A Comparative Guide to Anti-Money Laundering

A Comparative Guide to Anti-Money Laundering

A Critical Analysis of Systems in Singapore, Switzerland, the UK and the USA

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Foreword

Money laundering is the process by which criminals attempt to conceal the source and ownership of the proceeds of their illicit activities; if successful, the criminal maintains control and access to these funds when and where he chooses. The efforts to combat this phenomenon are the subject matter of this study, and in particular how anti-money laundering (AML) rules and regulations impact on four of the major cross-border banking centres: UK, USA, Singapore and Switzerland.

In looking at the evolution of the AML paradigm from its origins as a tool to combat drug trafficking, to its most recent application in the fight against terrorism, it is clear that the concept remains high on the political agenda. However, despite a plethora of rules there is still a lack of harmonization and uneven implementation, leaving open the question whether national AML systems really meet the international standards. To determine levels of implementation in these countries, the AML system in each of the four jurisdictions is examined in close-up. These country studies are then analysed as to their merits and deficiencies leading to the question, 'is the playing field being levelled in AML?'

Put in its wider context, this question reveals the reformulation of AML in terms of a shift from the 'rule based' to the 'risk based' approach. It may be that this change is just a reshuffling of ideas and approaches that were already in place before – nevertheless the impact on financial institutions cannot be underestimated. Banks and other financial service providers find themselves obliged to take responsibility for screening their clients according to certain risk factors. This means that financial institutions are increasingly being drawn into doing what so far had been the task of the public sector: anticipating risk, defining the details, such as what constitutes a terrorist threat, who should be regarded as a 'politically exposed person' and so on.

This study was commissioned by the *Stiftung Finanzplatz Schweiz*, the research was conducted by independent contributors situated in each of the four countries examined in detail, as well as experts from the Basel Institute on Governance. The study findings were presented at a seminar in January 2003 where the following international experts engaged in a critical discussion of the study's conclusions; Professor Michael Levi of Cardiff University, Professor Ernesto Savona of Transcrime at the University of Trento and Mr Stanley Morris, former head of FinCen.

Abbreviations

ABS	Association of Banks (Singapore)
AJP	Aktuelle juristische Praxis (periodical), Lachen
AML	Anti Money Laundering
ARA	Asset Recovery Agency
Bank Act	Bundesgesetz über die Banken und Sparkassen vom 8. November 1934
BBA	British Bankers Association
BCBS	Basel Committee on Banking Supervision
BCBS, CDD 2001	Basel Committee on Banking Supervision, Customer Due Diligence for Banks, October 2001.
BCC	Board of Commissioners of Currency (Singapore)
Botschaft 1996	Botschaft zum Bundesgesetz zur Bekämpfung der Geldwäscherei im Finanzsektor vom 17 Juni 1996, BBl 1996 III 1116
Botschaft 26 June 2002	Botschaft betreffend die Internationalen Übereinkommen zur Bekämpfung der Finanzierung des Terrorismus und zur Bekämpfung terroristischer Bombenanschläge sowie die Änderung des Strafgesetzbuches und die Anpassung weiterer Bundesgesetze vom 26 Juni 2002, BBL 2002, No. 32, p. 5390 *et seq*.
BSA	Bank Secrecy Act (USA)
BIS	Bank of International Settlements
BSP	Basel Statement of Principles
CAD	Commercial Affairs Department (Singapore)
CAFRA	Civil Asset Forfeiture Reform Act (USA)
CBP	The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, http://www.wolfsberg-principles.com/wolfsberg_principles.html
CC	Criminal Code
CCTV	Closed Circuit Television

CDB (German: VSB)	Code of Conduct with regard to the exercise of Due Diligence (Switzerland)
CDB 98	Swiss Bankers Association's Code of Conduct (1998 version).
CDB 03	Swiss Bankers Association's Code of Conduct (2003 version).
CDD	Customer Due Diligence
CDSA	Corruption, Drug Trafficking and Serious Offences Act (Singapore)
CFATF	Caribbean Financial Action Task Force
Cf.	Compare
CFTC	Commodity Futures
CHF	Swiss Francs
CICAD	Inter-American Drug Abuse Control Commission
CIP	Customer Identification Programme
Council of Europe, No.141	Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Strasbourg, 8 November 1990
CPF	Central Provident Fund (Singapore)
CTR	Currency Transaction Report
DBG	Bundesgesetz über die direkte Bundessteuer (Swiss Federal Tax Legislation)
Dept.	Department
Directive 91/308/EEC	Council Directive of the European Communities of June 1991 on Prevention of the Use of the Financial System for the Purpose of Money Laundering.
Directive 2001/97/EC	Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering
DPA	Data Protection Act (UK)
Draft Ordinance	Draft Ordinance of the Swiss Federal Banking Commission Concerning the Prevention of Money Laundering, dated June 2002
DSG	Swiss Data Protection Legislation (Datenschutzgesetz)
DTA	Drug Trafficking Act (Singapore and UK)
Due Diligence Regulation	Verordnung der Kontrollstelle für die Bekämpfung der Geldwäscherei über die

	Sorgfaltspflichten der ihr direkt unterstellten Finanzintermediäre vom 25 November 1998
Due Diligence Regulation Insurance	Verordnung des Bundesamtes für Privatversicherung über die Bekämpfung der Geldwäscherei 30 August 1999
ECB	Economic Crime Branch (Singapore)
ECU	Economic Crime Unit (UK)
edn.	Edition
ed.(s)	Editor(s)
EEA	European Economic Area
EJPD	Eidgenössisches Justiz- und Polizeidepartement (Federal Department of Justice), Switzerland
EU	European Union
ETS (German: EÜR)	European Treaty Series
FATF	Financial Action Task Force
FATF Cons. Paper 2002	FATF on Money Laundering, Review of the FATF Forty Recommendations, Consultation Paper, 30 May 2002
FATF 40/1990	Financial Action Task Force on Money Laundering, 'The Forty Recommendations of the Financial Action Task Force on Money Laundering 1990'
FATF 40/1996	Financial Action Task Force on Money Laundering, 'The Forty Recommendations of the Financial Action Task Force on Money Laundering 1990', revised 28 June 1996
FATF 40/2003	Financial Action Task Force on Money Laundering, 'The Forty Recommendations of the Financial Action Task Force on Money Laundering 1990', revised 20 June 2003
FBC	Federal Banking Commission
FCD	Decision of the Swiss Federal Court
FCPA	Foreign Corrupt Practices Act (US)
FDIC	Federal Deposit Insurance Corporation (US)
FIB	Financial Investigations Branch (Singapore)
FinCEN	Financial Crimes Enforcement Network (US)
FID	Financial Investigations Division (Singapore)
FIU	Financial Intelligence Unit
FN	Footnote
FOPI	Federal Office of Private Insurance (Switzerland)

FSB	Federal Reserve System
FSA	Financial Services Authority
FSF	Financial Stability Forum
FSMA	Financial Services and Markets Act 2000 (UK)
FTA	Futures Trading Act
GDP	Gross Domestic Product
GIC	Government of Singapore Investment Corporation
GwUe	Council of Europe Convention on Money Laundering, Search, Seizure and Confiscation of the Proceeds from Crime
HIFCA	High Risk Financial Crime Area
HNWIS	High Net Worth Individuals
IAIS	International Association of Insurance Supervisors
IDPC	Insurance Density Per Capita
IFA	Independent Financial Advisors
IMAC	International Assistance in Criminal Matters
IOSCO	International Organization of Securities Commissions
IRS	Internal Revenue Service (US)
JMLSG	Joint Money Laundering Steering Group (UK)
KYC	Know Your Customer
MACMA	Mutual Legal Assistance in Criminal Matters Act
MAS	Monetary Authority of Singapore
MEP	Mutual Evaluation Process
Message (1996)	Botschaft zum Bundesgesetz zur Bekämpfung der Geldwäscherei im Finanzsektor vom 17 June 1996, in: Bundesblatt 1996 III, p. 1101 *et seq*.
Minimal Standards	Mindeststandards für reine Internet-Banken und - Effektenhändler zur Kontoeröffnung auf dem Korrespondenzweg und zur Kontoüberwachung, cf. http://www.ebk.admin.ch/d/archiv/2001/neu5-01.pdf
MLA	Mutual Legal Assistance
MLA	Swiss Money Laundering Act of 10 October 1997
MLAC	Money Laundering Advisory Committee

MLATs	Mutual Legal Assistance Treaties
MLCA	Money Laundering Control Act (US)
ML/CG	Merrill Lynch/Cap Gemini methodology
ML Ordinance	Ordinance of the Swiss Federal Banking Commission Concerning the Prevention of Money Laundering, 18 December 2002
MLR	Money Laundering Regulations (UK)
MLRO	Money Laundering Reporting Office
MLS	Financial Services Money Laundering Source Bank
MROS	Money laundering reporting office in Switzerland
MSB	Money Services Businesses
N.	Note
NASD	National Association of Securities Dealers (US)
NBFI	Non-Banking Financial Institutions
NCIS	National Criminal Intelligence Service (UK)
NCUA	National Credit Union Administration (US)
NCCT	Non Co-operative Countries and Territories
NFI	Non-financial Institutions
NYSE	New York Stock Exchange
NZZ	Neue Zürcher Zeitung, Zurich
OAS	Organization of American States
OCC	Office of the Controller of the Currency
OECD	Organization for Economic Co-operation and Development
OECD Convention 1997	Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, 21 November 1997
OFAC	Office of Foreign Assets Control (US)
OFC	Off Shore Centre
OTC	Over-the-counter
OTS	Office of Thrift Supervision (US)
p.	Page
pp.	Pages
PCA	Proceeds of Crime Act
PCU	Proceeds of Crime Unit
PEP	Politically Exposed Person
PIU	Performance and Innovation Unit
PPP	Purchasing Power Parity
QFB	Qualifying Full Bank (Singapore)

RDS	Research, Developments and Statistics Home Office (UK)
Recht	Zeitschrift für juristische Ausbildung und Praxis (Berne)
s.	Section
SAR	Suspicious Activity Report/ing
SBA	Swiss Bankers Association
SDA	Schweizerische Depeschenagentur (Press Agency)
SEC	Securities and Exchange Commission (USA)
SEP	Self Evaluation Process
SES	Stock Exchange of Singapore Ltd.
SFGB (German: EBK)	Swiss Federal Gaming Board
SFA	Securities and Futures Act (Singapore)
SFBC	Swiss Federal Banking Commission
SFBC's Comment of 8 July 2002	SFBC's comment to the Draft Ordinance of the WG KYC – 8 July 2002. http://www.ebk.admin.ch/d/aktuell/neu090702-05d.pdf
SFBC Circ. 99/2 Outsourcing	Rundschreiben der Eidg. Bankenkommission: Auslagerung von Geschäftsbereichen (Outsourcing) vom 26 August 1999; (letzte Änderung am 22 August 2002). http://www.ebk.admin.ch/d/aktuell/RS_Outsourcing_D.pdf
SFBC Circ. 98/1	Guidelines on Combating and Prevention of Money Laundering of the SBA
SFBC-Money Laundering Report	Bericht der Eidgenössischen Bankenkommission zu ihrer Geldwäschereiverordnung 18 December 2002, March 2003
SFO	Serious Fraud Office
SGX	Singapore Exchange
SI	Statutory Instrument
SIA	Securities Industry Association (USA)
SIMEX	Singapore International Monetary Exchange
SJZ	Schweizerische Juristen-Zeitung (periodical), Zürich
SNB	Swiss National Bank
SRO	Self-regulatory organizations
STR	Suspicious Transaction Reports/Reporting
STRO	Suspicious Transaction Reporting Office/r

SUA	Specified Unlawful Activities
TI	Transparency International
UHNWIS	Ultra High Net Worth Individuals
UN	United Nations
UNDCP	United Nations International Drug Control Programme
VAT	Value Added Tax
VESBK-BGW	Verordnung der Eidgenössischen Spielbankenkommission über die Sorgfaltspflichten der Spielbanken zur Bekämpfung der Geldwäscherei 28 February 2000 (SR 955.021
VGW	Verordnung des BPV über die Bekämpfung der Geldwäscherei 30 August 1999 (SR 955.032);
VHNWIS	Very High Net Worth Individuals
WAK	The National Assembly's Standing Commission for the Economy and Taxation
WB	Wolfsberg AML Principles (1st revision, May 2002)
WB CB	The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, (5 November 2002). http://www.wolfsberg-principles.com/wolfsberg_principles.html.
WGB	OECD Working Group on Bribery in International Business Transactions
WG KYC	Working Group KYC. Refers to the working group constituted by the SFBC tasked to draft a federal banking commission Ordinance.
WG KYC, Annex II	Draft Ordinance, Report of the WG KYC, June 2002: Annex II. http://www.ebk.admin.ch/d/aktuell/neu090702-04d.pdf
WG KYC, Report	Bericht der durch die Eidgenössische Bankenkommission eingesetzten Arbeitsgruppe zum Entwurf einer Verordnung der Eidgenössischen Bankenkommission vom Juni 2002. (www.ebk.admin.ch/d/regulier/consult.htm)

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Executive summary

Mark Pieth and Gemma Aiolfi

INTRODUCTION

- The Basel Institute on Governance has conducted a comparative study of the anti-money laundering systems in Singapore, Switzerland, USA and the UK, each of which is an important financial centre in particular in cross-border banking.
- The study starts out by examining the international standards, tracing their historical and political roots and pointing out the driving forces that have shaped this topic in recent years.
- Thereafter, the four financial centres are reviewed from their individual economic perspectives and assessed for their domestic importance as well as their position internationally.
- Substantive legal reviews of the current position in each country were conducted *in situ* according to a set format which covered criminal and supervisory regulations in relation to anti-money laundering as well as mutual legal assistance and confiscation.
- In the final section of the study, the research in relation to the four countries is analysed and subjected to critique, with final conclusions rounding it off.

THE INTERNATIONAL STANDARDS AGAINST MONEY LAUNDERING

At the international level, the starting point for the development of anti-money laundering principles was the 'war on drugs', which culminated in the UN treaty criminalizing money laundering and establishing the range of topics for all further legal developments. The position changed dramatically in the 1990s with the expansion of money laundering with all serious crimes as predicate offences, including the abuse of power so that it has now become a tool in the repatriation of assets.

Soft law, that is, non-binding recommendations that are primarily addressed to governments and regulators rather than the industry itself, has

developed in tandem with international law. The focus here has been on customer due diligence standards and detailed work has been produced by the Basel Committee on Banking Supervision, and the Financial Action Task Force. The original 'Forty Recommendations' of this latter body were revised to cover money laundering in relation to all serious crime and were revised further in 2003.

The Recommendations comprise the international standards for countries and require the implementation of; criminal laws, rules to prevent money laundering, supervisory rules on the financial and non-financial sectors and provisions for international co-operation. Following the terrorist attacks in the USA, this body extended its remit by addressing the problems of the financing of terrorism and developing recommendations specific to this problem.

The Financial Action Task Force has also exerted pressure on non-members through its work on non-co-operative countries and territories which defined criteria consistent with its Recommendations for jurisdictions defined as 'offshore centres'.

Recent international initiatives have shifted towards a risk based approach which takes greater account of the practical application of standards by the industry itself. The approach also distinguishes between obligations in the client acceptance procedure and ongoing monitoring.

SINGAPORE

- Singapore has developed as a financial centre in a short time and has recently targeted the development of asset management as an area for growth. This has led to dedicated policies and incentives to make Singapore attractive to investors and fund managers alike. Features that contribute to Singapore's competitive advantage include a strong bank secrecy law, the availability of numbered accounts (albeit controlled), tax incentives as well as factors such as a stable government, a relatively strong economy and a highly educated population.
- In response to international criticism from the Financial Action Task Force, legislation was introduced to strengthen anti-money laundering laws which were originally modelled on UK laws, as well as introduce mutual legal assistance (so far only a treaty with the USA), and develop laws on confiscation. The penalties on conviction for money laundering offences are severe and include the possibility of substantial prison sentences as well as fines. However, these sanctions have yet to be applied. Tax offences are not included amongst the list of predicate offences for money laundering.
- The single regulator is the Monetary Authority of Singapore which has

issued detailed guidelines for the financial services industry, covering: the development of compliance programmes that include Know Your Customer procedures, suspicious transaction reporting, staff training, record keeping and compliance with the laws. The Association of Banks in Singapore has endorsed the Wolfsberg Principles as the recommended standard for private banking.
- There are no statistics on confiscation or criminal cases reported under the anti-money laundering legislation. Whilst Singapore looks strong on paper, questions as to implementation and effective international legal assistance are open, not least because legislation is still relatively new.

SWITZERLAND

- Banking in Switzerland has a long tradition and is a mainstay of the economy. Contributing factors to the success of this industry include the political and economic stability of the country, the traditional convertibility of the Swiss franc and comprehensive bank secrecy laws.
- Swiss legislation has been 'crisis driven' and has aimed to safeguard the reputation of Switzerland as a financial centre and accounts for the early development of customer due diligence rules for the banks, which was achieved on a private law basis – not through criminal law.
- The criminal law on money laundering is broadly drafted with all serious offences as predicates. There is also an offence for lack of due diligence in identifying clients and beneficial owners. Swiss law has a dual system of a right and an obligation to notify suspicious transactions, which results in extensive in-house vetting of clients both prior to a business relationship and on an ongoing basis. At present there is no requirement for banks to report if they reject a client prior to the opening of a business relationship.
- Mutual legal assistance procedures have been amended and improvements acknowledged by requesting states. However, tax evasion other than tax fraud is not a criminal offence in Switzerland; it is therefore not possible to afford legal assistance in this area.
- Self Regulatory Organizations have been set up to implement anti-money laundering regulations, and the law distinguishes between regulated entities, unregulated intermediaries participating in an SRO and intermediaries that are directly under the supervision of the Control Authority of the Ministry of Finance. The system to integrate non-bank financial intermediaries has proved difficult in practice.
- Statistics indicate that whilst there are relatively fewer notifications of suspicious transactions, they typically result in a criminal prosecution.

UK

- Anti-money laundering law and regulation in the UK has been slow in developing considering the importance of London as a financial centre. To date the rules have focused on the domestic retail market and have not taken account of the international significance of the UK market.
- The UK criminal law has been overhauled by the Proceeds of Crime Act, in force since early 2003. This law consolidates, updates and expands all earlier anti-money laundering legislation. The predicate offences are expanded to cover all serious crimes, rules on reporting suspicious transactions have been strengthened with clear sanctions for failing to report and objective standards to be met when determining when to report. However, banks will continue to face a dilemma in this area facing both the risk of criminal liability (tipping-off) or civil liability to the client (breach of contract). The new law creates a new civil forfeiture regime which is aimed at making confiscation effective.
- The efficacy of mutual legal assistance is still questionable and may be subject to further review in the future.
- Regulatory law is now in the hands of a single entity, the Financial Services Authority which has adopted the risk based approach in its dealings with the industry and in developing its guidelines. There remain questions as to whether the Know Your Customer provisions are sufficiently implemented to tackle beneficial owners of discretionary trusts and other similar tools that may be misused for money laundering purposes.
- Statistics reveal that an 'early warning system' is in operation, however the large number of notifications are not followed through in the criminal justice system, in addition the level of confiscation has been very low. Whether the new civil forfeiture scheme ameliorates the position without breaching human rights legislation will only emerge over time.

USA

- The most powerful economy in the world and a pioneering and proactive international player in combating money laundering, the USA also has a long history of dealing with domestic money laundering ranging from measures against organized crime, the war on drugs and more recently in order to combat terrorism with the 'Patriot' Act. The system though does not take sufficient account of the international significance of the US market, and continues to concentrate on the placement stage of money laundering with the emphasis on controlling cash transactions.

- Criminal law in relation to anti-money laundering in the USA is rigorous and threatens long prison sentences, drastic forfeiture as well as imposing stringent reporting requirements. The regulatory system though is uncharted and complex, relying extensively on self regulation with uneven coverage especially in relation to Know Your Customer rules for non-banking financial institutions.
- Civil forfeiture has been expanded to cover all predicate offences which cover hundreds of federal felonies, tax offences may also serve as a predicate offence. For mutual legal assistance in extradition to another country 'probable cause' has to be shown, but less formality is required for assistance in relation to money laundering, and no treaty is required.
- Statistics on convictions indicate steady numbers of offenders being given prison terms, and statistics on civil and criminal forfeiture reveal relatively modest sums compared to the economic significance of the US economy and the size of the problem.

CONCLUSIONS

- A convergence of approaches is developing between the most important international actors (that is, the Basel Committee on Banking Supervision and the Financial Action Task Force) and the financial industry itself, this drive to level the playing field so as to diminish regulatory arbitrage is manifested in the risk based approach. As a result, concurrent private sector initiatives are likely to continue to develop both internationally and nationally as the approach continues to be adopted by regulators at both levels.
- The risk based approach entails the sharing of responsibility for the development of rules that are not only operable but also effective in combating money laundering techniques. This participative approach is a move away from self-regulation but it affords both sides flexibility, empowers the industry to address the problems in the most cost effective way and is solution oriented.

Introduction

Mark Pieth

The deregulation of financial markets is an established phenomenon of Western financial centres as well as being a process that many nascent markets are pursuing, often coupled with other fundamental reforms. But taking the most sophisticated financial centres, it may seem paradoxical that so much effort is being put into re-regulation, with the fight against 'money laundering' being used as a kind of 'Trojan horse' in order to achieve it. Nevertheless, the consensus of governments and the financial industry alike, is that efforts have to be directed to combat the real threats posed by criminal operators taking advantage of the services on offer in these financial centres. This misuse of markets and financial services by criminals is facilitated by the inherent deficits of nationally organized (and in part rather incomplete) supervision of the financial services industries.

Above and beyond the problems mentioned relating to the furtherance of crime, there is the far greater problem that relates to the risk of the stability of the financial markets, and to make in-roads here, harmonization of regulatory approaches is essential. The intense efforts to tackle harmonization are demonstrated by the activities of international organizations of regulators (BCBS, IOSCO, IAS and so on) to develop standards that are then agreed internationally. In more recent times the private sector itself has risen to the challenges of addressing these issues with business organizations and looser groupings of companies (for example Bankers Associations at the domestic level, and the Wolfsberg Group at the international) being the prime movers here. The principal aim of these private initiatives must be the definition of a common denominator of best practice that is both workable and economically viable whilst at the same time addressing the risks of unfair competition. In the longer term, the current development of industry standards may actually lead to a competitive advantage for those who keep abreast of the relevant private standards and their developments (the potential gain being self-certification).

Overall however, regulation at the national level continues to lag behind both the international and the private sector driven initiatives in standard setting. Differences among even the largest of financial centres especially in the embattled terrain of cross-border banking may still lead to regulatory arbi-

trage. Therefore this comparative study of the most active cross-border banking centres – USA, UK, Singapore and Switzerland – is aimed at helping to identify these differences, highlight potential deficits and be of assistance in explaining divergence.

PART I

1. International standards against money laundering

Mark Pieth

I INTRODUCTION

The international standards against money laundering are the starting points for our comparison of anti-money laundering (AML) structures and practice in the four financial centres that are examined in this book. In taking a look at the international developments over the last 15 years, we aim to appraise the level of their implementation at the country level, pinpoint particular national and local solutions and also highlight differences between approaches in the various jurisdictions.

This chapter gives an historic narrative of the development of the international rules and, in going beyond the official historiography, raises questions that have hitherto seldom been addressed. Furthermore, although the common assumption that the emergence of international law is a result of policy initiatives put forward by the leading powers is essentially correct, it is equally true – as the participant observer can attest – that outcomes at the international level are also due to personality, circumstance and coincidence and, if we lose sight of these 'soft factors' the narrative risks become rather austere.

II CREATING A NEW PARADIGM (1970–1990)

A New Weapons in the War on Drugs

'Economic crime' is as old as the organized economy itself. Criminals invariably need to hide their bounty, but they also want to be able to retrieve and use it as they like. This is an aspect frequently overlooked. So why did the world community in the latter part of the 20th century feel compelled to develop a new concept of criminal law and corresponding rules that focus on the obscuring of ill-gotten gains? The official rhetoric is well known. The accumulation of capital from illegal markets, especially the drugs trade, had reached a dimension[1] that endangered the licit economy, with internationally organized

criminals empowered to an extent that they could destabilize public order. Seizure and forfeiture of ill-gotten gains as the primary countermeasure was regarded as an efficient means to tackle the problem. The theory being that seizure and forfeiture would reduce the motivation to engage in criminal activities, put constraints on criminal organizations and – focusing more closely on trading in forbidden goods – it would raise their costs and thereby their availability to the consumer.

