financing activities FATF Recommendations (2012) [3]. The FATF

stigmatises non-cooperative countries to ensure that all member countries implement customer due diligence measures to combat money laundering and terrorist financial activities (Njotini, 2009). Non-cooperative countries are those countries that fail to implement and adopt AML/CFT measures satisfactorily (FATF Recommendations, 2012). The satisfactory implementation of AML/CFT measures by member states could include, inter alia, defining money laundering activities, seizure and confiscation of the proceeds of money laundering and the consistent enforcement of the relevant AML/CFT laws (Njotini, 2009).

The first 40 recommendations of the FATF, which provided countermeasures against money laundering, were published in 1990 (Nyaude, 2015). The 40 recommendations on money laundering and the nine special recommendations on terrorist financing are regarded as the international standard for AML and CFT measures. These FATF recommendations set out the principles for action and allow countries a measure of flexibility in their enforcement in accordance with certain circumstances and constitutional frameworks. Moreover, the FATF recommendations are intended to be enforced at the national level through legislation and/or other legally binding instruments by all member states. The FATF promotes the effective application of legal and regulatory measures to combat money laundering in its signatory countries (FATF Recommendations, 2012; Nyaude, 2015). To achieve mandate, the FATF provides recommendations that serve as a framework for AML/CFT measures which must be implemented by its member countries to combat money laundering and terrorist financing (FATF Recommendations, 2012). Although the FATF recommendations are non-binding on member states (Ai and Jun, 2009), member states are expected to implement the FATF's AML/CFT measures in a way that suits their circumstances and constitutional frameworks (Henning and Hauman, 2017). This ensures effective and context-sensitive enforcement of customer due diligence measures as well as the AML and CFT measures in different countries and jurisdictions globally (Ai and Jun, 2009; Gordon, 2011). The FATF recommendations have been revised several times to reflect on money laundering trends and expand their scope beyond drug trafficking and money laundering (FATF Recommendations, 2012; Gordon, 2011). This has kept the FATF recommendations updated and generally relevant to the combating of money laundering, terrorist financing and other illicit financial crimes in the global economies and financial markets (Damais, 2007).

The FATF recommendations provide international standards for customer due diligence measures and other AML/CFT measures (Njotini, 2009). For instance, under the FATF recommendations, customer due diligence is performed on a simplified, comprehensive, ongoing and risk-sensitive basis (FATF Recommendations, 2012; Njotini, 2009). However, the enforcement of customer due diligence measures differs according to the level of money laundering risk a customer poses to the financial institution (Damais, 2007).

3.1 Simplified customer due diligence measures under the Financial Action Task Force

It is submitted that simplified customer due diligence generally provides the lowest level of due diligence, which must be complied with by a client and/or financial customer of banks or other related financial institutions. Simplified customer due diligence measures are generally considered and used where there is little or no risk of the financial services, financial transactions and/or the financial customer becoming involved in money laundering or terrorist financing activities. Simplified customer due diligence measures are designed for customers who pose a low money laundering risk to financial institutions globally (Pini, 2004). Low-risk customers generally include financial institutions, government administrations, regulated companies and transactions involving small amounts of money (FATF Recommendations, 2012). Low-risk customers also include working natural persons with small account balances and those who conclude transactions that do not pose high money laundering risks (Njotini, 2009). Simplified customer

due diligence measures obliges banks and other financial institutions to obtain unsophisticated and straightforward identification and verification documents such as customer identity card or passport from their clients (FATF Recommendations, 2012). Any information that is obtained from financial customers should enable banks and other financial institutions to know the relevant activities of such customers better. Simplified customer due diligence measures also helps to determine the nature of the business relationship to be formed between the financial customer and the financial institution (Njotini, 2009; FATF Recommendations, 2012). This enables financial institutions to determine the level of money laundering risk that each financial customer poses to the financial institutions and other customers (Damais, 2007; Ai and Jun, 2009; De Koker, 2004). Each financial institution must know the level of money laundering risk that is posed by its financial customers so that it can enforce customer due diligence measures that are commensurate with such risk (De Koker, 2004; Njotini, 2009).