The summary of this rationale can be found in many international texts on this subject and it has also frequently been advanced by national governments. Of course in a more detailed analysis, the approach begs answers to many questions: Why were the 1980s the right time for such measures? A short and obvious response here would be that deregulation and globalization of financial markets worked both for illicit and licit operators. Exponential growth in the number of international money transactions coupled with similar improvements in the electronic execution of transactions opened up new horizons for legitimate businessmen as well as money launderers. However, developments at the national level to deal with the criminal aspects of financial deregulation, did not keep pace with liberalization of the markets, leaving law enforcement agencies and supervisors reliant on traditional crime solving methods. In addition to the constraints of the territoriality concept and cumbersome co-operation procedures between states, law enforcement was rendered increasingly ineffective where transnational crime was involved.[2]

Crime control legislation has traditionally come about through a process in which a discourse conceptualizing behaviour as ‘evil’ and characterizing existing laws and organizations as insufficient to cope with the new threat has occurred. This mechanism has been described by academics as one of creating a ‘moral panic’[3] and was applied in earlier times to ‘crusades’ directed at ‘garroters’, ‘hooligans’, ‘dangerous aliens’, ‘sex offenders’, ‘muggers’ or ‘anarchists’, a similar process was set in train on an international level with regard to money laundering. In the early 1980s, the focus by European countries on transnationally-organized terrorism and political extremism of the Right and the Left led to the first European document to address ‘money laundering’ this text touched on political hijacking for ransom and other forms of terror.[4]

Rapidly however, concerns about the abuse of financial institutions to obscure ill-gotten gains shifted to the issue of capital accumulation on illegal markets, especially in illicit drugs. Fears in the USA about the growing numbers of drug users in the aftermath of the Vietnam War, led to the declaration of an all-out ‘War on Drugs’.[5] Traditional policing methods that tackled the problem by pursuing the street vendor, the macro-dealer and then the bosses of crime organizations operating in organized markets did not look as though they would yield much success, police strategists therefore looked for

alternative methods. 'Going for the money' in order to cut off the 'head of the serpent' using civil and criminal forfeiture concepts was just the starting point. The next step was to force financial institutions to establish and maintain a 'paper trail', in particular in relation to cash transactions. It was recognized that this would only constitute a coherent policy if it were applied world-wide. Therefore looking at it from the perspective of the time, recruiting the financial centres and ultimately the rest of the world into this policy was a very bold, but logical undertaking.

To make pronouncements as to whether these concepts were realistic and whether the consequences they generated both domestically and abroad, is beyond the scope of this work.[6] Similarly, the fundamental question whether organized crime does indeed pose the threat that governments and international organizations have always maintained it does, will also not be addressed here.[7] For the purpose of this study, it is sufficient to state that both the international community and national legislators believed in this threat to the extent that they changed their legislation.

Given the aspirations to develop a world-wide policy, the UN was the obvious place to secure such an agreement even if the strategists in the North did not regard it as the place to enforce its implementation.[8] In the context of the UN system it was quite logical to supplement existing narcotics treaties[9] with the ultimate prohibitionist text, which most importantly included the concept of forfeiture, not only of illicit drugs but of the profits of crime. The main difficulty when drafting the 1988 *UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances*[10] was to convince the countries of the Third World to participate in these efforts. They were perhaps accustomed to being described as the main drug 'suppliers' because of being the major source of the raw materials used in the production of the most common illicit drugs. Combating money laundering was portrayed as focusing on the 'demand side' and as the contribution of the countries of the North to attacking the drug problem from their side.

The UN treaty introduced the criminal law aspect of combating money laundering and ever since then the topics have basically remained the same: forfeiture of ill-gotten gains, criminalization of money launderers (be it individuals or companies), as well as mutual legal assistance and extradition.

The UN AML-programme did not address regulatory issues, other than the bar on opposing bank secrecy legislation to mutual legal assistance requests.[11] This begs the question why so many of the new instruments addressing 'market integrity' have used criminal law as a first step towards harmonization of law. One answer could be that the 'preference for criminal law' could be rooted in the US legislative tradition and the relative ease with which US legislators put criminal sanctions on many types of undesirable behaviour. However, the more compelling explanation must be found in the relative

simplicity with which countries in general agree to criminalize behaviour as opposed to engaging in the creation of complex and costly administrative or supervisory structure.[12] Of course in the context of AML, both approaches were ultimately necessary, but this was not yet evident in 1988.

Thus far, money laundering was nothing more than a rather utilitarian, 'strategic concept' to combat the accumulation of capital generated on illicit drug markets. In addition, the prime target was the introduction of forfeiture, as is evident from the historical texts preceding the UN Convention.[13] Little attention has been paid to the fact that this approach required the revitalization of an old sanction that had been abolished 200 years earlier after long battles when human rights charters were being developed. Until recently[14] 'confiscation' carried the stigma of its previous abuse by absolutist sovereigns as a means of dispossessing the nascent monied class in the 18th century. It is all the more astonishing that a concept that had so thoroughly fallen into disgrace could be re-cycled without any major policy debates 200 years later. From this perspective, the 'criminalization' of money launderers was a mere 'ancillary' step; between 1987 and 1988 the *travaux préparatoires*[15] to the Vienna Convention added this concept to the list of topics which had only a year or two earlier, been developed nationally in some of the member countries.[16] The criminal law programme of the Vienna Convention nevertheless still dominates the current standards. It requests member states to criminalize money launderers (using a complex and competitive three-fold definition in Art. 3)[17], to provide for asset forfeiture (Art. 5) and allow for extradition and mutual legal assistance (Art. 6 and 7).

B Originally on a Parallel Track: Customer Due Diligence

Concurrently with the emergence of AML laws, financial supervision was revolutionized. The two developments were originally totally independent of each other. The roots of Customer Due Diligence (CDD) are to be found in prudential law and in internal risk management within financial institutions. On the one hand, as early as 1971 legislators in the USA and other countries limited bank secrecy rules to cases where tax authorities suspected an illegal drainage of taxable assets abroad, especially to off-shore centres.[18]

On the other hand, an interesting illustration of the emergence of CDD as part of private risk management within institutions and among institutions can be found in Swiss law as the developments following the so-called 'Chiasso' scandal illustrate. In order to save the reputation of Swiss banking, the then President of the *Swiss National Bank* (SNB) Fritz Leutwiler and the *Swiss Bankers Association* (SBA) wrote the first version of the '*Swiss Bankers Code of Conduct*' (CDB) in 1977.[19] The SNB withdrew as a contracting party when the second edition of the CDB appeared in 1982, when it was made clear that

the text was a purely private document, a kind of 'gentleman's agreement' between some 400 banks in Switzerland. It was to develop into a key instrument of self-regulation. The fact that breaches of the code carry a private sanction of up to 10 million Swiss francs, adjudicated by a special private tribunal, adds to its credibility.

In substance, the CDB prohibits active encouragement of tax evasion. The main section of the text, however, spells out, in a detailed manner for the first time, rules on customer identification. It distinguishes specifically between regular customers and over-the-counter transactions, with information on how to treat domiciliary companies; develops the notion of 'beneficial ownership' and defines to what extent banks may rely on identification conducted by other financial institutions (banks or introducers). Written at a time of crisis to save the reputation of a financial centre that had overstretched its limits with legitimate and also dubious practices, this text developed into the blueprint of a series of international texts on CDD, starting with the *Basel Statement of Principles* (BSP)[20] and ultimately some 20 years after the first edition of the CDB, a key section of the '*Forty Recommendations*' of the *Financial Action Task Force on Money Laundering* (FATF).[21]

Although there was no explicit link at the time of the first CDB to preventing ill-gotten gains from entering the financial sector, this aspect rapidly gained significance both nationally and internationally. Following a US initiative, the *Cooke Committee*, the *Basel Committee on Banking Supervision* (BCBS), made up of the then 10 leading banking supervisors and organized within the '*Bank of International Settlements* (BIS) system', adopted the BSP on 12 December 1988. It was the first time that bank supervisors agreed internationally, in such a prominent way, on the risks of the abuse of the financial system 'to transfer or deposit money derived from criminal activity'.

From a current perspective, the text is rather basic, however it has been a crucial contribution to the creation of modern CDD rules: Clearly drawing on the Swiss CDB, as far as it relates to customer identification, giving the backbone of the 'Know-your-customer (KYC)-principle', namely: 'Banks should make reasonable efforts to determine the true identity of all customers'. The details though were still left open. It went on to state; 'It should be an explicit policy that significant business transactions will not be conducted with customers who fail to provide evidence of their identity'.

The rules on co-operation with law enforcement authorities were similarly in a fledgling stage: 'Banks should co-operate fully with national law enforcement authorities to the extent permitted by specific local regulations relating to customer confidentiality'. Thus far, only 'appropriate measures, consistent with the law, should be taken, for example to deny assistance, sever relations with the customer and close or freeze accounts'. And at that time there was no explicit mention of the right, let alone the obligation, to notify suspicion to

authorities (even though some countries, like the UK, already had established such concepts).[22]

It should not be forgotten that at the time, the prevention of the abuse of financial institutions by criminals was not yet an established supervisory concern. Only indirectly did supervisors manage to attribute to themselves such powers. Therefore the BSP 'was' a matter of concern to banking supervisors because public confidence in banks might have been undermined by the latter's association with criminals. The *Swiss Banking Commission* (SBC), to take this example once again, despite the protests of the Swiss Bankers Association used the clause on securing 'fit and proper conduct' by bankers in Art. 3, s. 2(c) of Swiss banking legislation as a hook to prevent money laundering.[23]

C The Merger: The Financial Action Task Force on Money Laundering 1989/90

1 Creating a permanent 'ad-hoc-group'

Even though the UN had just adopted its 1988 anti-drug Convention and the BSP had just been written, the industrialized nations and most notably the USA, the UK and France, were not satisfied that this would be sufficient to prevent the use of financial institutions for the laundering of drug proceeds. The US government under President Reagan had planned to create a task force to promote the programme of the Vienna Convention and wanted to introduce the idea at the G7 summit at Harrisburgh, USA in 1988. Political manoeuvring led France to oppose the suggestion, only to suggest something rather similar a year later, this time under its own chairmanship at the 1989 *Sommet de l'Arche*, G7 Paris summit. For reasons not yet entirely elucidated, the unlikely co-operation of a Republican US administration, fighting its war on drugs, and the France of socialist President Mitterrand, wanting to appear tough on economic crime and, especially help crack down on tax havens, led to the creation of a unique structure: an ad-hoc body, which was to remain permanently in place for at least a decade and a half and which was going to establish itself as the agenda-setter on preventing money laundering. The circumstances leading to its emergence remain known only to the insiders of the negotiations, which took place behind closed doors. So far, researchers have been able to bring to light[24] the fact that a serious distrust of the UN institutions led G7 to take matters in hand. G7 even turned down an offer by the UNDCP to run the secretariat of FATF in 1989, although its bid substantially undercut that of the OECD. With the choice of the OECD as its institutional location, the FATF opted for First World type procedures, it thereby also laid the groundwork for what was to be a refined peer-review mechanism, drawing from the OECD's established strict accession procedures.

From the outset however, G7 was interested in the participation of a group of important, but smaller financial centres (Austria, Benelux and Switzerland). Informal negotiations between the US Treasury and the Swiss Foreign Ministry cleared the entry of this group after an assurance was received that tax matters were to be excluded from the negotiations of the task force. From this perspective, it was highly symbolic that Switzerland assumed the chairmanship of the task force immediately after the original French presidency (1992/93 FATF III). From year four (FATF III) onwards, the membership of the group was enlarged to all OECD countries plus the 'Gulf Co-operation Council' (FATF II) and Singapore (FATF III).

From the beginning, FATF worked with a staff of three, but was heavily supported by country delegations. The actual power centre remained with a very informal 'steering committee' constituted as a kind of 'friends of the Chairman' group, without written rules. Within this steering committee the USA, France and the UK maintained their influence on the direction taken by the task force.

2 The FATF 'Forty Recommendations' of 1990

What may appear as a well-balanced minimum standard simply because the concept and rationale of the Recommendations survived for more than a decade, is actually the result of a patchwork of elements thrown together in complex negotiations by various contributing parties.

The programme was developed in three working parties (Working group I: Legal issues; Working group II: Regulatory issues; Working group III: International issues). The influence of the main negotiators has been very mixed: The USA, for all its interest in the issue, at first sight left relatively slight traces in the 'Forty Recommendations': The creation of the task force aside, the major achievement by the USA was to receive endorsement from the FATF for the criminal law programme of the Vienna Convention 1988. Its influence was also felt in the 'Legal Working Group' presided over by the US treasury, where the three-step money laundering methodology was adopted, a concept that is now used world-wide for the analysis of cases.[25]

But the USA did not prevail in the regulatory area. Its two main suggestions, routine reporting of cash transactions and the control of wire transfers, were turned down at the time. Although France had a certain sympathy for the US suspicion of cash (France's retail business was already extensively electronified), it sided with Germany, the UK and Japan, to dissuade routine reporting. The Europeans managed to persuade the USA to give preference to a suspicious transaction reporting approach, based on red flags, and a model concept had been developed with the Bank of England's *Guidance Notes for Banks and Building Societies*. The 1990 standards did not yet impose an outright obligation to report; the issue was to be revisited, however, at the revision in 1996[26] and further refined in 2003.

Switzerland once more contributed its detailed approach to KYC, contained in CDB. These rules were readily accepted by the FATF members, since they had already been introduced into the programme of the BSP in 1988.

A further essential decision was taken when the FATF endorsed the need for increased diligence in unusual circumstances,[27] a concept not always understood by all implementing parties.[28] With hindsight, this is the nucleus of a 'risk-based approach' to CDD. It allows a highly flexible attitude starting with simple and cheap routine operations in the vast majority of customer relations, especially in retail banking, progressing according to risk patterns towards a full investigation of a client's economic background, the reasons for specific transactions and understanding the logic of complex corporate structures if need be.

From a more systematic perspective, the standard of 1990 essentially contains:

- The criminal law standards (Rec. 1–8)
- Regulatory obligations for banks and non-banking financial institutions (Rec. 8–22)
- Additional rules on the supervision of the financial sector pertaining specifically to the prevention of money laundering (Rec. 26–29)
- Rules on international co-operation of authorities (Rec. 30–40).

It will be noted that the rules initially applied only to banks and were then gradually extended to 'Non-Banking Financial Institutions' (NBFIs) and 'Non-Financial Institutions' (NFIs), a process driven by interpretative notes and ultimately, the revisions of the Recommendations in 1996 and 2003, recognizing the fact that money launderers were increasingly making use of non-banks for their purposes.

The five main obligations for financial institutions defined in 1990 are still fundamental for the currently applicable standards:

- Customer identification
- Increased diligence in unusually large transactions
- Register the information on counts 1 and 2 and keep for five years
- Inform specialized national body in case of suspicious transactions or patterns of such transactions
- Organize in-house compliance and training structure.

This list of topics shows how criminal and regulatory law standards, developed in different contexts and by very different organizations, have now merged.

3 Recommendations, peer process and monitoring

The 'Forty Recommendations' would have remained just another document, had the FATF not created a strict monitoring mechanism based on peer pressure. This is probably the most fundamental contribution of the FATF to international law.[29] It suddenly made frequently belittled 'soft law' a viable option for developing standards of collective governance, especially in a framework where agreement on binding law would be very difficult to reach with a larger group of participants. Members agreed in a first round to account for their implementation efforts annually, by 'self declaration' ('Self-evaluation Procedure', SEP). Furthermore, they agreed to receive teams of experts from members of the Group for on-site visits and a series of in-depth interviews with officials and representatives of the private sector. This report would then be negotiated between examiners, the examined country and ultimately the Group. In order to address the examined country's shortcomings in a more direct manner within the Group, the FATF thought it indispensable to keep the reports confidential and to publish a 'softened' summary at its annual press conference – a precaution that should not have been necessary and is exclusive of public control over the work of the Group.[30] The procedures that were adopted by FATF basically drew on the accession procedures to the OECD. They have, in turn, influenced other focused evaluation procedures in the OECD[31] and other bodies, like the Council of Europe.[32,33]

Even though the monitoring procedure has proven highly effective, it also needs to be critically evaluated. Its main strengths may also be its weaknesses: Recommendations do not bind countries directly, rendering ratification procedures on a national level unnecessary. Therefore not only is the process driven by the executive branch, on an international level, it is an intergovernmental procedure and excludes direct democratic control by national parliaments. Theoretically, this would be relatively unproblematic because such Recommendations would ultimately have to be translated into domestic law by national parliaments. However, these Recommendations have proved to be politically binding. The peer process depends on 'naming-and-shaming' mechanisms, but in practice states – at least the smaller ones – do not have a choice of whether to implement or ignore the Recommendations.

The 'Forty Recommendations' even include formal sanctioning procedures, when special attention is requested in relation to persons, companies and financial institutions based in countries that apply these Recommendations insufficiently (Rec. 21). Ultimately, the FATF could even exclude a non-compliant country from its membership. To date, sanctioning procedures within the Group have generally been far more subtle in practice. However, the lack of democratic control has various consequences.[34] It opens up the process to the pragmatic expansionism of crime control concepts, it does not guarantee respect for the rule of law and, ultimately, the risk of hegemony is

germane to the notion of peer pressure. Insistence on the Nation State's ways of law making is no real alternative when developing internationally co-ordinated rules as long as there is no 'World Parliament'. On the other hand, thought needs to be given how to secure 'democracy beyond borders'[35] especially in areas where pragmatism may tend to prevail.[36]

4 Deficits and shortcomings

On a purely technical level, the shortcomings of this first global minimum standard on the prevention of money laundering are apparent from the subsequent reviews and amendments:

- FATF 40/1990 applies to banks only
- The 'Forty Recommendations' focus on drug trafficking as a predicate offence, although possible extension to other serious offences is already flagged in the original text
- CDD standards still remain very general; it will be seen that far more precision is necessary to prevent the misuse of institutions by criminals
- Little attention is given to co-ordination between national authorities and international co-operation is still weak.

Nevertheless, this standard – against the original authors' expectations – proved to be a sound basis for legal development over the next decade. The fact that a considerable margin of variation was contained in its first edition has to do with the methodology of harmonization through 'soft law'. The OECD's *Working Group on Bribery in International Business Transactions* replicated and conceptualized this approach later on in a more academic way. The model of 'functional equivalence'[37] allows countries to chose their own means to implement the standard, assuming that each legal system follows its own functional logic. The subsequent evaluation by the Group will determine whether, from a holistic perspective, the common goal is met by the specific implementation at the country level.

III SPREADING THE GOSPEL

A The Mechanics of Expansion

Shortly after the adoption of the 'Forty Recommendations', regional organizations and national legislators translated the new standards into binding law. Instruments such as the Council of Europe's Convention 141 *On Laundering, Search, Seizure and Confiscation of the Proceeds from Crime*[38] of 8 November 1990, or the EC Directives of 10 June 1991[39] are set in their own institutional

context. So, for example the EC would only indirectly refer to the obligations to criminalize money laundering,[40] since the EC Commission did not have power to enact criminal law under the 'first pillar' of community law. However, to a large extent, these texts and even more so the non-binding instruments of the OAS/CICAD[41] and the UN-model laws, simply reproduced the essence of the 'Forty Recommendations' and helped to implement them. They were successful in promoting national legislation and regulation in a first round in the key financial centres of the countries of the North.

The FATF itself, after having grown to the limits of its own group process, engaged in creating a series of regional 'satellites', reproducing its own structure, but allowing for regional ways of co-operation to dominate procedure. The first such satellite was to be the 'Caribbean Financial Action Task Force', made up of the financial centres of the Caribbean area, with participation of some of the current and former colonial powers.[42] Similar outposts have been created in other regions.[43] Problems of consistency arose when in 2000, the 'parent institution' published 25 criteria defining 'Non-co-operative Countries and Territories' and drafted a 'black list'[44] of such non-co-operative jurisdictions, including several members of its own satellite bodies. Since then, a certain animosity has crept into the relations between the CFATF and the FATF.

A further dimension was added to the outreach activities with the creation of the so-called 'Egmont Group'.[45] Following the introduction of the concept of suspicious transaction reporting, it was recognized at an early stage that 'information exchange' between both domestic and foreign special governmental agencies commonly referred to as 'financial intelligence units' or 'FIUs' was crucial to guarantee the effectiveness of AML systems. A number of FIUs started working together on an informal basis in 1995; the Egmont Group as it became known, aimed to provide a forum for FIUs to improve support to their respective national AML programmes by developing a more effective co-operation with the main focus on the areas of (systematic and standardized) information exchange and sharing of expertise. It happened to become the main framework for co-operation among the FIUs in the next couple of years and a core means of globalizing the AML efforts.

B Details

At their 15th Conference (June 1986, in Oslo) the European Ministers of Justice decided to address the issue of international co-operation in the investigation, seizure and confiscation of the proceeds of crime. The result was the Council of Europe's Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime.[46] This Convention addresses the issues

of international co-operation as well as criminal offences that follow up some of the FATF recommendations and goes beyond the Vienna Convention, in that it is not restricted to offences related to drugs and the list of predicate offences is extended to 'any criminal offences' for the first time.[47]

The predicate offences contained in the EC Directive of 10 June 1991 (*Directive 91/308/EEC*) corresponded to the offences contained in the Vienna Convention and also 'any other criminal activity', although this was framed as being optional, thereby leaving the individual member states to determine their own catalogue of predicate offences. The duty to report is established in the Directive, while Rec. 16 FATF leaves the choice between a duty or the right to report open.

The 1991 Directive was amended by the *Directive 2001/97/EC*, which extended the list of predicate offences as well as the list of activities and professions that have been shown to be vulnerable to money laundering techniques and typologies.

The work of the UN continues to be concerned with narcotics, but it has also extended its work to combating money laundering. The UN Office for Drug Control and Crime Prevention (UNODCCP) is the agency responsible for the 'Global Programme Against Money Laundering'. This is essentially a technical assistance programme in relation to criminal investigations and together with Interpol this agency maintains an automated compendium of information on the status of legislation and law enforcement in different countries known as the *International Money Laundering Information Network* (IMoLIN). The UNDCP has also drafted model laws on anti-money laundering, one for civil and one for common law systems.[48]

In December 2000 the 'UN Convention Against Transnational Organised Crime' and three protocols were adopted.[49] The purpose of the Convention is to 'promote co-operation to prevent and combat organized crime more effectively'. The Convention establishes four specific crimes to combat areas of criminality which are used in support of transnational organized crime activities: participation in organized criminal groups, money laundering, corruption and obstruction of justice. The protocols establish crimes with regard to the smuggling of migrants, trafficking in persons and the illicit manufacture of and trafficking in firearms. International co-operation is effected under the Convention through extradition, mutual legal assistance, law enforcement co-operation and collection and exchange of information.

Finally, over the last few years, the FATF has increased its co-operation with the International Financial Institutions (IFIs). The three organizations are developing a common methodology to harmonize mutual evaluations world-wide. They are currently seconding staff to each other and have embarked on a pilot programme of assessments.[50]

IV THE 1996 AND 2003 REVISIONS OF THE FATF RECOMMENDATIONS: 'BEYOND DRUGS AND BANKS'

A Broadening the Scope in 1996

1 Enlarging the list of predicate offences in 1996

The original focus on drug-related offences is mirrored in the national laws of the countries that had implemented the Vienna Convention at an early stage.[51] Other countries took account of the broader risks of abuse of financial centres by criminals.[52] It was also acknowledged that a narrow definition of predicate offences would make the corresponding notification systems ineffective, since it offered too many easy excuses for financial operators.[53] The enlargement of the scope of offences had already been heralded in a cautious manner in the 1990 Recommendations by the FATF;[54] the next steps were taken by the Council of Europe as early as 1990, when its definition of money laundering in Art. 6 broke away from the confines of the Vienna Convention: The legal definition of *predicate offence* according to Art. 1(e) refers to 'any criminal offence', whereas Art. 6, para. 4 grants parties the right to restrict the scope of predicate offences to certain categories contained in a declaration addressed to the Secretary General of the organization when depositing the instrument of ratification.

The breakthrough to enlarge the scope of predicates was achieved in 1996 within the FATF, when some key countries decided to abandon the previous restrictions. France, in its 1996 revision of AML laws[55] went as far as to include all offences in the concept of predicates. The common denominator within the FATF was to be more restrictive, and refers to 'serious offences' (Rec. 4). However, as a compromise, the redrafted Rec. 4 refers back to the individual country to define what it considers 'serious'. In Japan (and Korea) for example, these countries had – albeit in a different context – just opposed outright acceptance of active bribery of foreign public officials as a predicate offence to money laundering.[56] The FATF refused in 1996 to put bribery on its list of serious offences as part of its standard. In the meantime this debate has been overtaken by more recent legislative changes in Japan and Korea. The national prerogative to define what members consider a serious crime remains essential however, for those financial centres opposing the inclusion of tax fraud in the list of predicates.

2 Effects of the extended list of predicate offences

It is only with hindsight that the effects of the extension of the list can be assessed. From a practical point of view, it seems logical that crimes of a

similar gravity generating ill-gotten gains should be treated similarly. Academics would, however, maintain that thereby the nature of the money-laundering offence (and with it the entire AML structure) has been fundamentally modified: What used to be a pragmatic extension of the crime of drug trafficking and an ancillary provision to make asset forfeiture more effective, is now being turned into a free standing concept, that can be attached to any offence, serving the purpose of raising the sanction for the perpetrator and his accomplices considerably. It enables the formal offence of subverting the course of justice to be attached to virtually any economic crime.

On a quite different level of observation, the extension has made money laundering move away from a drug-related measure to a 'prime instrument of repatriation' of the stolen, embezzled, defrauded funds and profits of corruption. Nowadays, financial institutions will have to pay at least as much attention to abuses linked to 'graft' in both the general sense and in the particular in the preparation of payments made by those supplying illicit payments and creating 'slush-funds' (off the books assets) in order to bribe, and the subsequent processing of them to recipients. And it does not stop there, the subsequent laundering of the bribes and the profits generated from bribe-tainted contracts, as well as the bounty of simple forms of stealing are all areas that now pose risks for financial institutions.[57] Judging by the estimates, the new risks amount to figures as important as the funds generated on illegal markets world-wide.[58]

It may be argued therefore, that a relatively simple enlargement of the scope of the money-laundering offence could effectively have changed its main function entirely.

3 FATF 2003: A new set of predicates

The 2003 revision of the standards was finally able to define a common minimum of what was meant by 'serious offences'. The text of the Recommendation (now Rec. 1) gives the possible approaches: Either include all offences as predicates or define a threshold (be it by categories of offences or by penalties) or list them individually. The 'glossary' appended to the FATF 2003 gives 20 areas that as minimum need to be included as predicates.

The criminal law chapter now also contains clearer rules relating to the liability of legal persons (Rec. 3) and on freezing and confiscation (Rec. 3).

4 Enlarging the scope of professions bound by the AML rules

The Recommendation 8 follows up on earlier preparatory work of the FATF. As in other bodies that promote 'soft law', changes are anticipated in statements in evaluation reports and in interpretative notes as a side product of the ongoing work of the FATF.[59] Rec. 8 extends the application of Recs. 10–29 from banks to non-bank financial institutions (NBFIs). This principle is also

explicitly extended to non-supervised NBFIs (like Bureaux de Change etc.). Rec. 9 goes yet a step further by inviting Members to consider applying the core CDD-Recommendations to 'the conduct of financial activities' of otherwise Non-Financial Businesses. The methodology suggested in an annex to the FATF 1996 amendment, focusing on 'activities' rather than listing professions, prevails in the 2003 revisions of the FATF Recommendations for an even further modification of the standards.[60] This delicate distinction has given rise to extensive regulations on a national level.[61] More recently, the EU when modifying its 1991 AML directive spent a lot of time and energy on this issue, especially trying to find an adequate formula to include lawyers and notaries. Its approach mirrors the FATF's reasoning when subjecting the independent legal professions to the AML rules, as far as they are participating in financial and corporate transactions. The Directive however, adds further restrictions to inclusion of independent lawyers by enumerating specific transactions, believed to carry a high risk of abuse for money laundering.[62]

The definition of the scope of professions was one of the major issues revisited during the debate on the reform of the Recommendations[63] because the 1996 version left essential questions open. On a national level, questions such as to how to include raw material and commodity dealers within the scope of AML rules have caused great difficulties.[64] The 40 Recommendations of 2003 echo earlier Money Laundering Typology reports by the FATF when noting a 'displacement effect, whereby money launderers seek to use businesses or professions outside the financial sector'.[65] The list of NFIs, the FATF seeks to include, encompasses:

- casinos
- real estate dealers
- precious metals, stones dealers
- the legal profession and accountants
- trust and companies service providers.

The FATF focuses in particular on the legal and accounting profession.[66] One of the major issues here is how to draw the line between traditional lawyers' work and acting as a financial intermediary.

5 Toughening up reporting requirements

Whereas the 1990 text had left it to Member States to choose between optional and mandatory reporting, the 1996 FATF Recommendations declared reporting obligatory. Following the model of many countries (UK, France and USA), Rec. 15 states that financial institutions should be required to report their suspicions promptly. However, it still refers to 'competent authorities', as recipients of notifications, thereby leaving it to Member States to choose

whether to create a specialized 'Financial Intelligence Unit' (FIU) or to define reports as complaints to law enforcement bodies. In some countries *Suspicious Transaction Reports* (STRs) were sent directly to prosecution authorities but a criminal investigation would not necessarily result because the requisite qualified suspicion was lacking. Additionally law enforcement authorities are typically organized locally and would not have the capacity to liaise systematically with foreign counterparts.[67]

On the other hand, a theoretically and practically significant development was triggered by the reformulation of reporting requirements in 1996. Some countries have extended the notion of 'suspicion', thereby collapsing Rec. 14 (increased diligence in unusual transactions and patterns of transactions) with Rec. 5 (Reporting of suspicion). For instance, the Netherlands explicitly request 'unusual circumstances' to be notified to authorities, the UK and the USA have similarly early notification systems albeit using more implicit language. This arrangement has serious consequences for the number of notifications filed.[68] Other countries insist on actual suspicion, thereby keeping the number of notifications rather low (France, Germany and Switzerland).[69] Of course there is also a direct correlation to the quantity of notifications processed into criminal investigations – an unusual transaction notification system would generate probably less than 5 per cent of criminal investigations, whereas the corresponding figure for a suspicion-based system could be well over 50 per cent.[70] Therefore a corresponding degree of caution has to be exercised when comparing statistics from these countries.

These differences could give rise to a dispute over the rationale of monitoring.[71] Is an 'early warning system' preferable or should the financial professions – rather than the police, attempt to determine the economic logic of transactions or patterns of transactions before alarming the authorities (and, in most cases, even if unintentionally, the client)? Answers are also linked to other fundamental differences in the construction of notification procedures. Some countries request financial institutions to automatically block the funds involved, whereas others, typically those receiving 'unusual transaction reports' would only block upon request by the competent authority.

This 'philosophical debate' is interesting, but it hides an even more fundamental issue: Unusual transaction reporting shifts responsibility for outcomes from the financial institutions to the authorities, who then tell the financial institutions how to manage the client relations in question.[72] On the other hand, the overall tendency of AML concepts is moving away from a 'rule-based' towards a 'risk-based' approach to CDD, as will be explained later in this chapter. This latter approach utilizes the professional know-how, experience and also the differentiated approach of financial institutions to understand the economic background of financial transactions and the often complex financial structures on which they are predicated. There is – at a

minimum – an open issue here, if not indeed a risk of contradiction in the approaches put forward. If financial institutions are to take responsibility they need clear abstract rules and guidance, but they also need leeway for risk management. Some clarification of this discrepancy has been obtained through negotiations between the FATF, BCBS and, for instance, the Wolfsberg-Group, the 'triangle' discussed below in Section VII. In the meantime, the FATF and 'Basel' have agreed that regulators and prosecutors should grant financial institutions adequate flexibility for a 'risk based approach'.[73]

V SECURING IMPLEMENTATION WITHIN THE CLUB AND WITH NON-MEMBERS

Once the initial phase of dissemination beyond the constituency of the FATF and a first round of amendments to the standards had been made, the task force and its regional partner organizations like the Council of Europe, were ready to get tough with laggards, both within the group itself and outside.

A Within the Group: Monitoring

1 'SEP' and 'MEP'

The monitoring mechanisms mentioned above[74] have been described as a 'major departure from the traditional view that implementation of treaties and conventions was a purely domestic matter'.[75] Whereas the 'Self Evaluation Procedure' (SEP) allows members to describe their approach in their own words in a procedure followed annually on the basis of a standard questionnaire, the 'Mutual Evaluation Procedure' (MEP) relies on the on-site visit of experts from Member States to conduct interviews and give their critical judgement to the Group. In the course of intensive negotiations with the Group an evaluative text is finalized.[76] Outside observers have correctly criticized a lack of 'methodological coherence and standardization'.[77] The process combines comparative legal analysis, based on a functional approach to comparison of law, with a political assessment. Since the experts are drawn from Member States and the teams made up primarily of officials and law enforcement practitioners, there is little emphasis on academic conceptualization and analytical consistency. Even though the political significance of the examined countries might influence the subtlety with which the country's performance is monitored, the process still gained popularity. It has been copied and adapted to the needs of other organizations and initiatives.[78]

2 Sanctions

The original 'Forty Recommendations' of 1990 had already introduced a core

sanctioning concept in Rec. 21.[79] It took, however, until 1996 when first use was made of formal sanctioning. Until then the Group had relied entirely on informal peer pressure and the subtle threat of publication of unfavourable evaluation results in the annual report of the FATF.

1996 saw the first occasion of the FATF taking more formal measures, with moves to sanction Turkey, an OECD and FATF full Member. Clear lack of compliance with the 'Forty Recommendations' led the OECD President to write a formal letter to the Minister in charge, expressing his concern. Then a high-level mission was sent to Ankara, to motivate the Turkish Government to take urgent action. On 19 September 1996 the FATF made a public statement for the first time referring to Rec. 21.[80] A practical translation of the rather cryptic text of this Recommendation would mean that all financial institutions of the OECD/FATF area would be requested systematically to apply 'increased diligence' in dealing with persons, companies and financial institutions domiciled in Turkey. This would effectively reduce the ability of Turkish industry to do business internationally.

A second use of Rec. 21 was made in relation to Austria. After continuous refusal by the Austrian Government to abolish anonymous bearer passbooks and several 'soft' interventions by FATF (monitoring reports, intervention of officials with government representatives etc.), the FATF announced 'formal monitoring of the situation' in a press release of 11 February 1999. Subsequently, in February 2000, after a further year of inactivity by the Austrian Government, it publicly threatened to suspend Austrian membership to the FATF unless very concrete steps followed within a definite timeframe.[81] Ultimately, under this pressure, Austria decided to abolish its bearer passbook accounts.

The consistency of the FATF's actions have been put into doubt by media reports on the follow-up of some very critical evaluation reports with more powerful nations, especially the USA. Despite the fact that the 1997 evaluation report of the FATF[82] had identified serious deficiencies in the USA, especially in the area of implementing KYC policies (with banks and even more so with NBFIs) consistent follow-up action by the FATF does not seem to have been pursued, even though the Republican Congress showed a lack of will to comply during the last year of the Clinton administration.[83] Significant change only came about after 11 September 2001.

B Getting Tough with Non-Members

1 The NCCT process

Although compliance by the membership of the FATF had not yet been fully achieved and neither had the standards on CDD yet reached the necessary refinement to guarantee operational effectiveness, the FATF decided that the

ability of its members to protect themselves against money laundering could be undermined if non-member jurisdictions did not adopt and implement the Recommendations as well. Concerns about regulatory arbitrage and unfair competition being perpetrated by under-regulated Offshore Financial Centres (OFCs) was just as much in the minds of FATF Members as the law-enforcement perspective of taking action against crooks operating in territories averse to legal assistance. In what was an unprecedented move, the FATF chose to go beyond its original mandate to assess its own members[84] and in 1998 it initiated the process to identify Non-co-operative Territories and Countries (NCCTs).

> The aim was to seek out critical weaknesses in anti-money-laundering systems which serve operations in this area as obstacles to international co-operation and to reduce the vulnerability of the financial system by ensuring that all financial centres adopt and implement measures for the prevention, detection and punishment of money laundering according to internationally recognized standards.[85]

The FATF thereby joined a general trend pioneered by other organizations to develop the discourse on money laundering and related issues beyond the traditional link to predicate offences and re-conceptualize it as a problem of under-regulated OFCs.[86]

On 14 February 2000, the FATF published an initial report on NCCTs and defined 25 criteria consistent with the 'Forty Recommendations'.[87] The process described was to identify jurisdictions clearly falling below the established world-wide standard and to encourage them to enact and apply the necessary laws. In June 2000, without making approaches to the potential candidates through diplomatic channels (as had been done with the deficient Member States), the FATF went straight into publishing a first review in which 15 jurisdictions were identified as NCCTs on its famous blacklist.[88]

So far, the process had left the crucial question open as to what the consequences of blacklisting would be. Whereas G7 spoke of 'restricting financial transactions with those jurisdictions'[89] the Ministers of Justice and Home Affairs of the EU[90] went a step further and required suspicious transaction reports on all transactions with such countries. Considering that some rather large states (like Russia and Israel[91]), with a considerable volume of transactions were on the blacklist, this option does not seem very practical, in particular, if the effectiveness of what has been developed so far on suspicious-transaction-reporting is not to be discarded. On the other hand a process has already set in within the banking industry to apply increased diligence to NCCTs. This has been a strong motivating factor for countries like Liechtenstein to amend their legislation in a very short period of time[92] and to rush identification not only of new but also of existing client relations[93] in order to be de-listed.[94] In the meantime, most of the original jurisdictions on

the list have been exchanged for others, currently the Cook Islands, Guatemala, Indonesia, Myanmar, Nauru, Nigeria and the Philippines are listed.[95]

2 Critique

The process of peer-evaluation was strongly influenced by political motives beyond mere technical analysis but was acceptable to those subjected to it because of its element of reciprocity. This minimum of 'democracy' between states is lost if a group of nations starts subjecting non-members to an evaluation process they have not been able to discuss and accept. The fundamental element of peer relations is lost and with it an essential part of its legitimacy. However, the world is apparently accustomed to the fact that even in formalized international relations some powers have more say than others (take the Security Council of the UN), so that the NCCT-process (and similar extensions of evaluation beyond Members in the OECD's harmful tax initiative) have so far not been the subject of fundamental critique.[96]

VI RE-DEFINING THE PROBLEM: MOVING FROM ANTI-MONEY LAUNDERING TO OFCS

A closer examination of the materials reveals that from the outset, the initiatives against money laundering were not exclusively directed at combating criminal behaviour. It went nearly unnoticed at the time, but the historical evidence is conclusive and shows that the US administration in particular, attempted, from the first negotiation round within the FATF in 1989 to raise the Central Bank's ability to produce meaningful aggregate data on financial flows (in cash and electronically).[97] As a consequence of the liberalization of financial markets and the increasing pace of globalization, national control over financial markets was in danger of losing its grip. As the FATF was not necessarily the right institution to promote macroeconomic policy instruments, the issue was picked up by the IMF in its 1996 and 1997 'Data Dissemination Standards'[98] and its 'Code of Good Practices on Transparency in Monetary and Financial Policies' of July 1999.

While concerns about the 'stability of financial markets' in macroeconomic terms may have been a hidden sub-text to the FATF discourse from the early days, this issue has been put on the international agenda in a much more prominent way by the creation of the Financial Stability Forum (FSF) in February 1999. This G7-initiated body was created to

> promote international financial stability, to improve the functioning of markets and to reduce systemic risks through enhanced information exchange and international co-operation in financial market supervision and surveillance.[99]

On 25 May 2000, the FSF published a list of 'jurisdictions considered to have significant financial off-shore activities'.[100] The list distinguishes between three categories of jurisdictions, reflecting their perceived quality of supervision and degree of co-operation.

Shifting from the narrow focus of 'money laundering' to 'control of OFCs' implied that a definition of OFCs was required: Earlier neutral definitions of off-shore banking referring to banking abroad, meaning outside the territory of commercial activity, were superseded and the notion of off-shore centre rapidly became morally tainted and the expression was used as an equivalent to a 'regulatory' or 'tax haven'.[101] When referring to off-shore financial centres, reference was typically made to the services they offered, specifically the rapid and cheap incorporation of domiciliary companies ('International Business Corporations', IBCs), a slim regulatory and supervisory structure and a combination of strong customer confidentiality laws with inadequate mutual legal assistance.[102]

An integral part of the drive to control OFCs is the work on corporate vehicles used to obscure the provenance of funds. Within the FATF such efforts started in 1993 with the discussion on 'shell corporations'[103] it was continued over all these years but brought to more prominence in the OECD report *Behind the Corporate Veil*.[104]

At this point, the efforts of the FSF and the organizations concentrating on abuses of international business corporations merge with the efforts of the OECD on harmful tax competition in their joint efforts to impede the use of insufficiently regulated financial centres to circumvent the internationally established regulations.

VII SHARPENING THE FOCUS ON CDD: TOWARDS A RISK-BASED APPROACH

A New Initiatives in the Late 1990s

During the activity that went into developing the topic of money laundering into an instrument to control OFCs and to put pressure on NCCTs, it went nearly unnoticed that CDD standards had scarcely changed since 1990. This is rather astonishing if sound KYC and increased diligence in unusual circumstances were to be the major concepts of preventing money laundering.[105] It may well be that some of the larger Members of the FATF still had not really bought into the compromise agreed in 1990. The USA for example, was still more interested in cash reporting (cf. the re-drafted Recs. 22–24 of FATF/40 1996) than in a complete set of rules on customer identification applicable to domestic and foreign clients by all financial institutions alike.

With good reason, the BCBS identified significant deficiencies in KYC policies in banks throughout the world. It subsequently invited the 'Working Group on Cross-Border Banking', a joint group made up of members of the Basel Committee and the 'Off-shore Group of Banking Supervisors' (OGBS)[106] to examine existing KYC-procedures and to recommend 'standards applicable to banks in all countries'. In October 2001, based on the work of the Working Group on Cross-Border Banking, the BIS published a final version of the 'Customer Due Diligence for Banks' after having submitted an earlier version to a wide consultation procedure. As the text explains in its introduction, its approach is 'from a wider prudential, not just anti-money laundering perspective'.[107] Sound KYC-procedures are seen as crucial to the effective management of banking risks. The text goes on to elaborate the key risks. Going beyond the traditional approach of supervisors until the early 1990s, it establishes the need to ensure traditional *operational* risks just as much as *legal* and *reputational* risks are kept at bay. The BCBS builds a direct bridge back to its earlier texts on KYC, especially the Basel Statement of Principles[108] and other texts of the 1990s.[109]

The detailed rules on customer identification (including special paragraphs on trusts, nominees and fiduciary accounts, corporate vehicles, introduced business, client accounts opened by professional intermediaries, politically exposed persons, non-face-to-face customers, correspondent banking) are primarily meant for banks, the text however, expresses the opinion that rigorous CDD standards should not be restricted to banks, but also extended to NBFIs, including in particular, lawyers and accountants.[110]

Practically concurrently with these developments, the OECD Working Group on Bribery (WGB) studied possibilities that could prevent financial institutions from being misused by persons seeking to circumvent the newly agreed standards against transnational bribery of 1997. In 2000, the Ministerial Council of the OECD suggested that the appropriate bodies do more work on sound CDD, since it considered the existing standards as still rather basic.[111]

The work on money laundering related to corruption led to the creation in 1999 of an industry group, the Wolfsberg Group of Private Banks. The non-governmental organization, Transparency International (TI) and two experts made the suggestion to several large international banks that they should get together to develop common standards on money laundering (incidentally thereby also reducing the risks of money laundering related to corruption). The outcome of these deliberations was the 'Wolfsberg-AML-Principles', published in October 2000.[112] Even if this text – as a private agreement – is not in the same league with the intergovernmental instruments, it has greatly contributed to the discussion on CDD; the participant banks are pledging to live up to their standards on a world-wide basis in all their subsidiaries, including those in

OFCs. They are drawing from existing standards in developed countries, but they have contributed substantially to the harmonization of approaches across the Atlantic.[113] This instrument (similar to the BCBS-text) does not have a separate enforcement mechanism. National supervisors are however, indirectly acting as sanctioning bodies, since they are influenced by the self-binding standards set by the largest competitors in the market.[114]

These developments have helped raise awareness in relation to problem areas with the members of the FATF when they prepared their consultation paper for the last round of review of the FATF 'Forty Recommendations'[115] and for the first time in its history, the FATF has actually broadly consulted with the private sector and civil society before revising its Recommendations for a second time in 2003.[116]

The recent contributions on CDD by these institutions and organizations are a reflection of a more general discourse, which reflects the unease at the somewhat exclusive focus of FATF on the non-co-operative outsiders[117] in the past. While it is relatively easy to hit at NCCTs, especially the 'Liechtensteins' and the 'Vanuatus', it is far more challenging to actually make the AML systems effective in the large financial centres. New concepts are put forward instead or alongside the NCCT process, such as the 'white listing' of conforming financial institutions[118] or the creation of a '*cordon sanitaire*' around the regulated area, alternatively with regulated institutions to fend off the free influx of unmonitored funds.[119]

B The Emerging Standards on CDD

1 Redefining the scope of professions and activities subject to AML rules

Over the last decade AML-prevention was stepped up gradually with banks world-wide. Criminals and money launderers increasingly sought to evade scrutiny by using NBFIs or, in some cases, also NFIs. This shift was – as has already been mentioned[120] – recognized in the 1996 review of the FATF standards with the broadening of the scope of application of the Recommendations. Practical experience showed, however, that the new Rec. 9 and its annex still left too many questions open. In addition, the tentative list of activities subject to the Recommendation led to nationally diverging solutions. To define a common denominator of these activities has been one of the principal goals of the EU when revising its AML Directive.[121] Controversy, especially over how to include the legal profession,[122] led to substantial delays in the work on the Directive. The FATF revised Recommendations 2003[123] are now suggesting a far more explicit and detailed treatment of the scope of the Recommendations than in 1996. Consistent however with its earlier approach, the FATF lists risk prone *activities* alongside professions, when dealing with

non-financial businesses (talking of casinos, real estates agents, trust and company service providers, lawyers, notaries, accounting professionals).[124]

Understandably, the other documents – the Basel CDD Standard and the Wolfsberg Principles – applicable as they are to banks only, do not expand to NBFIs, even if the Basel Standards mention that the need for rigorous CDD should not be restricted to banks.[125]

2 The changing concept of CDD

When the FATF defined CDD for its purposes of combating money laundering in 1989/90, it used a model based on five obligations of financial operators:

- They were obliged to 'identify the immediate client' (regular clients under all circumstances, occasional clients above a threshold) and verify their identity based on official documentation. Additionally, they were to identify 'beneficial owners' if they differed from the immediate client (here the text was silent on verification)[126];
- They were to apply increased diligence when confronted with 'complex, unusual large transactions' or 'unusual patterns of transactions which have no apparent economic or visible lawful purpose'[127];
- They were to record information (sub indent 1 and 2) and to maintain records for at least five years[128];
- They were to report suspicion of money laundering to the competent authorities (FIUs)[129];
- They were to develop in-house compliance concepts, train their employees and introduce an audit function to test the systems.[130]

The later documents on CDD apply a somewhat different methodology, influenced by the practical needs of the industry: First the concepts distinguish between obligations in the *client-acceptance* procedure[131] and *ongoing monitoring*.[132]

Under the heading of KYC, they go beyond the original formal identification requirements for natural and legal persons. Within KYC, the current standards request financial entities to seek enough information from their clients to understand the client's business[133] in order to detect unusual transactions or patterns of transactions.[134] Whereas the original formulation of 1990 had left it to the intuition of the account manager whether he or she detected transactions out of tune with the information they had of their client,[135] the more recent standard requests the collection of substantive information on the client, in the context of private banking they go as far as requesting a 'client profile'.[136] Additionally, if corporate vehicles or trusts are involved, the financial operator is requested to understand the 'structure of the company sufficiently to

determine the provider of funds . . . and those who have control over the funds'.[137] KYC has developed from a formal routine documenting of identity to a complex process of understanding the client's business. However, the question immediately arises of how much time, effort and ultimately money needs to be invested into CDD? The answer is not an absolute one, rather the current discourse on CDD offers a new approach.