The verification documents should contain the financial customer's background, business activities and country of origin. These documents should further indicate whether the customer holds any public or high-profile office (FATF Recommendations, 2012). The verification documents should provide information that enables financial institutions to build detailed customer profiles, which are essential when determining the level of risk a financial customer poses to such institutions (Damais, 2007; Gordon, 2011). The verification process can be conducted after the establishment of a business relationship between the financial institution and the financial customer (FATF Recommendations, 2012). Notably, simplified customer due diligence measures do not exempt financial institutions from the duty to monitor all their financial customer's activities (Harrison and Ryder, 2013). This follows the fact that even low-risk financial customers might engage in money laundering and terrorist financing activities. As such, their transactions and financial activities should always be monitored to detect, prevent and combat terrorist financing and money laundering activities (Henning and Hauman, 2017; Kersop, 2014).

3.2 Comprehensive customer due diligence measures under the Financial Action Task Force

Comprehensive customer due diligence (CCDD) measures are also known as enhanced due diligence (EDD) measures (Harrison and Ryder, 2013). These are additional measures, procedures, rules and/or regulations that are used by banks and other financial institutions to detect and curb illicit activities by financial customers that pose a higher risk of money laundering and/or terrorist financing to such institutions and other unwitting financial customers. CCDD/EDD measures usually involve complex procedures that are affected by financial institutions such as banks to conduct detailed background checks on their financial customers. This could also involve obtaining detailed and/or confidential information about the financial customers to curb money laundering and terrorist financing activities in the financial institutions. Banks and other financial institutions should effectively use CCDD/EDD measures to minimise and curb money laundering and/or terrorist financing risks. Banks and other financial institutions should further use CCDD/EDD measures to maintain practical and strict compliance standards, especially when dealing with high-risk customers. The FATF provides that CCDD/EDD measures should be used in specified situations and/or transactions involving high-risk customers (Njotini, 2009). High-risk customers include politically exposed persons, persons that engage in cross-border correspondent banking and cross-border account payments (FATF Recommendations, 2012). The FATF obliges banks and other financial institutions to apply extensive and stringent customer due diligence measures on all financial transactions that are concluded with high-risk customers (Harrison and Ryder, 2013). This follows the fact that high-risk customers pose greater money laundering and terrorist financing risks to financial institutions and other financial

customers (Damais, 2007; Ahlosani, 2016). The CCDD/EDD measures of the FATF require careful scrutiny of customer activities and financial transactions (Njotini, 2009) by financial institutions so as to curb money laundering and terrorist financing activities (Harrison and Ryder, 2013; Ping, 2008). This approach empowers financial institutions to timeously detect suspicious financial transactions and financial activities of their financial customers to combat money laundering and terrorist financing risks (Njotini, 2009). The poor enforcement of CCDD/EDD measures against high-risk customers could give rise to rampant money laundering and terrorist financing activities that are conducted through financial institutions in any affected country (Henning and Hauman, 2017; Damais, 2007). This suggests that the proper reliance on the CCDD/EDD measures of the FATF by financial institutions will minimise money laundering and terrorist financing activities in its member countries (Harrison and Ryder, 2013).

3.3 Ongoing monitoring/ongoing customer due diligence measures under the Financial Action Task Force

Ongoing monitoring measures and/or ongoing customer due diligence (OCDD) measures are generally used by financial institutions to ensure that their business policies are consistently updated in accordance with the systemic risks that are posed to them by financial crimes such as money laundering and terrorist financing. OCDD refers to the regular monitoring of financial customers' account transactions by banks and other related financial institutions to ensure that such transactions are consistent with the customers' risk profile and source of funds. The FATF provides that OCDD is a crucial pillar of the KYC measures that are used by banks and other financial institutions to detect, prevent and combat money laundering and terrorist financing activities in many countries. OCDD is usually used by banks and other related financial institutions to periodically assess the financial activities of high-risk customers to detect and combat money laundering and terrorist financing activities. The FATF provides that the proper use of OCDD measures protects banks and other financial institutions from risks such as non-compliance on the part of high-risk customers and reputational damage that is caused by financial crimes such as money laundering and terrorist financing. The FATF provides further that OCDD is an essential AML/CFT measure that should be effectively used by banks and other financial institutions for deterrence purposes (FATF Recommendations, 2012). OCDD empowers banks and related financial institutions to keep updated records of important confidential data and information from their financial customers, which is used to detect and combat money laundering and terrorist financing activities in many countries and jurisdictions (Ahlosani, 2016; Hudson, 2013). OCDD helps financial institutions to effectively discourage the establishment of business relationships between such institutions and high-risk customers who usually practice money laundering (Njotini, 2009). This approach also discourages banks and other financial institutions from recklessly conducting financial activities with dubious financial customers (Goldsmith *et al.*, 2007). In this regards, it is submitted that employees of financial institutions should have relevant expertise and training to monitor, assess, detect and discourage money laundering and related risks that ensue from all dubious financial customers (Ping, 2008; Njotini, 2009).