Before examining the current discourse on CDD, the depiction of risk management should be rounded off with a brief mention of the other standard setting bodies that seek to prevent the misuse of financial systems by intermediaries, other than banks. For example, the President's Committee of the International Organization of Securities Commissions (IOSCO) passed a resolution in October 1992 on money laundering,[138] which stated that each member should consider, *inter alia*, the extent to which customer identifying information is gathered and recorded by financial institutions under its supervision; the extent and adequacy of record keeping requirements; the system of reporting suspicious transactions; the procedures in place to prevent criminals from obtaining control of securities and futures businesses; the means to ensure that securities and futures firms maintain appropriate monitoring and compliance procedures and the most appropriate means to share information. While the IOSCO Objectives and Principles issued in 1998 emphasize market integrity as a whole, the BCBS focuses on overseeing individual companies and institutions. The IOSCO Principles also outline measures to combat financial crime and in particular money laundering.

The International Association of Insurance Supervisors (IAIS)[139] has followed a similar route to the BCBS in that their consolidated *Insurance Core Principles* issued in October 2000, cover the role of supervisors in dealing with financial fraud and money laundering. They particularly stress the importance of information sharing with foreign counterparts, but differ from the Basel and IOSCO Principles in that the IAIS Principles do not require the introduction of special regulations or maintaining internal controls to combat financial crime and money laundering.[140]

3 From a 'rule-based' to a 'risk-based' approach

In the early days, when supervision moved into the area of preventing money laundering in order to safeguard public trust in the banking industry, supervisors defined the risks and the measures to be taken by banks. Financial operators would follow specific rules. Banks risked sanctions for non-compliance, on the other hand, their responsibility was qualified if they followed the rules, even if the goal was not necessarily reached. In many instances, the rules proved to be unnecessarily burdensome and procedures invited purely formal compliance. In other situations they were inadequate because they did not necessarily take specific increased risks into account.

Based on an alternative approach, developed out of the established practice of self-regulation in some countries, the *risk-based approach* shifted part of the responsibility for defining the risks, for developing counter measures and, above all, for a dynamic risk management onto the institution. This approach had the advantage of allowing banks a relatively *simple* and cheap *ordinary procedure* for retail banking and cases without specific risk factors in general. However, as soon as risk indicators became apparent, they were expected to react with a finely calibrated concept[141] of asking intelligent questions, of building a body of information on the client, on matching information on his regular activities with transactions. They were to ask questions about the source of the wealth, possibly the destination, the economic reason for the transaction[142] and, if it did not appear to make sense, additional explanation, up to the point where the professional financier was satisfied or where clarifications left him uncertain, possibly even suspicious of his client's activities.

This latter form of regulation is also normative, in the sense that financial institutions develop 'compliance rules' to be followed by their officials. It is decisive, however, that the institution carries a large part of the responsibility. And at the same time the institution is granted a margin of appreciation.

If the banking and indeed, the wider financial community has to put up with an increasing density of regulation, it has – as a kind of counterweight – managed to convince supervisors of the benefits of a risk-based approach for both sides. This is probably the most significant impact of the Wolfsberg Group and its discourse with regulators. The BCBS also introduces its paper by sketching the risk-situations, it anticipates different standards according to the kind of banking[143] and the risk intensity of the type of customer[144] and FATF 40/2003 integrates its approach into its programme.[145]

4 The new standards

The generally used format in all new documents distinguishing between client acceptance procedures and ongoing monitoring[146] reflects the experience that it is often the case that risk indicators emerge only over time and depend on building a profile of the client with the obligations under the ongoing monitoring procedures the same as those under the account opening procedures. Additionally, banks will define the role of compliance units, checking on account managers, as well as the use of automated systems to select cases for closer checking.[147]

The new texts distinguish between three types of standards in client acceptance procedures:

- Ordinary procedure
- Simplified procedure
- Increased diligence

a Ordinary procedure

a 'KYC'

1 Formal identification

Fundamental to all KYC concepts is sound formal identification of the *immediate client.*[148] Traditionally, here all regular clients need to be submitted to the procedure; for walk-in-clients (occasional clients[149]), usually a minimum threshold excludes small routine operations, like the everyday currency exchange of modest sums.

Both on customer identification and the identification of *beneficial owners*[150] the emphasis of the new standards has shifted from documentation to *verification*.[151] This may lead to a significant increase of work in banking practice. Especially understanding the control structure and determining the beneficiaries of the *corporate entities and trusts* will require far greater attention.[152] Whereas all the texts accept that there are legitimate uses for complex corporate structures and trusts, they insist on means to prevent the use of a 'front' for others.[153] Here the Wolfsberg text is relatively short. Its main emphasis is on understanding the structure of the legal entity.[154] The BCBS's standards go further, especially when discussing special care in cases of companies with *nominee shareholders* and *bearer shares*.[155] Some of the ideas put forward, specifically those regarding bearer shares originate from the OECD's 2001 report *Behind the Corporate Veil*[156] and are picked up in great detail by the FATF Consultation Paper,[157] the actual recommendations, however, turn out to be far more general at this point.[158]

2 'Due diligence'

As indicated, determining unusual, or suspicious circumstances according to FATF 40/1996 Recs. 14 and 15, requires a certain measure of knowledge about the customer's line of business. This is the area where ordinary, simplified, but also intensified procedures diverge. In the normal case, routine questions will have to suffice (profession, type of business etc.). Only in special circumstances and specific areas of business (private banking, high network clients, substantial volume of business etc.) will there be an obligation to enquire routinely about the 'purpose and reasons for opening the account', about the 'source of wealth', the 'estimated net worth', 'source of funds', let alone to seek corroboration on reputation.[159]

b Simplified procedure

The FATF stresses that a simplified procedure can only be applied in strictly limited cases.[160] Looking at the options, however, it appears that suggestions

are very much in line with the reasoning of the BCBS.[161] The main topic of simplified procedures on KYC is 'introduced business' and the right of financial operators to rely on identification and verification performed by third parties.[162] Under this heading three situations need to be distinguished:

- Outsourcing of CDD
- The treatment of intermediaries and introducers
- Correspondent banking

a Outsourcing

If financial institutions choose to employ outside agents to take over part of the KYC-work (and this issue might become particularly acute in electronic banking, where outside certification agencies will be crucial in identification procedures[163]) the financial institution will need to have immediate and full access to the entire KYC-file of its agent as if he were part of the institution and, of course, the ultimate responsibility lies entirely with the financial institution.

b The Use of Agents and Introducers

A lot of work has gone into the detail on the role of agents. The *Wolfsberg Group* tasked a sub-group to come up with differentiating rules on specific types of intermediaries. This text, published in 2002 distinguishes between:

- Introducing intermediaries
- Managing intermediaries
- Agent intermediaries.[164]

The over-riding principle suggested by Wolfsberg, already contained in its principles, is that a financial institution *may rely* on due diligence conducted by an intermediary if it is satisfied with the intermediary's reputation, his integrity and with his due diligence procedures. The approaches chosen by the BCBS[165] and the FATF[166] do not fundamentally diverge, even if both texts insist on the ultimate responsibility of the recipient bank for KYC:[167]

> The banker will perform due diligence on the intermediary and establish that the intermediary has a due diligence process for its clients or a regulatory obligation to conduct such due diligence that is satisfactory to the bank[168]

The BCBS is more specific in insisting particularly that:

> All relevant data and other documents pertaining to the customer's identity should be immediately submitted by the introducer to the bank, who must carefully review the documents provided.[169]

This amounts to requiring a *summary check* on the due diligence process of the introducer on his client.

The BCBS flags serious problems where intermediaries are 'not empowered to furnish the required information' (especially referring to lawyers) and suggests that the bank should not permit the intermediary to open an account. Some national laws as well as the EU Directive seek a more differentiated approach regarding lawyers.[170]

c Correspondent Banking

Special attention to the problem of correspondent banking has been given by national and international bodies, especially after the US-Senate hearings following the Bank of New York scandal.[171] After a period of uncertainty and a rather inconclusive search for standards the *US Patriot Act*[172] has come up with strong language on this issue. In parallel, the BCBS[173] and the FATF[174] have put their concepts on paper. Wolfsberg has – based on the work of a subgroup – prepared its own principles in dealing with correspondent banking.[175]

All these texts acknowledge the need of the banking world to use correspondent relationships. Their common ground is to subject the respondent bank to closer scrutiny. Information on the structure, the ownership, the management and the respondent bank's AML-rules, on their supervision and their reputation are required. It is foreseeable that the known banks within the FATF-area will rapidly produce standard documentation. Additionally a certification body might collect this type of information on others as well. Increased diligence will be needed, however, in applying a 'risk-based approach', for banks outside the FATF/OECD area and particularly for banks based in NCCTs. Finally, all the texts are clear in refusing to enter into or continue correspondent relations with 'shell banks', defined by the FATF as a respondent established in a jurisdiction where it has no physical presence.[176]

c Increased diligence

According to the 'risk-based approach' it is primarily up to the financial institutions to develop the indicators and specified procedures to deal with increased risk situations. Wolfsberg[177] enumerates:

- Persons residing in and/or deriving funds from countries identified by credible sources as having inadequate anti-money laundering standards or representing high risks for crime and corruption;
- Persons engaged in types of business activities or sectors known to be susceptible to money laundering;
- 'Politically exposed persons' (frequently abbreviated to 'PEPs') referring to individuals holding or having held positions of public trust such as government officials, senior executives of government corporations, politicians, important political party officials etc., as well as their families and close associates.

This is merely an illustration of what the BCBS means when it talks of 'specific identification issues' or – in the context of on-going monitoring – of 'intensified monitoring for higher risk accounts'.[178] Indicators of higher risk may relate to the geographic origin of the client, his personal situation, his line of business, to the type of transaction he is seeking etc.

Supervisors have however, singled out some circumstances typically prone to risks and have developed standard procedures to be observed. Internationally here again a process of harmonization has set in. Examples for such specified cases are:

- Politically exposed persons (PEPs) and
- non-face-to-face customers.

a PEPs

Past scandals illustrate that financial institutions put themselves at high risk in reputation terms if they are misused by so-called 'potentates' to hide the bounty of 'graft' (be it the product of theft, embezzlement, fraud, corruption or other forms of misappropriation and abuse of their position).[179] Some regulators[180] have started to define particular procedures and the BCBS, Wolfsberg and the FATF[181] have picked up the issue in their standards. This development is new and has partly been promoted by the work of international bodies and national implementation of new standards against transnational corruption.

The BCBS defines 'PEPs' as 'Individuals who are or have been entrusted with prominent public functions, including heads of state and of government, senior politicians, senior government, judicial or military officials, senior executives of publicly owned corporations and important political party officials'.[182]

The standards require 'additional diligence', that is, matching information that is available publicly, possibly conducting investigations of particular individuals, using specified client advisors (geographic desks) and seeking senior management approval for client acceptance.

C Playing 'Ping-Pong' with Regulators

The documents discussed here are of diverse status and it would be inappropriate to place intergovernmental texts and private 'gentlemen's agreements' on an equal footing. Nevertheless, the current development is more driven by the discourse between these organizations than it may at first seem.

Although the first edition of the Wolfsberg-Principles did not introduce new concepts going beyond the standards of traditionally well-supervised countries, Wolfsberg has participated both in the consultations with the BCBS and the FATF and has adapted its 2000 version in a first review in 2002 to these texts.[183] On the other hand, the BCBS and representatives of the FATF have participated several times in seminars organized by the Wolfsberg Group and have exchanged views. Finally, the OECD WGB has invited representatives of all these organizations to participate in its discourse on OFCs and the prevention of corruption-related money laundering.

The Wolfsberg Group is, it must be said, not merely a professional lobbying organization. The representation of civil society participating in its deliberations gives it a wider ambition.

On the other hand, the inter-governmental organizations have recognized, with their acceptance of a risk-based approach the crucial contribution of self-regulation of the industry.[184] The system relies on financial institutions taking their share of the responsibility and actively engaging in risk management.[185] This eminently practical arrangement between supervisors and members of the industry has been anticipated in *legal theory*: Foucault[186] and others had, primarily with a view to individual persons, explained why we are ready to follow rules of our own free will. He maintained that 'Government' only really works if private subjects are ready to assume responsibility. In this respect, the shared approach to CDD is an application of 'governance-at-a-distance',[187] extended to corporate entities. One of the key lessons learned by supervisors since 1990 is, that 'empowerment' of co-operative entities in the private sector is the most effective way to secure business integrity. This explains why defining due diligence is currently done in a triangle involving inter-governmental organizations/government agencies – members of the private sector – and civil society.

VIII SEPTEMBER 11TH AND THE AFTERMATH: A NEW PARADIGM – OR MORE OF THE SAME?

After the shock of September 11th, one obvious route in tracking down the terrorists was to pursue the money trail.[188] It rapidly became apparent that existing instruments to confiscate funds destined to finance terrorist organizations

and activities were not universally available, equally it could not be taken for granted that AML concepts were applicable since those funds were not necessarily derived from criminal behaviour.[189]

The FATF tried to short-circuit this difficulty[190] by a daring, if intellectually untenable[191] assertion; by simply defining the financing of terrorism as a variation of money laundering lengthy discussions and new concepts seemed to become totally superfluous. Everything that had ever been said about money laundering was now also applicable to the financing of terrorism. Apart from the skewed logic of this reasoning, the use of AML concepts against the financing of terrorism raised a series of questions, partly technical, partly concerning issues of principle.

On a practical level, authorities, including supervisors, have so far declined to give the financial industry an abstract guidance on what is a 'terrorist'. Whereas in combating drug-money laundering or in obscuring the funds of graft legal concepts had defined predicate offences, financial institutions are left to fend for themselves in combating terrorism. This can put them in an awkward position since there is no clear definition of a terrorist let alone the supporters of terrorism and the families of imprisoned terrorists. Financial institutions carry the entire risk to reputation alone. This approach goes beyond the sketched concept of 'governance-at-a-distance'. Equally the FATF's *Guidance for Financial Institutions in Detecting Terrorist Financing* of 24 April 2002[192] were considered less than helpful by the private sector, since they either referred to situations frequently lost in the bulk of the business of retail banking, or they repeat elementary 'red flags' and truisms already contained in older documents. In practice, financial institutions have to follow concrete lists of names supplied by secret services, law enforcement agencies and supervisors. The search based on such lists essentially follows the embargo principle. The search is focused narrowly on the required information. To make use of the far wider concept of increased diligence for the purpose of preventing financing of terrorism, is far more difficult.[193] This explains why institutions, in offering their assistance, have asked for clearer guidance on concepts of terrorism and more specific information related to the lists of names.[194]

As indicated, the extension of the AML-principles to the financing of terrorism also raises more fundamental questions. The development can be seen as a next step in the de-materialization of the money laundering paradigm. Applied first to illicit drug dealing and other illegal markets and then as a means of repatriating misappropriated resources, primarily of countries in the South, it is now increasingly being used as a 'neutral' concept attached to the profits of offences in general. So far it has been used in a wider sense against crooks and undemocratic leaders and their accomplices. From this wider perspective the inability or unwillingness of international bodies and

supervisors to define terrorism (beyond the empty formula used in the UN Convention[195]) is most unfortunate because the formula 'combating the financing of terrorism' threatens to extend the use of AML-mechanisms to all sorts of unrest world-wide. To put it another way, there is a danger that AML efforts could themselves be perceived as an instrument of oppression, rather than the emancipatory tool that it has been so far.[196]

NOTES

1. At the time of the negotiations of the Vienna Convention the UN published estimates on the yearly turnover in illicit drugs amounting to sums in the region of US$300 bn. After 1991 this figure was raised to US$500 bn, even though criticism arose from within the organization (UNDCP executive director Giacomelli against advice of UNDCP by the Inter-Governmental Expert Group to study the economic and social consequences of illicit trafficking in drugs, GA/C 3/45/8 of 18 December 1990); the FATF was more cautious, especially as far as laundered funds were concerned and reduced the estimates to roughly US$122 bn per annum for the USA and Europe (FATF, I Report, 7 February 1990, p. 3 *et seq*).
2. Passas, 1999, p. 399 *et seq*.
3. Hall *et al*., 1978.
4. Council of Europe R. 80 (10) of 27 June 1980, as an attempt to counter the threat of the *Brigate Rosse* or the *Rote Armee Fraktion* as well as right-wing groups like the Bologna bombers.
5. Pieth, 1991, p. 38 *et seq*.
6. A critical discourse on whether the rules can achieve the goals of reducing illicit markets at all or whether they do not risk to indirectly stimulate organized crime, has set in since they were adopted. The literature on this topic is far too extensive to be quoted in this context. Furthermore, the real effectiveness of AML-laws is at debate. Cf. for instance Kilchling 2002.
7. Critical among others: Besozzi, 2001, p. 267 *et seq*.
8. See Section II.C on the genesis of the FATF.
9. UN Single Convention on Narcotic Drugs, 1961; that Convention as amended by the 1972 Protocol Amending the Single Convention on Narcotic Drugs, 1961 and the 1971 UN Convention on Psychotropic Substances.
10. United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances adopted in Vienna on 19 December 1988 ('Vienna Convention').
11. Vienna Convention, Art. 7, para. 5.
12. Tiedemann, 1974, p. 1 *et seq*.
13. United Nations 'Comprehensive Multi-disciplinary Outline of Future Activities in Drug Abuse Control' of 1988.
14. Cf. the prohibition of confiscation in some traditional constitutions to the present day (Mexico).
15. United Nations 'Comprehensive Multi-disciplinary Outline of Future Activities in Drug Abuse Control' of 1988.
16. For the US: Money Laundering Control Act of 1986; For the UK: Drug Trafficking Offences Act 1986 (DTOA); Bernasconi, 1988, p. 39, 48 *et seq*.
17. Art. 3 s.1(b)(i), (ii), (c) (i).
18. US Bank Secrecy Act (1971); Ackermann 1992, p. 81 *et seq*.
19. Vereinbarung über die Sorgfaltspflicht bei der Entgegennahme von Geldern und die Handhabung des Bankgeheimnisses vom 9 Dezember 1977.
20. Basel Statement of Principles of 12 December 1988.
21. Financial Action Task Force on Money Laundering, 'The Forty Recommendations of the

Financial Action Task Force on Money Laundering 1990' (FATF 40/1990), revised 28 June 1996 (FATF 40/1996), revised again 20 June 2003 (FATF 40/2003).

22. Bank of England's Guidance Notes for Banks and Building Societies of December 1990.
23. Zulauf, 1994, p. 374 *et seq*. Rhinow/Bayerdörfer, 1990, p. 38, 71 *et seq*.
24. Cf. early discussions in the Steering Group of the FATF.
25. Report of the US-Customs to the Subgroup Statistics and Methods of the FATF.
26. FATF 40/1996, Rec. 15–18.
27. FATF 40/1990, Rec.15.
28. Pieth, 1998b, p. 163 *et seq*.
29. Cf. especially FATF Annual Report 2002/3, paras. 16,21; FAFT 40/2003, Rec. 12,16.
30. The OECD Working Group on Bribery (WGB) using similar types of monitoring procedures has decided to publish all reports integrally – a decision accepted by Member States.
31. OECD Convention 1997, Art. 12, Recommendation 1997 IIX.
32. Group of States against Corruption (GRECO).
33. Gilmore 1999; Sansonetti, 2000, p. 222 *et seq*.
34. Levi/Gilmore, 2002, p. 110.
35. Beck, 1998, p. 374 *et seq*.
36. Pieth, 1999, p. 540 *et seq*.
37. Aiolfi/Pieth, 2002, p. 351 *et seq*.; note also Pieth, 2000, p. 56.
38. Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Strasbourg, 8 November 1990 (Council of Europe, No.141).
39. Council Directive of the European Communities of June 1991 on Prevention of the Use of the Financial System for the Purpose of Money Laundering (Council Directive 91/308).
40. By declaration of the Council of governments of member states, referring to other binding mechanisms like the 'Vienna Convention' and the 'Council of Europe, No. 141'.
41. The Inter-American Drug Abuse Control Commission (CICAD) set up in 1984 as an autonomous agency of the Organization of American States (OAS), CICAD is primarily involved in co-ordinating the anti-drug programmes of the OAS. It published model laws in 1988 entitled: Model Regulations Concerning Laundering Offences Connected to Illicit Drug Trafficking and Related Offences.
42. Cf. http://www1.oecd.org/fatf/Ctry-orgpages/org-cfatf_en.htm
43. Asia /Pacific Group on Money Laundering (APG), cf. http://www1.oecd.org/fatf/Ctry-orgpages/org-apg_en.htm; Eastern and Southern African Anti-Money Laundering Group (ESAAMLG), South American Financial Action Task Force (GAFISUD); cf. also FATF Annual Report 2002/3, para. 84.
44. Cf. http://www1.oecd.org/fatf/NCCT_en.htm; and for the first 'blacklist': http://www1.oecd.org/fatf/pdf/NCCT2000_en.pdf.
45. Named after the location of the first meeting at the Egmont-Arenburg Palace in Brussels. See http://www.ustreas.gov/fincen/int_fius_egmont_list.html
46. Opened for signature November 1990, the Convention does not carry the word 'European' in its title, reflecting the fact that the instrument is open to like minded states outside the Council of Europe. ETS no.141.
47. See Art. 1 ss. a and d; Art. 6 COE ETS no. 141.
48. Another multilateral organization that has prepared a Model Anti-Money Laundering Law is the Commonwealth Secretariat, primarily for use in Commonwealth countries.
49. Opened for signature December 2000, remained open until 12 December 2002. Ratification is a precondition for participation to the protocols.
50. For details, cf. FATF Annual Report 2002/3, para. 98 *et seq*.
51. France: drug related offences (Public Health Code 1987), UK: drug and terrorism related offences (Drug Trafficking Offences Act 1986, Criminal Justice Act 1993), Luxembourg: drug related offences (Act on the sale of medication and the fight against drug abuse 1973 and the complementing Act of 17 July 1990); Pieth, 1998, p. 162.
52. Especially German speaking countries like Germany, Austria and Switzerland.
53. For critique Pieth, 1998b, p. 159 *et seq*. on Luxembourg; cf. also the Oberholzer Case in Zürich, NZZ, No. 56, dated 8/9 March 1997, p. 55.
54. FATF 40/1990, Rec. 5.

55. France: loi no. 96–392 du 13 mai 1996 relative à la lutte contre le blanchiment et le trafic de stupéfiants et à la co-opération internationale en matière de saisie et de la confiscation des produits du crime.
56. Cf. Art. 7 of the OECD Convention on Bribery of Foreign Public Officials in International Business Transactions and the Official Commentary no. 28; Country Evaluations under Phase I of Japan and Korea of the OECD WGB.
57. Aiolfi/Pieth, 2002b (unpublished manuscript).
58. The IMF has estimated that the amount of money laundered world-wide from all sources is between 2–5 per cent of the world gross domestic product (ranging from US$600 bn to 1.5 trn, using 1996 statistics, on an annual basis). In: IMF Background Paper, *Financial System Abuse, Financial Crime and Money Laundering*, 12 February 2001.
59. Pieth, 2000, p. 54 *et seq*.
60. Cf. below Section VII.A.
61. Cf. the German AML (Gesetz über das Aufspüren von Gewinnen aus schweren Straftaten vom 25.10.1993, Art. 3).
62. Directive 2001/97/EC, Preamble (16); Art. 1, s. 2 (Art. 2a, s. 5).
63. FATF Cons. Paper 2002, s. 3; http://www1.oecd.org/fatf/40RecsReview_en.htm.
64. Cf. Mark Rich; Geschäftsprüfungkommission des Nationalrates 29 June 2001; http://www.parlament.ch/D/Veroeffentlichungen/Kommissionsberichte/GPK_GWG_d.pdf; http://www.admin.ch/cp/d/3C483AFB.80E0CFC0@gs-efd.admin.ch.html.
65. FATF Annual Report 2002/3, paras. 12,16 and interpretative note.
66. Cf. FATF Money Laundering Typology 2000/2001 (11, para. 33).
67. Cf. Germany and Critical Comments, Pieth, 1998b, p. 159 *et seq*.
68. Cf. Kilchling, 2002, p. 431 *et seq*.
69. Ibid.
70. Switzerland: over 70 per cent in 2000, up to 80–90 per cent in 2001. (cf. MROS, 3. Rechenschaftsbericht für das Jahr 2000, pp. 10 and 4. Jahresbericht für das Jahr 2001, p. 9)
71. Pieth, 1998b, p. 164.
72. Cf. suggestions made by the FATF in its Cons. Paper 2002, §127 *et seq*.
73. FATF 2003, Rec. 5 and 6; BCBS CDD 2001 and below, Section VII.
74. See above, Section II.C.3.
75. Levi/Gilmore, 2002, p. 94.
76. Sansonetti, 2000, pp. 218–226; www.fatf-gafi.org.
77. Levi/Gilmore, 2002, pp. 94/95.
78. Ibid.
79. Other peer evaluation mechanisms built after the FATF model have been more reluctant to foresee sanctions so far, even though they will probably need to create formal sanctioning mechanism with time passing, ‘OECD targets UK corruption’, in: *The Guardian*, 7 June 2002, p. 27.
80. Levi/Gilmore, 2002, p. 100.
81. FATF XI, pp. 20–22; Levi/Gilmore, 2002, p. 101; Kern, 2000, p. 19.
82. FATF Second Mutual Evaluation Report on the United States, 21 March 1997 (Confidential).
83. International Counter-Money Laundering and Foreign Anti-Corruption Act 2000, House of Representatives Report 106/2728, Committee on Banking and Financial Services, Chairman Senator Leach.
84. Winer, 2002, pp. 30/31.
85. Cf. www.fatf-gafi.org/ncct_en.htm; FATF ‘List of Non-Co-operative Countries and Territories as of June 21st 2002’; Levi/Gilmore, 2002, p. 103.
86. See below, Section VI.
87. FATF Criteria for Defining Non Co-operative Countries or Territories (14 February 2000), available at http://www1.oecd.org/fatf/pdf/NCCT_en.pdf, cf. also FATF XI, Report p. 18 *et seq*.
88. FATF Criteria for Defining Non-Co-operative Countries or Territories (14 February 2000).
89. Report from G7 Finance Ministers to the Heads of State and Government, Fukuoka, Japan, 8 July 2000, http://www.g7.utoronto.ca/g7/finance/fm20000708-press.htm.

90. At the joint Ecofin and Justice and Home Affairs (JHA) Council held in Luxembourg on 16 October 2001.
91. Israel was removed from the blacklist in June 2002; Russia was removed in October 2002 and accepted as a member of the FATF in June 2003.
92. Gesetz vom 22 Mai 1996 über die beruflichen Sorgfaltspflichten bei der Entgegennahme von Vermögenswerten (revised version enacted as of 1 January 2001).
93. Letter of Commitment des liechtensteinischen Bankenverbandes 17 July 2000; Pressemitteilung des liechtensteinischen Bankenverbandes über die Ausdehnung der Sorgfaltspflicht 19 July 2000.
94. A goal achieved in 2001.
95. FATF Annual Report 2002/3, para. 115 and press-release, p. 2.
96. See however Levi/Gilmore, 2002, p. 104.
97. US Working Group documents, WG I & II FATF I 1989/90; see also Pieth, 1998b, p. 161; *idem*. 1999, p. 532.
98. IMF, Special Data Dissemination Standard (SDDS), March 1996; General Data Dissemination System (GDDS), December 1997; (cf. http://dsbb.imf.org/gddsweb/what-gdds.htm).
99. FSF, International Standards and Codes to Strengthen Financial Systems, April 2001, p. 19 (http://www.fsforum.org/Standards/Repiscsfs.pdf+International+Standards+and+codes+to +Strengthen+financial+systems&hl=de&ie=UTF-8); cf. also Sansonetti 2001, p. 40.
100. Financial Stability Forum Releases Grouping of Offshore Financial Centres (OFCs) to Assist in Setting Priorities for Assessment (http://www.fsforum.org/Press/P20000525.html; http://www.bis.org/press/p000526.htm).
101. UNODCCP, Paradis financiers, sécret bancaire et blanchiment et d'argent, Vienne, 19 Mai 1998.
102. 'International Co-operation in the Fight against Corruption and Off-shore Financial Centres: Obstacles and Solutions', Conference of the Council of Europe, Limassol, 20–22 October 1998; Inter-governmental Expert Group of the UN for the Prevention of Crime and Criminal Justice, Meeting in Paris 30 March–1 April 1999: 'The Corruption and the International Financial Circuits: Elements of a Global Strategy in the Fight against Corruption'; a similar definition is used by the OECD Working Group on Bribery, cf. DAFFE/IME/BR/WD 2000(4), 16 February 2000, p. 6.
103. Shell Corporation Typology, US Department of Justice (DoJ), 1993.
104. OECD 'Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes', Paris, 2001; cf. also the private study by Wymeersch, 2001; Savona 2002, p. 57 *et seq*.
105. As both the BCBS CDD, §3 and the FATF Cons. Paper 2002, §29 and 30 now maintain.
106. BCBS CDD 2001, §3.
107. Ibid., §4.
108. See above FN 20.
109. Cf. The list of initiatives in BCBS CDD 2001, §18.
110. Ibid., §7.
111. Cf. OECD Working Papers DAFFE/IME/BR (2000) 8; DAFFE/IME/WD (2000) 4.
112. Cf. www.wolfsberg-principles.com.
113. Aiolfi/Pieth, 2003.
114. UK Proceeds of Crime Act 2002: A new provision will require the Courts to take account of Guidance that has been approved by HM Treasury when considering whether a person within the financial sector has committed an offence of not reporting.
115. FATF Cons. Paper 2002; http://www1.oecd.org/fatf/40RecsReview_en.htm.
116. For details of the consultation process, cf. FATF Annual Report 2002/3, para. 15.
117. 'Money laundering, fighting the dirt', in: *The Economist* 23 June 2001, p. 80 *et seq*.
118. Winer, 2002, p. 5 *et seq*.
119. Pieth, 2002, p. 125.
120. Above, Section IV. A.4.
121. Directive 2001/97/EC, esp. Preamble (15) and Arts. 1 and 2.
122. See above, Directive 2001/97/EC, Introduction (16, 17), Art. 2 (Art. 2a, s. 5) and FATF Cons. Paper 2002, §272–288.

123. FATF 40/2003, Rec. 12,16 and ‘Glossary’.
124. Ibid.
125. BCBS CDD 2001, §7.
126. FATF 40/1990, Rec. 12, 13; FATF 40/1996, Rec. 10, 11.
127. FATF 40/1990, Rec. 15; FATF 40/1996, Rec. 14.
128. FATF 40/1990, Rec. 14; FATF 40/1996, Rec. 12.
129. FATF 40/1990, Rec. 16–19; FATF 40/1996, Rec. 15–18.
130. FATF 40/1990, Rec. 20; FATF 40/1996, Rec. 19.
131. BCBS CDD 2001, §20; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. 5;WB, Arts. 1 and 2.
132. BCBS CDD 2001, §53 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. 5;WB, Arts. 3 and 5.
133. BCBS CDD 2001, §26 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*., FATF 40/2003, Rec. 5 b), WB, Art. 1.2.2.
134. BCBS CDD 2001, §53 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. 11;WB, Arts. 1 and 4.
135. See FATF 40/1990, Rec. 15; FATF 40/1996, Rec. 14.
136. BCBS CDD 2001, §21 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003 Rec. 5 d); WB, Arts. 1 and 2.
137. WB, Art. 1.2.2.; FATF 40/2003 Interpretative Note no. 4c (to Rec. 5).
138. Resolution on Money Laundering, www.iosco.org/resolutions/resolutions-document06.html.
139. IAIS was established in 1994, for further details see www.bis.org/press/p981006b.htm.
140. For a comparison of the Basel Core Principles, IOSCO and IAIS Principles, see The Joint Forum Core Principles Cross-Sectoral Comparison, Basel Committee on Banking Supervision, November 2001.
141. The BCBS CDD 2001 talks of ‘graduated customer acceptance policies’ (§20) and of the need to be ‘risk-sensitive’ (§53); FATF 40/2003, Rec. 5d, second para. echoes this formula.
142. Cf., for example WB, Art. 1.3.
143. BCBS CDD 2001, §20.
144. Ibid.
145. FATF Annual Report 2002/3, para. 21, last indent.
146. BCBS CDD 2001; FATF 40/2003, Rec. 5d).
147. Cf. WB, Art. 5.1.
148. BCBS CDD 2001 §21 *et seq*.; FATF 40/1996, Rec. 10; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. 5a); WB 1.2.
149. FATF 40/1996, Rec. 10; FATF Cons. Paper 2002, §31 and 123 *et seq*.; FATB 40/2003, Rec. 5 and Interpretative Notes; WB, Art. 1.2.5.
150. BCBS CDD 2001, §21 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. 5b);WB, Art. 1.2.2.
151. BCBS CDD 2001, §23, 32 *et seq*.; FATF Cons. Paper 2002, §29 *et seq*.; FATF 40/2003, Rec. (chapeau); WB, Art. 1.
152. BCBS CDD 2001, §32–34; FATF Cons. Paper 2002, §172 *et seq*.; FATF 40/2003, Rec. 5b and Interpretative Notes WB, Art. 1.2.2.
153. BCBS CDD 2001, §32.
154. WB, Art. 1.2.2.
155. BCBS CDD 2001, §33, 34.
156. OECD ‘Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes’, Paris 2001.
157. FATF Cons. Paper 2002, §196–211.
158. FATF 40/2003, Rec. 33 f.
159. WB, Art. 1.3.
160. FATF Cons. Paper 2002, §81; cf. also Country Surveys in annex 2, p. 116 *et seq*.
161. BCBS CDD 2001, §20; now FATF 40/2003 Interpretative Notes, paras. 9–13 to Rec. 5.
162. FATF Cons. Paper 2002, §96 *et seq*.; FATF 40/2003, Interpretative Notes, par. 5 to Rec. 5.
163. Cf. BCBS CDD 2001, §45–48; FATF Cons. Paper 2002, 3.5.2 and annex 1, p. 113 *et seq*.
164. Questions & Answers, see http://www.wolfsberg-principles.com/faq_3.html.

165. BCBS CDD 2001, §36.
166. FATF Cons. Paper 2002, §108 and the country survey in annex 3, p. 118 *et seq*.; FATF 40/2003, Rec. 9.
167. Ibid.
168. WB, Art. 1.2.2. in fine.
169. BCBS CDD 2001, §36.
170. Directive 2001/97/EC, Preamble (17) and Art. 1, s. 5 (Art. 6, s. 3); for Switzerland cf. below Part 2, Country Reports, Ch. II.C.2.b.
171. GAO Report to the Ranking Member, Permanent Sub-Committee on Investigations, Committee on Government Affairs, US Senate: Suspicious banking activities, possible money laundering by US corporates formed for Russian entities, October 2000.
172. 'USA Patriot Act', H.R:3162.
173. BCBS CDD 2001, §49–52.
174. FATF Cons. Paper 2002, §48 *et seq*. and now FATF 40/2003, Rec. 7.
175. Wolfsberg AML Principles for Correspondent Banking, 5 November 2002, www.wolfsberg-principles.com.
176. FATF Cons. Paper 2002, §54 and FATF 40/2003, Rec. 18.
177. WB, Art. 2.2.
178. BCBS CDD 2001, §31 *et seq*. and §54 and now FATF 40/2003, Rec. 5d.
179. FATF Cons. Paper 2002, §42.
180. Among them, the USA and Switzerland.
181. BCBS CDD 2001, §41–44; FATF Cons. Paper 2002, §42–47; FATF 40/2003, Rec. 6; WB, Art. 2.2, last indent and 2.3.
182. BCBS CDD 2001, §41.
183. WB AML-principles, revised edition, May 2002.
184. Pieth, 2002 (Festschrift für Lüderssen), p. 317 *et seq*.
185. BCBS CDD 2001, §55–59; cf. FATF 40/1996, Rec. 19; FATF Annual Report 2002/3, para. 21, last indent.
186. Defert/Ewald (eds), on Foucault 1976–79, p. 635 *et seq*.
187. Cf. Garland, 1996, p. 445 *et seq*.
188. Pieth, 2002, p. 115.
189. FATF, Guidance for Financial Institutions in Detecting Terrorist Financing, 24 April 2002, Sources of terrorist funds §11–14.
190. FATF, Special Recommendations on Terrorist Financing, 31 October 2001.
191. Kersten, 2002, p. 49.
192. Cf. now FATF Annual Report 2002/3, Annex B. Guidance on Implementing the Eight Special Recommendations, incl. New Interpretative Notes on Alternative Remittance (Rec. VI.) and Wiretransfers (Rec. VII.).
193. Explicitly acknowledged in §9 of the FATF, Guidance for Financial Institutions in Detecting Terrorist Financing, 24 April 2002.
194. WB statement of January 2002, 'The Suppression of the Financing of Terrorism'.
195. UN Convention for the Suppression of the Financing of Terrorism, 9 December 1999, Art. 2; quoted in FATF, Guidance for Financial Institutions in Detecting Terrorist Financing, 24 April 2002, §10: its aim being 'to intimidate a population or to compel a Government of an international organization to do or abstain from doing any act'.
196. Pieth (2002).

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PART II

Country Reports

Foreword to the country reports

Mark Pieth

Following on from the broad overview of the international standards, this second part of the book focuses on each of the four countries and their respective financial centres. These reports were compiled by experts all of whom were based in the country about which they write. In describing the existing AML structures, the experts were required to follow a common format based on a questionnaire that was discussed with them beforehand. Local experts were chosen so as to obtain the 'inside view' of each system. The aim was to address the complete context of each of the AML systems and how they operate, in order to obtain an understanding from a functional perspective. The individual authors are responsible for the accuracy of the information contained in their respective contributions. The law is stated as at June 2003 for all reports except Switzerland which is stated as at October 2003.

The experts and their affiliations are as follows:

Singapore Madeline Lee, LL.B, LL.M, Advocate and Solicitor of Malaysia and Singapore, at Raslan Loong.
Switzerland Dr Nadja Capus and Mathias Pini, researchers at the faculty of law and assistants of Professor Mark Pieth, Basel University and the Basel Institute on Governance.
UK Michiel Visser, Leonardo Raznovich and Sara Fyson of Oxford Analytica, together with contributors to Oxford Analytica; Paul Clement, Daniel Nino Tarazona and Dr Kern Alexander. Updated by Nicola Padfield, Senior Lecturer at the Institute of Criminology, University of Cambridge and a Fellow of Fitzwilliam College, Cambridge.
USA Lucinda A. Low, Karl Abendschein and James Tillen, lawyers at the firm Miller & Chevalier Chartered, Washington, and Daniel M. Fisher-Owens, formerly of Miller & Chevalier Chartered.

In Part III of the study, there follows the complementary, external appraisal of these country reports, which draws together the various strands, giving a synthesis and critique of the various systems.

2. Role of Switzerland, United States of America, United Kingdom and Singapore as major financial centres

Oxford Analytica Ltd[1]

I OVERVIEW OF WORLD FINANCIAL MARKETS

World Gross Product in 2000 reached US$31.5 trillion. The USA, with 31 per cent of world output, was the largest economy, while the UK was the fourth largest with a 4.5 per cent share. Switzerland and Singapore contributed with 0.7 per cent and 0.3 per cent of world output and the 18th and 39th largest economies respectively.[2]

Global investment assets totalled US$66.5 trillion[3] in 2000. The consolidated foreign cross-border claims of banks reporting to the BIS, as well as the local claims in local and foreign currency of their foreign affiliates, reached US$11.49 trillion, by the end of 2001.[4] About 76 per cent of foreign claims consisted of loans and deposits, and the remaining 24 per cent were securities (mainly debt). Total financial assets held by institutional investors in OECD countries exceeded US$36.5 trillion in 1999,[5] while wealth management and private banking assets were estimated in US$26.2 in 2000.[6]

As of September 2001, the total outstanding value of the world bond markets exceeded US$30.8 trillion.[7] The largest part of the debt market consists of domestic bonds issued in local currencies. As of March 2002, the stock of international debt reached US$7.4 trillion, following net issuance of international debt equal to US$1.06 trillion in 2001.

The world's 20 main stock indexes measured by their market capitalization exceeded US$11 trillion in 1995, US$17.7 trillion in 1997, US$31.2 trillion in 1999 and US$29.4 trillion by the end of 2000.[8]

In 2001, foreign exchange dealing averaged a daily volume of US$1.6 trillion.[9] Meanwhile, the outstanding notional amounts of global over-the-counter derivatives reached US$111.1 trillion in 2001.[10]

II SECTORAL TRENDS

A Banking

1 Switzerland

The Swiss banking system held assets equal to US$1.4 trillion in 2001, about five times the country's GDP. About 40 per cent of such assets were held in accounts owned by residents, with the remaining 60 per cent owned by foreigners. Similarly, 34.6 per cent of the 369 institutions that constitute the Swiss banking system were foreign-owned. Consolidated foreign claims of Swiss banks *vis-à-vis* the rest of the world were 9.2 per cent of the total cross-border claims. Total claims of foreign banks on Switzerland, representing roughly 1.5 times the Swiss GDP, were 3.33 per cent of total cross-border claims.[11] Bank fiduciary business totalled nearly US$242 bn, with foreign customers contributing almost US$212 bn.[12]

2 UK

In 2000, the UK banking system consisted of 664 institutions holding assets worth US$4.8 trillion, just over three times the country's GDP. Approximately 72 per cent of these institutions were foreign,[13] and held 53 per cent of the total assets held by banks in the UK.[14] Consolidated foreign claims of UK banks *vis-à-vis* the world accounted for 10 per cent of total foreign claims reported to the BIS. In turn, claims of foreign banks on the UK were 12.7 per cent of the total world claims,[15] representing 1.03 times the UK's GDP.

3 USA

The US banking system comprised 8315 commercial banks holding assets worth US$6.2 trillion, roughly 60 per cent of the country's GDP in 2000.[16] Less than 7 per cent of these banks were foreign-owned, yet they held a share of domestic assets equal to 22.5 per cent of total assets held by commercial banks in the USA.[17] The consolidated foreign claims of US banks *vis-à-vis* the world, accounted for 7 per cent of total cross-border claims reported to the BIS. Claims of foreign banks on the USA exceed 23.5 per cent of the total foreign claims, making the country the leading primary borrower despite representing only 27.5 per cent of global GDP.

4 Singapore

In 2000, Singapore's 121 banks, mostly owned by foreigners, managed assets worth US$183 bn, almost twice the country's GDP.[18] Being an offshore[19] financial centre, Singapore borrowed only 1.2 per cent of the total claims of world banking institutions, yet Singapore's claims *vis-à-vis* the rest of the world were 1.45 times the country's GDP in 2000.

B Insurance

World-wide insurance premiums were equal to US$2.4 trillion in 2000.[20] Cross-border sales of insurance accounted for 1.2 per cent of all insurance transactions in that year.[21] The majority of international insurance transactions are carried out through commercial presence, mainly consisting of affiliates and branches established in overseas markets.

1 Switzerland

Insurance premiums in Switzerland reached US$29.9 bn in 2000, representing 1.23 per cent of the world insurance market. Although Switzerland is the 12th largest insurance market in the world, it has the highest insurance density *per capita* (IDPC) valued at US$4153.9.

2 UK

Insurance companies in the UK traded premiums worth US$290.2 bn in 2000, roughly 10 per cent of the world insurance market. As a result, the UK is the third largest insurance market in the world and has the third highest IDPC (US$3759.2).

3 USA

The USA was the largest insurance market in 2000, totalling US$865.3 bn or 35 per cent of world insurance sales. Despite the size of the market, the insurance density was 3251.2 dollars *per capita*, making it the fourth highest.

4 Singapore

Sales of insurance premiums in Singapore equalled US$3.9 bn in 2000, making it the 33rd largest insurance market. Thus, the Singapore insurance market was roughly 0.16 per cent of the world insurance market, with insurance density *per capita* equal to US$966.3.

C Securities Dealing

1 Switzerland

The Swiss Stock Exchange ranked 11th by share turnover in 2000 and 7th by market capitalization. Thus, market capitalization was roughly three times the Swiss GDP. The total market value of bonds listed in the Swiss Stock Exchange was US$246 bn in 2000.

2 UK

The London Stock Exchange ranked third by share turnover and fourth by market capitalization, the latter being close to twice the UK GDP. The market value of bond securities listed in the UK was US$1.4 trillion.

3 USA

The USA, with the two largest stock exchanges – the New York Stock Exchange (NYSE) and the NASDAQ – was the leading market by share turnover and market capitalization. Total market capitalization for both Stock Exchanges was equal to 1.5 times US GDP in 2000. In the same year, the market value of all bonds listed in the USA was equal to US$2.1 trillion.

4 Singapore

The Singapore Stock Exchange ranked 17th by share turnover and 17th by market capitalization, which was 1.6 times Singapore's GDP in 2000. In that year, the market value of bonds listed on the stock exchange was US$218 bn.

D Institutional Fund Managers

1 Switzerland

Institutional investors in Switzerland managed funds worth US$544 bn in 2000. The value of assets under management was more than twice the size of the Swiss GDP. Pension funds managed 47 per cent of the total funds, followed by insurance funds that accounted for 37 per cent of the total, and 323 open-end mutual funds managing the remaining 16 per cent.[22] In relation to world funds, Swiss funds accounted for approximately 5 per cent of global funds managed by insurance firms, 2.4 per cent of the assets managed by pension funds and an estimated 0.7 per cent of the assets managed by mutual funds.

2 UK

In 2000, UK institutional investors handled assets exceeding US$3.3 trillion, just over twice the country's GDP. After the USA and Japan, the UK was the largest market of funds managed by institutional investors. British-owned investment institutions managed less than 60 per cent of all the assets managed in the UK by institutional investors. Yet, assets managed by UK affiliates of global managers were more than 25 per cent of the world-wide assets managed by these multinational institutional investors.[23] UK institutional investors managed 13 per cent of the world's insurance funds, 11.5 per cent of global pension funds and just 3.4 per cent of mutual funds. As for the origin of the funds managed by UK institutional investors, 23 per cent were from overseas clients and 32 per cent from private clients.

3 USA

In 2000, institutional investors in the USA managed assets worth US$19.5 trillion, equal to nearly twice the country's GDP in 2000, and approximately 53 per cent of world-wide assets managed by institutional investors. US funds accounted for 32 per cent of world insurance funds, 51 per cent of global

Table 2.1 International comparison of market capitalization

Market	Market capitalization as of end 2000 (US$ m)	Percentage of total world market capitalization	Country's GDP (US$ m)	Market capitalization as percentage country's GDP
New York (NYSE)	11 534 600.00	39.1	9 837 406	117
Nasdaq	3 596 627.68	12.2	9 837 406	36
Tokyo	3 158 168.00	10.7	4 841 584	65
London	2 612 181.97	8.9	1 414 557	185
Euronext Paris	1 446 271.53	4.9	1 294 246	112
Deutsche Börse	1 270 243.20	4.3	1 872 992	68
Switzerland	792 071.99	2.7	239 746	330
Italy	768 269.58	2.6	1 073 960	72
Toronto	745 317.89	2.5	687 882	108
Euronext Amsterdam	640 573.82	2.2	364 766	176
Hong Kong	623 512.11	2.1	162 642	383
Madrid	504 311.87	1.7	558 558	90
Australia	372 862.75	1.3	390 113	96
Stockholm	328 399.33	1.1	227 319	144
Taiwan	247 647.28	0.8	NA	
Euronext Brussels	182 514.43	0.6	226 648	81
Singapore	155 125.60	0.5	92 252	168
Korea	148 388.44	0.5	457 219	32
Johannesburg	131 320.70	0.4	125 887	104
Kuala Lumpur	113 176.64	0.4	89 659	126
Copenhagen	111 839.14	0.4	162 642	69
Total	29 483 424.06	100		

Source: Federal Department of Finance, Switzerland; International Federation of Stock Exchanges

pension funds and 55 per cent of the mutual open-end fund industry. The 8155 mutual funds operating in the USA represent 16 per cent of all open-end mutual funds in the world. Moreover, at the end of 2000 there were also 383 domestic, 76 foreign and 74 global close-end funds, managing US$138.5 bn or 34 per cent of the estimated value of the world close-end funds.[24]

4 Singapore

In Singapore, institutional investors managed assets worth US$163 bn in 2000, about 1.7 times Singapore's GDP. Singapore's insurance funds managed US$25 bn, pension funds US$50.4 bn and mutual funds and other discretionary funds US$87 bn.[25]

Table 2.2 World market shares in cross border asset management, 2000

Country	Market share (%)
Switzerland	27
Luxembourg	19
Caribbean Region	15
UK	11
USA	9
Hong Kong	5
Channel Islands	7
Other	7

Source: Swiss Federal Department of Finance

E Derivatives

Daily average global turnover of over-the-counter (OTC) derivatives totalled US$1.86 trillion on a net-to-gross basis by the end of 2001.[26] Cross border reported deals were 42.4 per cent of the reported total net-to-net turnover.