3.4 Risk-sensitive/risk-based approach under the Financial Action Task Force

The risk-sensitive/risk-based approach (RBA) to customer due diligence measures are used to curb money laundering and terrorist financing in many countries globally (Njotini, 2009). The RBA is crucial to the effective enforcement of the revised *International Standards on*

Combating Money Laundering and the Financing of Terrorism and Proliferation, which were adopted by the FATF in 2012. In other words, the RBA to AML/CFT was adopted as one of the 40 recommendations of the FATF to enhance the combating of money laundering and terrorist financial activities in its member states. The FATF recommendations oblige financial institutions to develop an understanding of the systemic risks, which are associated with their businesses and related transactions to prevent the negative effects of money laundering and terrorist financing. The RBA requires financial institutions to provide proportionate responses to the money laundering and terrorist financing risks that they encounter from time to time. The RBA generally requires financial institutions to balance their compliance obligations with their available financial resources to preserve customer experiences. Thus, financial institutions should focus their resources to combat riskier activities such as money laundering and terrorist financing. This approach minimises compliance and administrative costs for both financial customers and financial institutions. Moreover, the application of the RBA prepares financial institutions for money laundering and terrorist financing risks before they ensue. This implies that financial institutions should carefully identify and determine all possible risks to robustly combat money laundering and terrorist financing activities in financial institutions (Spedding, 2004). In this regards, as indicated earlier, a health proportionality balance between the identified risks and the available resources is crucially important for the enforcement of RBA measures by financial institutions in accordance with the FATF recommendations (Spedding, 2004). The proper reliance on RBA enhances the enforcement of CDD measures by financial institutions and/or regulatory bodies to curb money laundering and terrorist financing activities (Njotini, 2009). The FATF provides that the RBA should be enforced distinctly from the rule-based approach, which relies on the interpretation of the rules rather than risk matrixes (Spedding, 2004).

4. Concluding remarks

From the discussion above, it is clear that various international best practices on CDD and related AML/CFT measures are used to investigate, detect and combat money laundering and terrorist financing activities in the financial institutions of many member countries of the FATF. For instance, the CDD measures under the BCBS and the FATF are currently used to curb money laundering and terrorist financing activities in many countries and jurisdictions. Notably, simplified CDD measures, CCDD measures, OCDD measures and RBA measures of the FATF are generally used by financial institutions as AML/CFT regulatory frameworks in its member states. It is submitted that the current AML/CFT laws in South Africa and other countries are based on international standards and/or best practices that are provided in the FATF recommendations and the BCBS Core Principles (Scott and Stephenson, 2008). However, Mugarura submits that the implementation of CDD measures as a global paradigm is less effective in developing countries such as South Africa owing to challenges such as financial exclusion and lack of resources (Mugarura, 2014). The authors concur with this submission and assert further that developing countries such as South Africa do not always have the sufficient socio-economic infrastructure and the political will to effectively implement international AML/CFT measures and best practices (De Koker, 2014). These challenges are still negatively affecting combating money laundering and terrorist financing activities in most developing countries (De Koker, 2004; Mugarura, 2014). In this regards, it is submitted that the FATF recommendations and the BCBS Core Principles should be binding on all member states to ensure accountability and effective enforcement. The FATF and the BCBS should further consider developing new standards and/or best practices that are consistent with the specific needs of developing countries. This follows the fact that the current AML/CFT international best practices of the FATF and the BCBS seems to be

more tailor-made for developed countries than developing countries (Mugarura, 2014). The governments, regulatory bodies and other relevant stakeholders should provide sufficient socio-economic infrastructure, financial resources and the political will to effectively enforce the international AML/CFT measures and best practices of the FATF and the BCBS.

Notes

1. Alldridge (2008). Before 2009, the Basel Committee was made up of developed countries only. For example, the UK, the United States of America (USA), Germany and France. The current committee members of the BCBS include South Africa, the UK and Turkey.
2. The provisions of these papers are discussed fully in Ahlosani (2016).
3. FATF Recommendations (2012). The FATF has 34 member jurisdictions including South Africa and the UK.

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