Table 2.3 Over-the-counter (OTC) derivatives markets

	End-2001 (Outstanding US$ bn)	As percentage of total
OTC Derivatives markets		
Foreign exchange contracts	16 748	15
Interest rate contracts	77 513	70
Equity-linked contracts	1 881	2
Commodity contracts	598	1
Other	14 375	13
Total	111 115	100
Foreign exchange contracts:		As percentage of FX
Outright and Forex swaps	10 336	62
Currency swaps	3 942	24
Options	2 470	15
Interest rate contracts		As percentage of IR
FRAs	7 737	10
Swaps	58 897	76
Options	10 879	14

1 Switzerland

At the end of 2001, Switzerland was the seventh largest market by activity of OTC derivatives with a daily turnover of US$62.6 bn US, about 3.3 per cent of the world total turnover of derivatives on a net-to-gross basis.

2 UK

The UK was the leading market with a turnover of US$628.1 bn, representing 34 per cent of world total turnover of derivatives.

3 USA

The USA ranked second with US$284.7 bn, and a market share equal to 15 per cent, followed by Germany, Japan and France.

4 Singapore

With a daily turnover of US$72.5 bn, or approximately 4 per cent of world turnover, Singapore was the sixth largest derivatives' market.

F Foreign Exchange

Foreign exchange daily turnover averaged US$1.6 trillion in 2001.

1 Switzerland

Switzerland handled US$71 bn in foreign exchange transactions, thereby becoming the sixth largest market for foreign exchange dealing.

2 UK

The UK is the largest market with an average daily turnover of US$504 bn, accounting for 31 per cent of the world's foreign exchange activity.

3 USA

The USA rank second with foreign exchange transactions worth US$254 bn, equal to 15 per cent of the world's Forex market.

4 Singapore

Singapore registered an average daily turnover of US$101 bn in 2001, thereby representing the 4th largest market for foreign exchange transactions.

Given that two different currencies are involved in each transaction, the sum of the shares of foreign exchange market turnover for the different currencies adds up to 200 per cent rather than 100 per cent. The US dollar ranked first with 90.4 per cent of the daily foreign exchange turnover, followed by the Euro with 37.6 per cent, the Yen with 22.7 per cent, the Pound Sterling with 13.2 per cent, the Hong Kong dollar with 2.3 per cent, and the Singapore dollar with 1.1 per cent.

III THE ROLE OF THE BANKING SYSTEM WITHIN THE DOMESTIC ECONOMY

1 Switzerland

Swiss financial institutions employed approximately 120 000 workers in 2000, contributing to 5.7 per cent of total employment.[27] Estimates of the contribution of the financial sector to Swiss GDP differ depending on the measure used. The Swiss Federal Department of Finance estimates that banks' and insurance companies' value added in 1990 purchasing power parity (PPP) is US$18.8 bn, or US$27 bn, at 2000 prices, corresponding to about 7.8 per cent of the Swiss GDP. Once other financial services such as auxiliary activities are accounted for, this figure reaches about 14 per cent.[28] About half of this value added was generated by private banking.

2 UK

In 2000, the UK financial services' industry employed 1 065 000 individuals, equal to 4.6 per cent of the employed labour force, and generated 5.8 per cent of the country's GDP.[29] The banking sector, which alone employs 444 000 workers, contributed with 3.6 per cent of GDP. Insurance companies generated 1.4 per cent of GDP, securities dealing 0.3 per cent and fund management 0.5 per cent. Other related services such as legal services, accounting and management consulting contributed with an additional 2.9 per cent of UK's GDP in 2000. Financial activity in the city produced approximately 2.6 per cent of

Table 2.4 Contribution of selected economic sectors to Swiss GDP

Sector	Contribution to total GDP (%)
Financial services (including pension funds)	14
Manufacturing	6
Trade and tourism	16
Construction and energy	8
Metals and machinery	10
Chemicals and plastics	4
Food and textiles	3
Agricultural natural resources	4
Public services	19
Other services	16

Source: Authorities of the Swiss Confederation

GDP,[30] while banks and insurance companies in London alone generated roughly 1.7 per cent of the UK's GDP at 1990s PPP.

3 USA

According to estimates by the US Department of Commerce, financial services domestic product, including real estate, totalled US$1.9 trillion, or 19.7 per cent of the country's GDP in 2000. Without taking real estate into account, financial services industries contributed around 8.3 per cent of GDP in 2000. Depository institutions contributed approximately 3.7 per cent, followed by insurance companies with 1.7 per cent, security and commodity brokers with 1.5 per cent, finance companies and mortgage brokers with 0.6 per cent, insurance agents and brokers with 0.7 per cent, and holding investment offices with 0.1 per cent of US GDP. As for the sector's geographical distribution, New York's financial services (excluding real state) contributed 19.2 per cent to the State's GDP, for Connecticut the corresponding figure was 13 per cent, for Rhode Island 12.3 per cent, South Dakota 11.8 per cent and North Carolina 10.8 per cent.[31] Banks and insurance companies in New York city generated value added equal to 119 bn at 1990 PPP or 1.2 per cent of US GDP.

4 Singapore

In Singapore, the financial services sector contributed about 11 per cent of the

Table 2.5 Contribution of selected economic sectors to Singapore's GDP

Sector	Contribution to total GDP (%)
Goods producing industries	31
Manufacturing	23
Construction	6
Utilities	2
Other goods industries	0
Services producing industries	69
Wholesale and retail trade	16
Hotels and restaurants	3
Transports and communications	15
Financial services	11
Business services	12
Other services industries	12

Source: Authorities of the Swiss Confederation

country's GDP and employed over 100 000 employees that were equivalent to 6 per cent of the total employment in the economy.

Other important financial centres include offshore locations such as Luxembourg, Gibraltar or the Bahamas, where financial services industries contributed with about 20 per cent of their respective GDPs.[32]

A report by Merrill Lynch/Cap Gemini noted that while US wealth tends to be invested mainly onshore, whereas Europe's is largely invested offshore, this explains to some extent why financial services in the euro-zone account for only 6 per cent of the area's GDP and only 2.5 per cent of the employment.[33]

IV PRIVATE BANKING

a Definition

Private Banking is defined as the management of significant individual wealth through specific and customized banking services. In contrast to traditional retail banking, whose profitability largely depends on the possibility to reach economies of scale, private banking supplies tailor-made services aimed at managing the financial assets of wealthy individuals.

Measuring the size of private banking markets is not straightforward, given the absence of data disclosure requirements that often characterizes these types of accounts, which often seek confidentiality for tax purposes and various other concerns regarding the origin of wealth. Yet, recent trends towards deregulation in financial markets, as well as the development of new technologies and products, have contributed to increases in trade volumes and concentration of asset management activities in a few selected financial centres, thereby grouping more data and facilitating changes in legislation.[34]

Private banking activity can be measured by using two different methodologies. The first, used by the London-based think tank Scorpio Partnership, is based on data collected directly from banks. Using this methodology, Scorpio Partnership estimated that the assets owned by US citizens but held overseas in private bank accounts had reached US$2.2 trillion in 2001. This represents a US$200 bn increase from the US$2 trillion in 2000.[35]

A second methodology used to measure private banking activity is the so-called 'Cap Gemini Ernst & Young Lorenz curve methodology', employed by Merrill Lynch/Cap Gemini in their joint report on private banking. According to this model, which first requires estimation of total wealth by country, and secondly the analysis of the distribution of this wealth across the population, the market value of assets managed by private banking was US$26.2 trillion in 2000.

B Private Banking Trends

Two significant trends have been shaping private banking markets over the last decade.

- First, concerns over tax evasion and money laundering recently reinforced by the events of September 11th have favoured legislation requiring additional disclosure of information.
- In addition, the second half of the 1990s witnessed extraordinarily high growth rates in private assets due to a surge in executive pay. Moreover, an increase in IPOs, mergers and acquisitions generated substantial individual wealth.

These trends have benefited onshore banking at the expense of offshore activity.

It should be noted that estimates by Scorpio Partnership are based on information provided only by the world's 10 largest global banks. Cross references with other sources, as well as the historical fragmentation of the private banking industry, tend to favour estimates generated using the Merrill Lynch/Cap Gemini (ML/CG) methodology.[36] Moreover, Booz Allen and Hamilton suggest that 50 per cent of high net worth individuals (defined as individuals owning at least 1 million US dollars to be invested in financial assets) use private banks to entrust the management of their wealth, while 35 per cent co-manage their assets alongside professional investors and the remaining 15 per cent take full charge of their assets.

Private Client Management,[37] a firm specializing in private banking analysis, estimates that Scorpio Partnership's data accounts for roughly 10 per cent of the global wealth management market, in which case, the total market would lie around US$25 trillion. Moreover, the Boston Consulting Group Global Wealth Report acknowledges that the top 20 private banking institutions manage approximately 10 per cent of the private assets world-wide. The report also highlights that 60 among the most well known financial institutions at the global level only hold assets worth US$3 trillion, which confirms earlier descriptions of a fragmented and competitive private banking market. Unsurprisingly, global players have been benefiting from improved merger and acquisition activities in 2000 and 2001, leading to increased commercial presence in dispersed markets.[38]

C The International Market for Individual Wealth

According to the Merrill Lynch/Cap Gemini report, the international market for individual wealth can be defined by four categories:

- Mass affluent individuals are those who hold over US$100 000;
- High net worth individuals (HNWIs) are those who hold assets exceeding US$1 million;
- Very high net worth individuals (VHNWIs) are those with more than US$5 million in investment assets; and
- Ultra high net worth individuals (UHNWIs) are those with more than US$30 million of investment assets.

Private banking services in most countries are addressed to individuals holding US$1 million or more in assets, which covers banking services supplied to all levels of HNWIs. The ML/CG report estimates that, in 2000, a total of 7.1 million HNWIs at the global level held US$26.2 trillion in assets. Approximately 62 per cent of these assets were held in Europe and North America, which have a similar distribution of wealth among the wealthy individuals. Thus, about 90 per cent of the reported accounts are owned by high net worth individuals, 8.6 per cent by very high net worth individuals, and 1.3 per cent by ultra high net worth individuals. This distribution suggests that the thresholds used to define the segments of the private banking market can significantly affect the relative size of the market.

In terms of investment behaviour, HNWIs allocate 91 per cent of their assets in standard products such as cash, fixed income and equities. A total of 5 per cent is then allocated to structured products such as indexes trackers and derivatives, and the remaining 4 per cent to less tailored investments such as hedge funds, private equity and managed future funds. However, ultra high net worth individuals are reported to allocate twice as much wealth to non-standard products.

Table 2.6 International distribution of global wealth

Region	Total wealth (US$ trillion)	Total HNWI (million)	Average (US$ million per HNWI)
N. America	7.6	2.2	3.44
Europe	8.5	2.5	3.33
Asia	5.2	1.7	2.98
Latin America	3.4	0.3	11.96
Middle East	1.0	0.3	3.45
Rest of World	0.6	0.1	12.0
Total	26.2	7.1	3.69

Source: Merrill Lynch/Cap Gemini Ernst & Young

Estimates of the distribution of assets among offshore and onshore centres also differ by methodology. Scorpio Partnership estimates that about 25 per cent of private client assets are currently held offshore, compared to 50 per cent, 10 years ago.[39] In turn, ML/CG estimates that offshore private banking still attracts 32 per cent of the global individual wealth. This means that the offshore market effectively manages between US$6.5 trillion and US$8.5 trillion. These estimates are close to BCG estimates that place offshore private assets above US$5 trillion.

1 Switzerland

The leading offshore centre[40] of private asset management is Switzerland, with an offshore market share estimated between 25 per cent and 32 per cent of the total market.[41] In line with these figures, the Swiss Federal Department of Finance estimates the share of global cross-border assets managed by institutions in Switzerland at 27 per cent. The Swiss National Bank estimates that financial institutions in Switzerland manage approximately US$2.25 trillion on behalf of customers, of which about half belong to foreign investors.[42] Accordingly, Swiss offshore private banking is estimated at between US$1.5 trillion and US$1.8 trillion, while domestic private banking is estimated at between US$300 bn and US$500 bn.[43] Therefore, Switzerland's total high net worth market is considered to be worth somewhere between US$1.8 trillion and US$2.3 trillion, which is more than 7.5 times the country's GDP, and about 9 per cent of the world total high net worth market.[44] According to the Swiss Bankers Association, private banking services generated roughly US$13 bn in valued added in 2001 or approximately half the valued added by banking services to the Swiss economy.

2 UK

The total private wealth in the UK is estimated at US$1.4 trillion, which is about the size of the UK economy. Thus the UK has about 5 per cent of the global private wealth reported by ML/CG. In terms of the offshore private wealth, the UK manages about 11 per cent of the world offshore assets or roughly US$920 bn. International Financial Services of London estimates that private clients managed about 66 per cent of their wealth through funds. In addition, 32 per cent of the assets managed by UK funds belonged to private clients.[45] Therefore, funds managed about US$900 bn of the total private wealth in the UK, and private client equity holdings were about US$300 bn.

3 USA

US private assets reached an estimated US$23 trillion in 2000. Just over two million individuals in the USA held about US$6.9 trillion or almost one-third of the US private assets, and classified as high net worth individuals reported

by ML/CG.[46] The USA is believed to account for 26 per cent of the high net worth individuals market. About US$800 bn to US$1 trillion of the private wealth held in the USA has foreign origin, which represents about 10 per cent of the global offshore market. Private Equity Funds, which reached US$200 bn in 1999,[47] and hedge funds obtain most of their managed assets from HNWIs. The net foreign purchase of US long-term securities almost doubled between 1995 and 2000, rising from US$232 bn to US$456 bn. Meanwhile, the net foreign purchase of corporate bonds increased threefold and reached US$182 bn, while that of stocks increased by 15 and reached US$175 bn. As a result of this trend, the share of net foreign purchase of US corporate securities passed from 30 per cent in 1995 to 80 per cent in 2000.[48]

4 Singapore

Singapore, with a private banking market worth about US$32 bn, remains an evolving private banking market, albeit still small by international comparisons.[49] Singapore defines eligible to private or priority banking services those accounts that hold at least US$120 000. DBS, a Singapore bank, accounts for 40 per cent of the private banking business in the country. Most of the private wealth invested is believed to have domestic origins. Yet, Singapore has focused on establishing a favourable environment for financial services in order for it to become a global financial services centre, and a niche for wealth management. The government has sought to boost the country's asset management industry by committing a significant portion of government reserves, managed by the MAS and the Government of Singapore Investment Corporation (GIC) with external asset managers, to increase the pool of domestic funds available for professional management. The operating environment for fund managers was further improved through the streamlining of regulations and the offer of tax incentives. As a result of these actions, the asset management industry has grown and now has 215 asset management companies. These favourable conditions also led to Credit Suisse establishing in Singapore its global base for private banking in 2000.[50] Many analysts suggest that Singapore has recently benefited from more stringent anti-money laundering legislation in Switzerland. In addition, experts believe the favourable regulatory environment in Singapore will attract a significant share of the global hedge fund industry. This has potentially significant implications given that world hedge funds held assets increased from US$400 bn in 2000 to US$760 bn in 2002. A significant amount of these resources were offshore and belonged to HNWIs.[51]

V NON-BANKING FINANCIAL SERVICES: ORGANIZERS AND INTRODUCERS

Private Banking has undergone enormous changes in recent years. The range of services offered by banks has shifted from classic asset management to needs-oriented financial planning. In all cases, a comprehensive approach has combined the legal and technical aspects of arrangements and takes into account the client's personal goals in the short, medium and long term. Various consultancy services relating to insurance, retirement, estate planning, tax efficiency, and financing are highly relevant. In order to provide these services to consumers, banks and asset management funds have developed specialized consultancy companies.

The shape of the world private banking industry depends heavily on the stability of legislation and the incentives provided by the regulatory environment. Non-banking financial services not only work closely with clients, but also with government officials to develop and strengthen the competitive advantage of financial centres. Yet, the core of these auxiliary services are oriented towards addressing the priorities of high net wealth individuals, including:

- multiple access to information and systems;
- consolidated reporting on a multi-currency basis;
- access to different field specialists; and
- requirements on personal asset management to be run like business assets and based on performance-fee structures and greater geographical diversification.

Private wealth management institutions require contrasting approaches that foster innovation and yet maintain a tradition of services, wealth preservation, discretion and transparency. In this sense, private banking not only relates to asset management, but also to a global scope of auxiliary services that provide a multidisciplinary approach with an integrated delivery of value and expertise.

Auxiliary services contributed to 3 per cent of the GDP in Switzerland, and 2.9 per cent of the UK GDP in 2000. In addition, in support of Singapore's efforts to become a global financial centre, the government announced measures to upgrade its legal services sector to meet the demands of an expanding volume and growing sophistication of onshore, offshore and cross-border financial transactions. In January 2000, the Singapore Parliament approved a bill submitted by the Government to permit a limited number of foreign law firms to enter into joint ventures (including partnerships) or 'formal alliances' with local law firms in an effort to upgrade the country's legal services sector.

NOTES

1. Oxford Analytica Ltd: Members of the team are: Sara Fyson, Consultancy and Research Project Manager; Leonardo Raznovich, Researcher; Michiel Visser, Researcher; Paul Clement, Oxford Analytica Contributor; Daniel Nino Tarazona, Oxford Analytica Contributor, Dr Kern Alexander, Oxford Analytica Contributor.
2. *Source*: IMF.
3. Boston Consulting Group: Net Investment Assets include listed securities held directly or indirectly through managed investments, cash deposits, and money market funds, non listed investments such as commercial real estate and privately held businesses, less total debt.
4. *Source*: BIS press release ref 11/2002E.
5. *Source*: *OECD Institutional Investors Yearbook 2001*. The real total figure should be higher since insurance companies, pensions funds and investment companies are not necessarily taken into account in all countries. In Switzerland, for instance, the figure does not include pension funds.
6. *Source*: Merrill Lynch and Cap Gemini Ernest & Young.
7. *Source*: IFSL International Financial Markets in UK, May 2002.
8. *Source*: Federal Department of Finance, Switzerland (figures may differ depending on exchange rates used to calculate the dollar value). The Singapore Stock Exchange was added in 2000.
9. *Source*: BIS.
10. *Source*: *BIS Quarterly Report Review*, June 2002.
11. *Source*: BIS press release ref 11/2002E .
12. *Source*: Swiss National Bank.
13. Refers to either banks owned by foreign banks, affiliates of banks incorporated out of the UK or banks incorporated in the UK but owned by foreigners.
14. *Source*: Bank of England and FSA.
15. *Source*: BIS press release ref 11/2002E.
16. *Source*: Federal Deposit Insurance Corporation.
17. *Source*: Federal Reserve. Includes foreign agencies, branches, commercial, majority-owned banks (+25 per cent) and representatives.
18. *Source*: Monetary Authority of Singapore.
19. For the purposes of this chapter, offshore banking includes all wealth invested in a foreign jurisdiction to the jurisdiction where the wealth originates. The definition does not discriminate jurisdictions in any way or make assumptions about provenance, legal or fiscal treatment.
20. *Source*: SwissRe. The figure includes life and non-life premiums.
21. Excluding premiums earned by branches abroad.
22. *OECD Institutional Investors Year Book*, ICI, IMA, IPEUROPE, Lipper. Swiss pension funds are mostly domiciled in Luxembourg.
23. *Source*: Fund Managers' Association.
24. *Source*: IFL UK expertise for International Markets.
25. *Source*: MAS and Central Provident Fund.
26. BIS Triennial Central Bank Survey March 2002
27. *Source*: World Trade Organization.
28. *Source*: Authorities of the Swiss Confederation.
29. *OECD Institutional Investors Year Book*, ICI, IMA, IPEUROPE, Lipper. Swiss pension funds are mostly domiciled in Luxembourg.
30. *Source*: Merrill Lynch and Cap Gemini Ernest & Young.
31. *Source*: US Department of Commerce, Bureau of Economic Analysis
32. *Source*: Government of Gibraltar Office, Rochert-PR.ch, Bahamas Government.
33. *Source*: European Commission.
34. *Source*: Quelle politique pour maintenir une place financière concurrentielle? Exposé de M. le Conseiller fédéral, Kaspar Villiger à l'occasion du déjeuner-conférence annuel du 12 novembre 2001 de Genève Place Financière.

35. www.financeasia.com
36. ABN Amro research has found that Brazil, where one-third of Latin American high net worth wealth can be sourced, is worth US$1 trillion. It also indicated that Latin America as a whole is worth US$3 trillion.
37. www.complinet.com
38. Bloomberg February 2002 review: The Rothschilds. Private Client Management: Uncertainty reigns as private banks chase onshore riches.
39. *Source*: Scorpio Partnership: Private Banking in Switzerland.
40. For the purposes of this report, offshore banking includes all wealth invested in a foreign jurisdiction to the jurisdiction where the wealth originates. The definition does not discriminate jurisdictions in any way or make assumptions about provenance, legal or fiscal treatment.
41. *Source*: Scorpio Partnership, Chase Morgan Private Bank, Gemini.
42. *Source*: *SNB Monthly Journal* 2000
43. *Source*: Scorpio Partnership.
44. *Sources*: Quelle politique pour maintenir une place financière concurrentielle? Exposé de M. le Conseiller fédéral, Kaspar Villiger à l'occasion du déjeuner-conférence annuel du 12 novembre 2001 de Genève Place Financière; ML/CG 2000 report.
45. IFSL: Fund Management Report September 2000.
46. *Source*: *Fortune Review*.
47. *Source*: Federal Deposit Insurance Corporation.
48. *Source*: BIS Bruno Gehrig: Global Trends and their implications for financial market infrastructures.
49. *Source*: Client Private Management, DBS targets Singapore's affluent.
50. *Source*: *Financial Times* 18/04/02.
51. *Source*: Goldman Sachs and Client Private Management 'Hedge funds are increasingly being seen as the fourth asset class, after equities, bonds and property and Singapore remains cautious towards developing hedge fund industry'.

3. Country Report: Anti-money laundering laws and regulations in Singapore

Madeline Lee[1]

I EXECUTIVE SUMMARY

The objective of this chapter is to provide an analysis of the anti-money laundering (AML) laws, regulations and practice in Singapore. The main sources of information are official media releases, legislation, academic texts and commentaries. Some unofficial interviews and discussions with bankers and officials in Singapore were also made.

Singapore has commendably achieved its status as an important financial centre in Asia within a relatively short period of time. In light of the scale of the money laundering problem world-wide, Singapore recognizes the importance of a sound and effective anti-money laundering system to sustain a competitive financial centre in Asia.

Initial legislation effort to fight money laundering in Singapore focused on the proceeds from drug trafficking activities. However, it has become increasingly clear that money laundering extends beyond the proceeds of drug trafficking. As such, the Corruption, Drug Trafficking and Serious Offences (Confiscation of Benefits) Act (CDSA) was amended in 1999 to extend the asset confiscation and AML provisions of the former Drug Trafficking (Confiscation of Benefits) Act beyond drug laundering provisions to cover serious crimes. In addition, wider scope of powers is given to the enforcement agencies and financial regulators in Singapore to deter money laundering. At about the same time, the Extradition Act was amended to make serious crimes money laundering offences extraditable. In 2000, the Mutual Assistance in Criminal Matters Act was enacted. This is an independent and comprehensive legislation introduced to address the issues of provision and receipt of legal assistance by Singapore from foreign authorities in criminal matters. Other guidelines issued by the Monetary Authority of Singapore in relation to anti-money laundering were also updated in 2000.

The reply from Singapore to the 2001–02 Self Assessment Exercise held by

the Financial Action Task Force (FATF) indicated that it is in full compliance with 27 out of the 28 Recommendations which require specific action.

Singapore has in the recent years shown that it is ready to be a global player in the combat of money laundering crime that has taken an international perspective. However, the success of combating money laundering depends ultimately on the initiative of financial institutions to carry out the provisions as well as the spirit of the existing legislation and guidelines.

II INTRODUCTION

The first section of the report provides an overview of the development of Singapore as a financial centre and in particular, traces the steps in which the Monetary Authority of Singapore (MAS) becomes the primary regulator of the financial industry in Singapore.

The text then goes to analyse the role of the MAS in all elements of monetary, banking and financial aspects of Singapore and provides a description of the status and position of the banks in Singapore.

The second part of the chapter provides an overview of the development of the AML regulations in Singapore followed by a detailed analysis of each AML regulation. Other AML regulations and guidelines issued by the MAS and the Association of Banks of Singapore are also covered under this section.

The text continues with a study of the organization of the law enforcement agencies in relation to the investigation and prevention of money laundering in Singapore and their specific role.

The last section of the chapter is on the implementation of the banks' internal controls in relation to AML. As one of the main topics of discussion in relation to the implication of AML regulations on banking operation has been the rigidity of the laws relating to banking secrecy, this section also covers the recent amendments made to the Banking Act to fine-tune the banking secrecy provision to facilitate investigations under the AML regulations.

A Scope and Limitations of the Chapter

For the purpose of this chapter, discussion on the internal controls in relation to AML of the financial institutions has been limited to the local banks in Singapore. Every effort has been made to incorporate the latest development that is relevant as well as to support the research with the latest statistical data. However, this effort has been constrained in some instances by the lack of access to both the governmental and financial institution officials, their views and supporting statistics. The Monetary Authority of Singapore Act, 1970 ('MAS Act') has a specific provision for the preservation of secrecy in relation

to the affairs of the MAS.[2] Further, the reluctance of banks to share information on their internal controls has proved a major hindrance to provide a constructive analysis of how the banks implement the AML regulations and guidelines.

III HISTORICAL DEVELOPMENT AND SIGNIFICANCE OF SINGAPORE AS A FINANCIAL CENTRE

A Singapore's Economy

Singapore is one of the few economies in Asia that has registered sustained economic growth for over three decades with full employment and prolonged price stability. Its sound financial system, which has weathered several financial crises including the Asian currency turmoil with relative stability, plays an important role in its continued growth.

The recent sharp slowdown in the US economy, coupled with the global slump in the electronics industry in 2001 precipitated a synchronized downturn across most countries including Singapore. In 2001–2003, Singapore experienced one of its worst recorded economic downturns.

The financial and business services[4] sector in Singapore has increased its average contribution to GDP growth over the past decade from 1.9 per cent in the 1970s to 3.4 per cent in the 1980s and 2.3 per cent in the 1990s. In contrast, the manufacturing sector's contribution dropped from 3.2 per cent in the 1970s to 1.4 per cent in the 1980s and 1.8 per cent in the 1990s. These two sectors, which are regarded as the twin engines of growth, accounted for 54 per cent of GDP in the 1990s.[5] A table setting out the contribution to Singapore's GDP by the various industries is set out in the Annex to this report.[6]

B Recent History of the Development of Singapore as a Financial Centre

Prior to independence in 1965, Singapore's competitiveness was based on its traditional function as an important centre for regional trade. While a financial infrastructure had developed to service the entrepôt trade, financial services nonetheless had generally played only an ancillary role. The role of local banks, the first of which was established in 1903, was complementary to the operation of foreign banks. Local businessmen depended on foreign banks for foreign exchange transactions and for other transactions, they looked to the dialect-speaking local banks.[7]

Singapore's growth as a financial centre is the result of a conscious development strategy. Shortly after independence, the Singapore government began

Table 3.1 Gross Domestic Product at 1995 market prices[3]

Year	1960	1965	1970	1975	1980	1985	1990	1995	2000	2001	2002
Overall EDP (S$m)	6 775.0	8 891.0	16 207.2	25 258.8	37 958.6	51 702.0	77 298.9	118 962.7	161 142.8	157 318.5	160 853.4
Growth (%)		7.5	13.7	4.1	9.7	–1.4	9.0	8.0	9.4	–2.4	2.2

implementing a set of aggressive policies to enhance the economic development of various parts of the Singaporean economy. After its separation from the Malaysian Federation in 1965, with no natural resources and the loss of a historical hinterland, Singapore was forced to seek new areas of growth.

Among the development strategies devised in the late 1960s was the expansion of the financial sector – not just to facilitate the development of Singapore's non-service sector, but to serve as an engine of economic growth. The aim was to develop into a modern sophisticated financial centre to serve the financial needs not only of Singapore and the surrounding region but also beyond.[8]

In 1968, Singapore launched the Asian dollar market, an Eastern version of the Eurodollar market centred in London. Licences were issued to banks and merchant banks to allow them to operate the Asian currency units which is essentially a separate accounting system that accepted deposits in foreign currency.

In 1970, the MAS was created as the central bank of the country. The creation of MAS provided greater focus and better co-ordination to the functions of supervising the financial sector and formulating and implementing exchange rate policy.

Since Singapore began its strategy to become a financial centre, a variety of new financial markets have been introduced and these include the money, capital and foreign exchange markets, the Asian dollar and Asian bond markets, insurance and reinsurance, financial management and advisory services, financial futures, stockbroking, and gold and other commodities markets.

Over the next decade, a number of incentives including fiscal incentives were introduced to encourage participation in the Asian dollar market and in the rising number of financial activities offered by Singapore.

Within a decade from the abolition of the foreign exchange control in 1978, Singapore has emerged as the world's fourth busiest foreign exchange dealing centre. From a market size of US$30 million in 1968, the market had ballooned to US$503 bn in 1998.[9]

After the split from the Malaysian Federation and the consequential split from the Stock Exchange of Malaysia and Singapore in 1965, the Stock Exchange of Singapore Ltd (SES) was incorporated in 1973.

In 1984, the Singapore International Monetary Exchange (SIMEX) emerged as a new financial market to replace the Gold Exchange of Singapore which began operation the same year when foreign exchange controls were removed. SIMEX sets the record for being the first Exchange to establish *inter alia* an international trading link with the Chicago Mercantile Exchange, the first Financial Futures Exchange in the Asia-Pacific time zone and the first to introduce Nikkei Stock Index futures contract. SIMEX currently ranks as the world's fifth largest derivatives trading centre. In 1999, SES and SIMEX were merged to pave the way for the Singapore Exchange (SGX).

To attract participation of foreign banks, MAS created 'offshore bank' and 'restricted bank' licence categories in the early 1970s. Restricted banks could conduct limited domestic retail operations, but were limited to one branch and could not accept deposits of less than Singapore Dollar (S$)250 000 per non-bank customer. Offshore banks were not allowed to accept interest-bearing deposits from resident non-bank customers and faced a ceiling on the extension of S$ credit facilities to resident non-bank customers.

Much of the progress of the development of Singapore as a major financial centre is attributable also to its strong leadership and political stability.

In 1984, several measures were introduced to develop fund management and investment banking. It was noted that the huge pool of mandatory and discretionary savings under Singapore's self-financing retirement fund, the Central Provident Fund (CPF) had diverted potential investment capital, which could have been managed by private fund managers. The government then liberalized rules to allow CPF account holders to invest in foreign stocks. The CPF funds and the Government's cultivation of the fund management industry in stages have seen the amount of funds under management by the industry leap five-fold to S$124 bn within a period from 1991 to 1997.

While the Government's dual-track approach was successful in making Singapore a major financial centre, it became clear by the late 1990s that the approach increasingly put Singapore at a competitive disadvantage to other regional financial centres, such as Hong Kong and Sydney. To encourage more competition, strengthening of the banking system and further enhancement of its position as an international financial centre, MAS announced a new plan in 1999 with the following three key features:

- A 5-year liberalization period
- Improvement in the corporate governance practices
- Increasing foreign shareholding limit of local banks

In implementing the 1999 plan, the minimum disclosure standards have been raised, a risk-focused MAS bank inspection has been adopted and the banks' minimum cash balance has been reduced.

As part of the liberalization, MAS created a new 'Qualifying Full Bank' (QFB) licence to allow selected foreign banks to have up to ten locations (branches or off-site ATMs); increased the number of Restricted Banks; and gave Offshore Banks greater flexibility in the Singapore Dollar (S$) wholesale business.

The limit on foreign shareholding in local banks is removed by the lifting of the 40 per cent limit on foreign shareholdings of local banks. However, MAS has emphasized that it would not support a foreign bank to actually acquire a local bank. As a safeguard, MAS requires foreigners intent on

acquiring more than threshold level of 5 per cent of a local bank to first obtain its approval.

In June 2001, MAS also announced a shift from the three-tier bank licensing regime (full, restricted, offshore) to a new two-tier system that will distinguish between full (retail) banks and wholesale (non-retail) banks.

MAS has also loosened restrictions on the internationalization of the S$, so that only limited S$ restrictions remain. For example, banks cannot make S$ loans to non-resident financial institutions for speculative activities.

Singapore recognizes that consolidation is a world-wide trend in banking, and is an essential element in the upgrading of local banks.[10] It is the view of MAS that given the size of Singapore, it is unlikely that Singapore can sustain more than two local banks of sufficient critical size. In an action widely seen as intended to prompt a wider consolidation, government-linked Development Bank of Singapore (Singapore's largest bank) acquired the government's former postal savings bank, Post Office Savings Bank, in 1999. As a result, in the last two years, Singapore went from having five principal local banks to three. Third-ranking Overseas Chinese Banking Corporation acquired fifth-ranked Keppel Bank , while number two United Overseas Bank bought over fourth-ranked Overseas United Bank. A full list of the number of commercial banks in Singapore is annexed.[11]

C The Framework for Financial Supervisors

The main statutes which provide the key elements to the regulatory structure of the financial sector in Singapore are as follows:

- Currency Act (Cap. 69)
- Monetary Authority of Singapore Act (Cap. 186)
- Securities and Futures Act (Act 42 of 2001)

1 The Currency Act

The Currency Act, enacted in 1967, established the Board of Commissioners of Currency, Singapore (BCC) as the body exclusively entrusted with the role of currency issue and redemption. It is intended that the BCC will merge with the Monetary Authority of Singapore by March 2003.[12]

2 Monetary Authority of Singapore Act

The Monetary Authority of Singapore Act (MAS Act) established the Monetary Authority of Singapore (MAS). As a statutory board, the MAS is owned and controlled by the Government. Its Board of Directors is chaired by the Minister for Finance.

The MAS was established as the central bank of Singapore, to take over the

various functions of numerous government departments and agencies. The MAS essentially performs the various functions normally associated with any other central bank, with the exception of currency issue. The MAS serves as banker and financial agent to the Government and as banker to the banks. It supervises and regulates the activities of commercial banks, finance companies, insurers and generally oversees the activities of other financial institutions, including merchant banks and discount houses. MAS is also responsible for the formulation of monetary policies and policies for the development of Singapore's financial system.

The stated mission[13] of the MAS is 'to promote sustained and non-inflationary growth of the economy as well as fostering a sound and progressive financial services sector'. The objectives[14] identified are as follows:

1. To conduct monetary and exchange rate policies, and to manage the official foreign reserves and the issuance of government securities.
2. To supervise the banking, insurance, securities and futures industries, and develop strategies in partnership with the private sector to promote Singapore as an international financial centre.
3. To build a cohesive and integrated organization of excellence.

3 The Securities and Futures Act

The Stock Exchange of Singapore Ltd (SES) (now known as the Singapore Exchange Securities Trading Limited (SGX)) and the Securities Industry Council, both previously came within the purview of the Securities Industry Act, (Cap. 289) and the Singapore International Monetary Exchange Ltd (SIMEX) (now known as Singapore Exchange Derivatives Trading Limited) which previously came under the purview of the Futures Trading Act (Cap. 116) are all administered by MAS.

On 1 December 1999, the Singapore Exchange was inaugurated following the de-mutualization and merger of the SES and the SIMEX.[15] The decision to merge SES and SIMEX was driven by global trends. The combined entity will be able to more closely align the securities and derivatives business strategies, minimize operating costs by sharing overheads and increase its value-positioning *vis-à-vis* other foreign exchanges.[16]

The Securities and Futures Act (SFA) was passed by Parliament in October 2001 to provide a single rulebook, the legislative framework governing the securities and futures industry by consolidating the provisions in the Securities Industry Act, the Futures Trading Act as well as certain provisions in the Exchanges (Demutualization and Merger) Act (Cap. 99B) and the Companies Act (Cap. 50). Since its enactment in October 2001, MAS has been implementing the SFA in stages. The first phase was implemented in January 2002, putting in place provisions relating to takeovers, supervisory and investigative

powers of MAS. In May 2002, the second phase of the SFA was implemented, covering areas relating to offers of shares, debentures and collective investment schemes, as well as appeal processes. The final phase of the SFA came into operation on 1 October 2002 and the remaining provisions covering *inter alia*, conduct of business, market conduct, disclosure of interest etc. became operational. Accordingly, the previous Securities Industry Act and the Futures Trading Act were repealed. A package of Notices and Guidelines were issued by the MAS on 1 October 2002 to further support the implementation of the SFA.[17]

D Development of MAS as the Primary Regulator of the Banking Sector

MAS was established in 1970. It was only after commencement of its operations that MAS appreciated that it required further supervisory powers and in late 1972, the original MAS Act was amended.[18] The amendments introduced by the Monetary Authority of Singapore (Amendment) Act 1972, were *inter alia*, to extend the role of MAS to enable it to request information from financial institutions and to make recommendations to them where it was considered necessary in the public interest.

The role of MAS as a banker and financial agent to the government was extended to government companies and statutory boards under the MAS (Amendment) Act 1984. In 1998, the MAS Act was amended further to include financial sector promotion as one of the MAS' main objectives.

Section 21 of the MAS Act empowers MAS to supervise and regulate banking, insurance, and securities industries, and with the exception of currency issuance, virtually all activities within the financial system of Singapore fall under the purview of MAS. In the case of banks, insurance and finance companies, compliance with the Banking Act (Cap.19), Insurance Act (Cap. 142) and Finance Companies Act (Cap.108) respectively are enforced at all times. To the securities industry, MAS administers the new SFA in conjunction with guidelines and notices issued by the Singapore Exchange.

In 1997, MAS embraced a different regulatory philosophy, moving from a merit-based regulation where the regulator decides what comes to the market to a disclosure-based regime which empowers investors to make informed decisions. In general, MAS has moved to a less intrusive regulatory approach. In particular, MAS is developing a disclosure-based regime of capital market regulation, as opposed to a prescriptive legalistic regime. MAS realizes that self-regulation relies upon market forces and mechanisms to encourage the adoption of best practice. One of the ways in which Singapore encourages companies to improve their transparency is to implement schemes or competitions to recognize transparency and good corporate

governance practice.[19] New rules on corporate governance have also been introduced including a requirement that local banks constitute nominating committees.

MAS has also instituted a fundamental shift in emphasis away from 'one-size-fits-all' regulation of institutions to risk-focused supervision.

In February 1998, MAS unveiled a series of reforms to increase competitiveness of Singapore as a financial centre. These reforms include closer working relationship with other government agencies and instituting a new supervisory framework based on the following:

- maintaining high prudential and supervisory standards
- shifting the emphasis from regulation to supervision
- implementing a risk-focused approach to bank supervision
- increasing banking disclosures standards.

IV INSTITUTIONS OF THE ANTI-MONEY LAUNDERING SYSTEM

The MAS supervises the operations of financial institutions to ensure that they comply with the provisions under the relevant legislation The supervision by MAS will also ensure that these institutions maintain high standards in their practices.

To create confidence in Singapore's banking system, the MAS places great emphasis on the solvency of the banks, their liquidity position, the quality of assets, their efficiency of management and also the effectiveness of their control system.

The supervision is done through field inspection and examination of statistical reports, accounts and other information submitted by these institutions. The MAS also reviews the reports of external auditors of these institutions.

Section 28(4) of the MAS Act empowers the MAS to issue guidelines and impose conditions of operations on such financial institutions as it thinks fit. Section 28(5) goes on to state that the MAS has the authority to withdraw the licence of the concerned financial institution for failure to comply with any direction or guideline issued or condition attached to an approval or conditions of operation imposed.

Section 54A of the Banking Act empowers the MAS to give directions or impose requirements on or relating to the operations and activities of and standards to be maintained by banks if it appears to the MAS to be necessary or expedient in the public interest or in the interest of the banking system. Section 54(3) requires every bank in Singapore to comply with any direction given or requirement imposed by the MAS. Non-compliance of the provisions of the

Banking Act is an offence under Section 71 of the Banking Act and a fine not exceeding S$100 000 and in the case of a continuing offence, a further fine not exceeding S$10 000 for every day during which the offence continues after conviction will be imposed.

A MAS Guidelines on AML

Pursuant to Section 28(4) of the MAS Act, the MAS has on 22 February 2000 issued six separate Guidelines on Prevention of Money Laundering to (1) banks, (2) merchant banks, (3) finance companies, (4) life insurers, (5) dealers and investment advisers and (6) future brokers, futures trading advisers and futures pool operators (MAS Notices). The contents of the MAS Notices are essentially identical in substance and a detailed analysis of the guidelines is provided in the later section of this report. The Guidelines on Prevention of Money Laundering to the Bank dated 22 February 2000 was cancelled and replaced with a Notice in Prevention of Money Laundering on 11 November 2002. The latter is essentially identical to the previous guideline issued save for some typographical changes.

The MAS Notices replace the notices on AML which were issued in 1999 to each financial sector. The MAS Notices were issued after the spate of amendments made to the AML legislation (as discussed below).

The MAS also regularly publishes notices on tell tale signs or red flags that may indicate the existence of money laundering[20] and also updates the relevant financial sectors on the development of international AML regulation.[21] On-site inspections are also conducted by MAS to ensure that financial institutions have adequate control systems, processes and procedures to combat money laundering, terrorist financing and for reporting of suspicious transactions. Since the September 11th 2001 incident, MAS has intensified its supervisory efforts by conducting focused inspections to verify the financial institutions' compliance with the AML Guidelines and other directives. Inspection of a total of 129 financial institutions by MAS was conducted within a period of three months, shortly after 11 September 2001.[22]

B Singapore in the International Arena on AML

Singapore is a party to various anti-drugs and terrorism conventions including the Single Convention on Narcotics Drugs 1961, Convention on Psychotropic Substances 1971, the Convention against Illicit Traffic in Narcotics Drugs and Psychotropic Substances 1988 and the International Convention for Suppression of the Financing of Terrorism 1999.

Singapore has been a member of the Financial Task Force since 1991 and is also one of the founding members of the Asia Pacific Group on Money

Laundering. In June 2002, it was admitted into the Egmont Group of Financial Intelligence Units.[23]

In October 2001, the MAS together with the Commercial Affairs Department of the Singapore Police Force, hosted the 4th APG Typologies Workshop on Money Laundering which was attended by more than 100 law enforcements and regulatory experts from 23 jurisdictions and 6 international and regional organizations in the Asia Pacific Region. One of the highlights of the workshop was the establishment of a Working Group to examine ways to improve information sharing in money laundering investigations, which is to be co-chaired by Australia and the USA.

MAS also participated in the Singapore Inter-Ministerial Task Force on Anti-Terrorism, set up shortly after the terrorist attack in the USA on 11th September 2001.[24]

V CRIMINAL LAW

The Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act (Ch. 65A) (the 'CDSA') makes money laundering an offence in Singapore.

A History of the CDSA

The Drug Trafficking (Confiscation of Benefits) Act ('DTA') was first enacted in 1993 to criminalize the laundering of benefits from drug trafficking, as well as to allow for investigation and the confiscation of such benefits. The DTA was based largely on the United Kingdom Drug Trafficking Offences Act with modifications to suit local circumstances. The DTA was restricted to confiscation of assets derived only from drug trafficking. The Misuse of Drugs Act (Cap. 185), imposes very stringent penalties on those handling drugs and the aim of the DTA was to deny drug traffickers the money derived from drug trafficking.[25]

Since the enactment of the DTA in 1993, Singapore recognized that transnational crime is not restricted to drugs or proceeds of drug trafficking and that there is an international trend to criminalize the laundering of not only drug money but also the proceeds of other serious crimes as well.[26] In June 1996, the Financial Action Task Force had called on its members to extend or take measures to extend the scope of their anti-money laundering regime to include the proceeds of serious crimes.

The DTA was amended in 1999 to extend the asset confiscation and anti-money laundering provisions of the DTA beyond drug laundering provisions to cover serious crimes. A Second Schedule was inserted listing 182[27] non-drug-related crimes that are serious in nature but excludes crimes that cannot

be linked to money laundering (for example, bigamy and incest). The other amendments to fine tune the DTA include the following:

- The prosecution need not prove that the accused had actual knowledge that the proceeds are derived from drug trafficking or other serious crimes. Instead the accused can be convicted based on evidence showing that he had 'reasonable grounds to believe' that the person trafficked in drugs or the proceeds were derived from drug trafficking or other serious crimes.
- The penalties for money laundering are increased from seven years imprisonment and/or S$100 000 fine to seven years imprisonment and/or S$200 000 fine.
- Introduction of a new section to make reporting of suspicious transactions mandatory for all persons, including financial institutions and non-financial institutions.
- Introduction of a new section to make it an offence for a person who has reasonable grounds to suspect that a money laundering investigation is being or about to be conducted to tip-off another person with information which is likely to prejudice the investigation.
- To introduce a facility for the sharing of information obtained under the mandatory reporting of suspicious transactions under the CDSA with foreign authorities.
- To rename the DTA to 'Corruption, Drug Trafficking and other Serious Crimes (Confiscation and Benefits) Act to reflect its wider scope.

The amendments to the DTA result in consequential amendments to other acts as follows:

- To amend the Extradition Act to make serious crimes money laundering offences extraditable (as drug money laundering offences are already extraditable).
- To repeal the Corruption (Confiscation of Benefits) Act as the amended DTA would also apply to corruption offences and would have a wider scope than the Corruption (Confiscation of Benefits) Act.

The CDSA strengthened the powers of regulators to control money laundering and allows for greater co-operation between Singapore and foreign regulatory authorities to combat money laundering. The CDSA is in effect the de-facto legislation enacted to combat money laundering although there is no mention or definition of the word 'money laundering' in the Act.

The term 'criminal conduct' is defined as 'serious offence' committed in or outside Singapore.[28]

However, it is notable that fiscal crime, that is, tax evasion (which would include duty evasion and exchange control) have not been included in the list of serious offences.

The CDSA provides for regulations to be made for carrying out the purposes and provisions of the CDSA[29] but to date, none has been prescribed.

B The Offences Under the CDSA

The five basic money laundering offences under the CDSA are as follows:

1 To assist another to retain the benefits of drug trafficking or serious offence[30]
2 To conceal or transfer the benefits of drug trafficking or serious offence[31]
3 For a secondary offender to acquire the proceeds of drug trafficking or serious offence for no or inadequate consideration[32]
4 Failure to disclose knowledge or suspicion of money laundering to the authorities or employer[33]
5 Tipping off a money laundering investigation.[34]

The offences of money laundering under the CDSA are directed at two types of offenders. First, the primary offender who is actually engaged in the unlawful activity, which has produced the money and for whose benefit the money is laundered. Second, the provisions directed at the secondary offender – any person who assists in one way or another the primary offender, or who fails to discharge a duty imposed on him. The benefits derived by both the primary offender and the secondary offender may be the subject of a confiscation order made by a court following the conviction of the offenders.

1 Assisting another to retain the benefits of drug trafficking or criminal conduct

Sections 43(1) and 44(1) of the CDSA provide that any person who enters into an arrangement knowing or having reasonable grounds to suspect that it facilitates the retention or control of the benefits of drug trafficking or criminal conduct commits an offence. A person is liable if the arrangement that he has entered into enables the benefits of the drug trafficking or criminal conduct to be concealed, removed from Singapore, transferred to nominees, used as security to obtained funds, or used to acquire property by way of investment or otherwise.

An offence under Sections 43(1) and 44(1) attracts a custodial sentence of up to seven years, or fines up to S$200 000 or both, may be imposed.[35]

A person will not be guilty of an offence under this part, if he discloses his knowledge or belief that any property, funds or investments are derived from

or used in connection with drug trafficking or criminal conduct to an Authorized Officer on his own initiative before or soon after entering into the arrangement.[36] Such disclosure will not be treated as a breach of any restriction upon the disclosure placed by law,[37] contract or rules of professional conduct. Further, there would be no liability in damages for any loss arising out of such disclosure or anything done or not done in relation to the funds or investments in consequence of the disclosure.[38]

'Authorized Officer' is defined under the CDSA to mean:

1 any officer of the Central Narcotics Bureau;
2 any special investigator of the Corrupt Practices Investigation Bureau appointed under the Prevention of Corruption Act (Cap. 241);
3 any Commercial Affairs Officer appointed under the Police Force Act (Cap. 235);
4 any police officer; and
5 any other person authorized by the Minister for the purposes of the CDSA.

To raise the statutory defences available to a person being prosecuted for assisting another to retain benefits from drug trafficking or criminal conduct, a person must prove one of the following[39]:

a that he did not know and had no reasonable ground to believe that the arrangement he has undertaken related to the proceeds of drug trafficking or criminal conduct, or facilitated the retention or control of such proceeds;
b that there is reasonable excuse for his failure to disclose his knowledge or belief; or
c if the arrangement was undertaken by him in the course of his employment, he has disclosed his knowledge or belief to his employer in accordance with the procedures designated by his employer.

The CDSA provides for anonymity to those making disclosure to an authorized officer that there is a suspicion or belief that any property, funds or investments are derived from drug trafficking or criminal conduct.[40] The identity of the individual making such disclosure and the fact that such disclosure had been made shall not be revealed by any witness in any civil or criminal proceedings and shall not be published or broadcast unless otherwise ordered by the court.[41]

2 Concealing or transferring benefits of drug trafficking or criminal conduct

Sections 46(1) and 47(1) of the CDSA provide that a person is guilty of an offence if he is found to have concealed, disguised, converted or transferred

any property which represents the benefits from drug trafficking or criminal conduct. The offence applies to a person who is involved in producing the illegal benefits as well as any person who knows or has reasonable grounds to believe that all or part of the property in question directly or indirectly represents another person's benefits of any drug trafficking offences or criminal conduct.[42] In this connection, concealing or disguising any property means concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to the property.

The maximum penalty for this offence is a fine of S$200 000 or imprisonment for seven years, or both.[43]

3 Acquiring benefits of drug trafficking or criminal conduct

Sections 46(3) and 47(3) of the CDSA prohibit a person from acquiring a property for no or inadequate consideration, if he knows or has reasonable grounds to believe that the property directly or indirectly represents another person's benefits of drug trafficking or criminal conduct. The consideration is regarded as inadequate if its value is significantly less than the market value of that property and of the provision of services or goods which are of assistance to him in drug trafficking or conducting a crime is not to be treated as consideration.

The maximum penalty for this offence is a fine of S$200 000 or imprisonment for seven years, or both.[44]

4 Tipping-off

Sections 48(1) and (2) of the CDSA provide that a person is guilty of an offence if he knows or has reasonable grounds to suspect that an investigation in connection with the CDSA is underway or a disclosure has been made to an authorized officer under the CDSA, and he discloses such knowledge or belief to any person which is likely to prejudice that investigation or any proposed investigations.

A defence is available to the accused if he is able to prove that he did not know and had no reasonable ground to suspect that his disclosure was likely to prejudice any investigations or proposed investigations.[45]

If a solicitor discloses such information to his client or potential client in connection with the giving of advice to a client or potential client in the course of his professional employment, he is exempted from the purview of this offence.[46] This defence is not available to the solicitor if the purpose of the disclosure is to further any illegal purpose.[47]

The maximum penalty for this offence is a fine of S$30 000 or imprisonment for three years, or both.[48]

5 Failure to disclose knowledge and/or suspicion that any property is derived from drug trafficking or criminal conduct

Section 39(1) of the CDSA imposes a positive duty of disclosure on any person who knows or has reasonable grounds to suspect that a part or the whole of any property is the direct or indirect proceeds of drug trafficking or criminal conduct, or the property was used or intended to be used for such purpose. The duty arises where the information or matter on which the knowledge or suspicion is based, comes to one's attention in the course of one's trade, profession, business or employment.[49] A person who does not disclose the said information, knowledge or suspicion to an authorized officer as soon as reasonably practicable, is guilty of an offence unless he can show that he has reasonable excuse for not disclosing the information. A disclosure to the appropriate person in accordance with the procedure established by his employer is considered sufficient.[50]

Solicitors or their employees are exempted from the purview of this offence if the information is subject to legal privilege.[51]

The party providing the information under Section 38 of the CDSA is protected to the extent that the disclosure will not be a breach of any obligations of confidentiality imposed either by law, contract or rules of professional conduct.[52] Further, there will be no liability in damages for any loss arising out of such disclosure, or any act or omission in consequence of the disclosure.[53]

The maximum penalty for this offence is a fine of S$10 000.[54]

C Proving Liability under the CDSA

To prove liability for the offence, the CDSA provides for an objective knowledge test. The prosecution need not show that the accused had actual knowledge that he was dealing with proceeds deriving from drug trafficking or other criminal conduct. It is sufficient to show that the accused had 'reasonable grounds to believe' that the proceeds were derived from drug trafficking or criminal conduct.[55]

A body corporate is deemed to be liable for the conduct of its employees or agents who had acted within the scope of their actual or apparent authority.[56]

D Confiscation of Benefits of Drug Trafficking or Criminal Conduct under the CDSA

In considering the approach towards the confiscation of benefits under the CDSA, the legislators adopted the practical approach to allow the person to pay a confiscation of the benefits or the total sum the court assesses to have been derived from drug trafficking or criminal conduct. The legislators

preferred this approach to confiscating the physical assets and thereafter, selling them off. This will avoid imposing unnecessary burdens on the authorities to manage assets or businesses which are not easily disposable, for example, supermarkets.[57]

The Public Prosecutor can apply for a confiscation order against a defendant who is convicted of a drug trafficking or serious offence under the CDSA in respect of benefits derived by him from the drug trafficking or serious offence if the court is satisfied that such benefits have been so derived.[58] There is a rebuttable presumption that the defendant derived benefits from the drug trafficking or serious offence if the defendant holds any property or any interest therein (including income accruing from such property or interest) disproportionate to his known sources of income, the holding of which cannot be explained to the satisfaction of the court.[59] In deciding whether to grant the confiscation order, the court can admit any relevant evidence admitted in the proceedings against the defendant for the drug trafficking or serious offence.

The amount to be recovered from the defendant under the confiscation order shall be determined by the court to be the value of the benefits derived by the defendant from the drug trafficking or serious offence.[60]

In the event that the defendant defaults in paying the amount imposed under the confiscation order, the term of imprisonment for which the court can direct ranges from two years if the amount does not exceed S$20 000 to 10 years if the amount exceeds S$100 000.[61]

A person who asserts an interest in the property or asset which is subject to the confiscation order may apply to the court, before the confiscation order is made for an order declaring the nature, extent and value of his interest. In deciding whether to make such order, the court has to be satisfied that the applicant has not in any way been involved in the defendant's drug trafficking or serious offence and that the applicant acquired the interest for sufficient interest and without knowing, and in circumstances such as not to arouse a reasonable suspicion, that the property was, at the time he acquired it, property that was involved in or derived from the drug trafficking or serious offence.[62]

E Issuance of a Restraint Order and Charging Order

If proceedings have been instituted against the defendant for a drug trafficking or serious offence (before its conclusion) and the Court is satisfied that there is reasonable cause to believe that the benefits have been derived by the defendant from the drug trafficking or serious offence, the High Court can make a restraint order to prohibit any person from dealing with any realizable property or a charging order on realizable property for securing the payment to the Government.[63] A restraint order or charging order can also be made if an

accused has been formally informed[64] that he may be prosecuted for a drug trafficking or serious offence or if the accused dies or cannot be found or is outside the jurisdiction during an investigation for a drug trafficking or serious offence provided that there is reasonable cause to believe that the benefits have been derived by that person from the drug trafficking or serious offence.[65]

The application for a restraint order or charging order has to be made by the Public Prosecutor before a judge in chambers under an *ex parte* application. In respect of an application for a restraint order, notice shall be given to persons affected by the order.[66]

A restraint order can be made against all realizable property held by the specified person including property transferred to him after the making of the order. The description of the property need not be described under a restraint order.

The description of the property which is subject to a charging order has to be specified on the said order. This property can include a gift that is caught under the CDSA which is defined to mean a gift made by the defendant within a period of six years prior to the commencement of the proceeding for the drug trafficking or serious offence or when a confiscation order has been made against him if the concerned gift is not part of the benefits derived by the defendant from the drug trafficking or serious offence. There is no limitation period in relation to gift of property which is part of the benefits derived by the defendant from the drug trafficking or serious offence.[67]

A charging order can be made notwithstanding that a confiscation order has already been made provided that the value of which the charging order is made does not exceed the amount payable under the confiscation order. If a confiscation order has not been made, the amount of which a charging order can be made is limited to an amount equal to the value of the property charged.[68]

F Power of Investigation under the CDSA

Another aim of the CDSA is to provide assistance to those investigating money laundering in Singapore and elsewhere. As such, the CDSA empowers the court to grant an authorized Officer a production order against a person who appears to the court to be in possession of the material to which the application relates.

There are two types of production orders under the CDSA, a general order under Section 30 of the CDSA ('General Production Order') and a specific one applicable to financial institutions under Section 31 of the CDSA ('Specific Production Order').

A section in relation to a production order to be made to assist a foreign authority investigating a foreign drug trafficking or serious offence in Singapore was also discussed during the second reading of the Drug Trafficking (Confiscation of Benefits)(Amendment) Bill in Parliament.[69]

Section 41 of the CSA facilitates the sharing of information obtained from a suspicious transaction report ('STR') with foreign corresponding authority[70] provided that there is reciprocity, confidentiality and the use of the information is controlled (including an undertaking that it will not be used as evidence in any proceeding). This in addition to the legal assistance that Singapore can render to foreign agencies under the Mutual Assistance in Criminal Matters Act (Cap. 190A) 2000.

The General Production Order is available against any person, except a financial institution for which the Specific Production Order is applicable. While an authorized Officer under the CDSA may apply for a General Production Order, only the Attorney-General can apply for a Specific Production Order. This difference reflects the seriousness of a production order against a financial institution.

Before an application for a General Production Order or a Specific Production Order is granted, the court will need to be satisfied that there are reasonable grounds for

1. suspecting that the specified person has carried out or has benefited from the drug trafficking or serious offence;
2. believing that the material to which the application relates is likely to be of substantial value to the investigation; and
3. it is in the public interest that the material should be produced or that access to it should be given.[71]

A financial institution which complies with a Specific Production Order and provides material to the authorities would not be in breach of obligations of confidentiality imposed by law including Section 47 of the Banking Act rules of professional conduct or under contract.[72] Nor would it be liable for any loss suffered by the customer consequent upon production of materials pursuant to a production order.[73]

G Issuance of Warrants

Section 34 of the CDSA empowers the court to issue a warrant authorizing an authorized officer to enter and search a specified premises.

Before a warrant is issued, the court has to be satisfied that a production order has not been complied with or that the similar conditions for granting a production order (as discussed above) are met or that there are reasonable grounds for suspecting that there is on the premises material relating to the specified person or to drug trafficking or serious offence which is likely to be of substantial value to the investigation but the material cannot at the time of the application be particularised.[74]

Obstruction of an authorized Officer in execution of a warrant issued under Section 34 is an offence and the penalty shall be a fine not exceeding S$10 000 or imprisonment for a term not exceeding two years or both.[75]

H Obligations of Financial Institutions

Section 37 of the CDSA imposes obligation on a financial institution to retain a copy of each financial transaction document for the minimum period of six years from the day after the account is closed, the deposit box ceases to be used by the person or the transaction takes place, whichever is applicable. The financial institution shall also maintain a register of original documents released[76] before the end of the minimum retention period. Contravention of this section is an offence and the penalty shall be a fine not exceeding S$10 000.

The obligation on the financial institutions to retain documents is also reiterated in the Notices issued by the MAS to financial institutions which has the force of law (discussed below).

I Sharing of Information with a Foreign Authority

The CDSA empowers a Suspicious Transaction Reporting Officer ('STRO') in the Commercial Affairs Department ('CAD') to communicate any information disclosed to him or any authorized officer under Section 39(1) of the CDSA (that is, knowledge and/or suspicion that any property is derived from drug trafficking or criminal conduct) to a corresponding authority of a foreign country[77] subject to the following conditions being fulfilled:

1 There is an existing arrangement under which the requesting party has agreed to communicate to Singapore, upon Singapore's request, information received by the requesting party that corresponds to anything required to be disclosed to an authorized Officer under Section 39(1);
2 The STRO is satisfied that the requesting party has given an appropriate undertaking for protecting the confidentiality of the information to be given to it and for controlling the use of the said information; and
3 Such other conditions as the Minister may prescribe.

In practice, the CAD will enter into a memorandum of understanding (MoU) with the foreign country before agreeing to the sharing of information. There is no official figure as the number of MoUs have been entered into.[78] In September 2002, the Australian Transaction Reports and Analysis Centre (AUSTRAC) signed a MoU with the CAD for the exchange of financial intelligence between AUSTRAC and the STRO.[79]

Apart from the CDSA, other forms of legal assistance which Singapore can provide to foreign authorities in combating money laundering are contained in the Mutual Assistance in Criminal Matters Act 2000, which is discussed below.

J Cases on CDSA

To date, there are no reported cases on the convictions under the five offences discussed above (after the CDSA came into effect). However, three cases involving money laundering were cited as significant cases by the Commercial Affairs Department (CAD) and one further case was referred to in a recent conference paper delivered by the Director of CAD. Summaries of all four cases follow.

1 *Public Prosecutor* vs *David Chong Seah Wee*[80]

The Accused was a customer service office at a local bank and during the period between March 1997 and January 2002, he raised fictitious foreign exchange debit vouchers to withdraw money amounting to about S$12.6 million from the bank, purportedly on behalf of fictitious customers. The money was used by the Accused to feed his gambling habit, in particular, placing large bets on the Singapore Pools, which is the operator of a local lottery. The Accused deposited his large winnings with another local bank. Notwithstanding that the money is from a legitimate source, the frequency of his winnings which ran into millions raised the suspicions of the bank officer who lodged a suspicious transaction report with the STRO. The Accused was charged and convicted with multiple counts of cheating under the Penal Code and one charge of money laundering under the CDSA. He was sentenced to a total of 12 years' imprisonment.

2 *Public Prosecutor* vs *Andrew Yip*[81]

The accused, Andrew Yip @ Koh Weng Kee, an accountant with Wing On Fire & Marine Insurance, had misappropriated S$4.52 million, by deceiving the insurers' banks into believing that he was the payee of several forged cheques.

Investigations by the CAD showed that between 1 October 1999 and 4 July 2000, the Accused had laundered a total sum of A$980 490 (S$892 250) of his ill-gotten gains, by remitting the money from his bank accounts to a casino in Australia, where he gambled the money away.

In addition to the cheating offences, the accused was found guilty of one count of an offence of assisting another to retain benefits from criminal conduct under the Section 44(1)(a) under the CDSA. He was sentenced to an imprisonment of 48 months.

3 *Public Prosecutor* vs (i) *Ong Choon Ho* and (ii) *Yeo Kok Wei*[82]

This case was referred to as the first money laundering conviction under the new CDSA. The two accused, Ong Choon Ho Alvin (First Accused) and Yeo Kok Wei (Second Accused), both of whom were bank officers from Overseas United Bank, had conspired with three others, to use a forged letter to authorize the transfer of S$600 000 from the customer's account to an accomplice's account.

CAD's investigations showed that the Second Accused left Singapore for Malaysia with 26 S$10 000 notes to change for Malaysian ringgit. He returned to Singapore and converted the ringgit into smaller denominations at a money changer. CAD's investigations also revealed that the two accused had used part of the proceeds of the crime to purchase shares, so as to disguise the proceeds of crime as another form of property.

In addition to the forgery offences, Ong and Yeo were found guilty of one count of the offence of assisting another to retain benefits from criminal conduct under the Section 44(1)(a) under the CDSA. They were each sentenced to an imprisonment of 24 months for the offence under CDSA.

4 *Public Prosecutor* vs *Lam Chen Fong*[83]

The accused, Lam Chen Fong, is a partner of Wen Long Money Changer (licensed with both a money changer and a remittance licence). A total of 1163 victims have reported to the police the misappropriation of funds by Lam Chen Fong amounting to S$8.7 million. The Accused pleaded guilty to the following 22 charges:

- 20 charges of criminal breach of trust as an agent under Section 409 of the Penal Code, Chapter 224;
- 1 charge of transferring and converting benefits of criminal conduct under Section 47(1)(b) of the CDSA; and
- 1 charge of agreeing to give gratification in consideration of screening himself from legal punishment under Section 214 of the Penal Code, Chapter 224.

During sentencing, the Public Prosecutor called for 'a severe sentence to show the Court's abhorrence of the nefarious deeds of the Accused' notwithstanding that the Accused had no past criminal records.[84] The Accused was sentenced to a term of imprisonment of 22 years. In relation to the offence under Section 47(1)(b) of the CDSA, the Defendant was sentenced to three years' imprisonment.

VI MUTUAL LEGAL ASSISTANCE

As crimes become more transnational, it became increasingly obvious to Singapore that, to be an effective and responsible international partner, it was necessary to enact legislation that would allow Singapore to receive and to provide assistance to foreign counterparts to enable evidence to be used in legal proceedings.[85] At the 1999 Plenary of the Financial Action Task Force, Singapore was encouraged to enact a dedicated mutual assistance law. It was against this backdrop that, the Mutual Assistance in Criminal Matters Act, (Cap 190A) (MACMA) was enacted and came into effect on 1 April 2000. The Act consolidates existing mutual assistance provisions (for example, the provisions dealing with mutual legal assistance formerly covered under the CDSA) and provides for more forms of assistance previously not available under Singapore laws.[86]

MACMA provides a framework under which mutual legal assistance treaties will be negotiated, setting out the terms and form of assistance Singapore is prepared to give and also serving as the framework for Singapore to request and receive from other countries.

A Request by Singapore to Foreign Countries

Whether a country will accede to Singapore's request will firstly depend on the provisions of that country's laws. Under the MACMA, Singapore can ask for the following forms of assistance from any foreign country[87]:

1 Obtaining of evidence:

These evidence include obtaining the testimony of witnesses, seizing physical evidence, photographs, documents.

The Attorney General must be satisfied that there are reasonable grounds for believing that such evidence/items would be relevant to any criminal proceedings in Singapore.[88]

2 Voluntary attendance of persons in Singapore as witness in legal proceedings or to assist in criminal investigations.

A person who comes to Singapore under this provision will, during the period of his stay, be immune from prosecution or civil suit for anything which he has done before leaving the foreign country for Singapore or be required to give evidence or assistance in relation to any criminal matter in Singapore other than the criminal matter to which the request relates.[89]

The Attorney General must be satisfied that there are reasonable grounds to believe that the person in the foreign country is capable of giving evidence or assistance relevant to a criminal matter involving a Singapore office and that person consents to travel to Singapore for the purpose of giving such evidence or assistance.[90]

3 Enforcement of a Singapore confiscation order:

The Attorney-General must be satisfied that there are reasonable grounds for believing that some or all of the property concerned is located in that country.[91]

4 Assistance in locating or identifying a person who could be of assistance in criminal investigations or proceedings or who could be affected by such investigations or proceedings.

The Attorney-General must be satisfied that there are reasonable grounds for believing that person in the foreign country is a person who is or might be concerned in or affected by; or could give or provide evidence or assistance relevant to any criminal matter in Singapore.[92]

5 Service of court documents:

The Attorney-General may request the appropriate authority of the foreign country to assist in effecting service of any process where the Attorney General is satisfied that, for the purposes of, or in connection with, any criminal matter in Singapore, it is necessary or desirable to serve that process on a person or authority in that country.[93]

B Request to Singapore by Foreign Countries

Every request by a foreign country to Singapore for assistance shall be made to the Attorney General[94] and the request must (1) specify certain information (for example, purpose of request, identity of authority initiating the request) and (2) be accompanied by certain documents (for example, certificate that the request is made in respect of a criminal matter within the meaning of the MACMA[95]).[96]

The forms of assistance which Singapore can request are also the forms of assistance which Singapore can provide under the MACMA.[97] The MACMA distinguishes between assistance involving coercive measures, such as request for attendance of a person in a foreign country and those involving coercive measures, such as service of documents.[98] Assistance which involves coercive measures may only be provided to a foreign country which has entered into a mutual legal assistance treaty with Singapore. The MACMA provides the legal framework for Singapore to request and provide assistance from and to other countries. The treaty will set out other conditions for giving of assistance and provide safeguards against abuses by other countries. Assistance which does not involve coercive measures may be provided to any country without the need for a treaty to be entered.

C Safeguards

The safeguards built into the MACMA to prevent abuses are as follows:

1 Limited list of offences for which assistance is available – the list of offences for which assistance may be obtained or provided for under the MACMA is the same list currently available under the CDSA.
2 Requirement for mutual legal assistance treaty for certain forms of assistance which is 'coercive' in nature.
3 The Attorney-General will be the authority for requesting assistance from other countries[99] and receiving requests for assistance from other countries. The Attorney-General shall not be bound to honour a request if, in the opinion of the Attorney-General, *inter alia*:[100]

   a The foreign country in question had failed to comply with terms of any treaty or agreement between Singapore and that country.
   b The offence in question is of a political character.
   c The offence in question, if it had occurred in Singapore would constitute an offence under the military law applicable in Singapore.
   d The offence causes prejudice to a person on account of the person's race, religion, sex, ethnic origin, nationality or political opinions.
   e The matter requested is not of sufficient importance to the investigation of criminal proceedings or could reasonably be obtained by other means.
   f The requesting state fails to give an undertaking that the matter requested will not be used for purposes other than those for which the request was made.
   g The provision of assistance could prejudice the safety of any person or if it is not in the public interest to provide the assistance.

The MACMA does not deal with extradition[101]; all requests for extradition and assistance leading to extradition will continue to be handled under the provisions of the Extradition Act.

On 3 November 2000, Singapore concluded the first mutual legal assistance treaty with the USA, under the MACMA. The treaty, the Drug Designation Agreement, laid the foundation for co-operation between Singapore and the USA in the area of drug trafficking and drug money laundering investigations.[102] It is also reported that sometime in July 2002, the governments of Singapore and Switzerland began negotiations on a mutual legal assistance treaty for extension of legal assistance to each other and the anticipated date for finalizing the agreement is sometime later this year.[103]

VII EXTRADITION ACT

Drug and other serious offence money laundering are extraditable crimes under the Extradition Act.[104]

The Extradition Act provides for separate procedures and requirements for a declared Commonwealth country,[105] a foreign State (any foreign state with which Singapore had signed an extradition treaty, which is still in force)[106] and Malaysia.[107]

An 'extradition crime' in relation to a foreign state, means an offence, which falls under the list in the First Schedule of the Extradition Act or an intent to commit such crime. In relation to an 'extradition crime' for a declared Commonwealth country, there is additional criteria that the maximum penalty for the offence imprisonment for not less than 12 months under the law of that declared Commonwealth country.

A person shall not be liable to be surrendered to a foreign state if *inter alia*:

- the offence in question is of a political character;
- if he has been acquitted or pardoned by a competent tribunal or authority in any country;
- the prosecution of the fugitive is on account of his race, religion, nationality or political opinion.

Upon the request of a foreign state or declared Commonwealth country, the Minister is empowered to issue a notice to a Magistrate for issuance of a warrant for the apprehension of the fugitive.[108]

If a person is apprehended under a warrant issued in pursuance of an authorization by the Minister under the Extradition Act, the Magistrate shall, by warrant commit the person to prison to await the warrant of the Minister for his surrender provided the following criteria are met:

1 an authenticated foreign warrant for the surrender of the person is produced;
2 in the case of a person who is accused of an extradition crime, such evidence as would in the opinion of the Magistrate, according to the laws in force in Singapore, justify the trial of the person if the act had taken place in Singapore is produced;
3 in the case of a person who is alleged to have been convicted of an extraditable crime, sufficient evidence that the person has been convicted of that crime is produced; and
4 the Magistrate is satisfied, after hearing the fugitive's evidence that the fugitive is liable to be surrendered to the foreign state that made the requisition for the surrender.[109]

VIII LAW ENFORCEMENT AGENCIES OF THE SINGAPORE AML SYSTEM

Apart from an adequate legal framework, the complex technical, jurisdictional and legal issues raised in money laundering require an enforcement capability dedicated to combating such crimes.

In the FATF's first evaluation of Singapore's AML System, it was recommended that efforts should be concentrated on ensuring *inter alia* the legal and administrative system for suspicious transaction reporting to be more efficient and effective.

To assist authorities in their investigation of money laundering, officers of law enforcement agencies (referred to as 'Authorized Officer' under the CDSA) may obtain access to materials related to suspected money laundering transactions by applying to court for Production Orders under the CDSA. Material includes any book, document or other record in any form whatsoever, and any container or article relating to the material.

A The Commercial Affairs Department (CAD)

The CAD was established in 1984 under the aegis of the Revenue Division of the Ministry of Finance to combat complex commercial frauds and white-collar crime in Singapore. Prior to that, Singapore did not have an enforcement agency equipped with the necessary specialist and professional knowledge to tackle complex commercial transgressions. CAD was dissolved from the charge of the Ministry of Finance and was re-constituted (with the same name) within the Singapore Police Force on 10 January, 2000. The Commercial Crime Division was also merged with the new CAD creating a single law enforcement authority for all forms of commercial crimes in Singapore. CAD is in essence, the premier investigative authority on white-collar crimes in Singapore which will investigate offences under the SFA, Companies Act, the CDSA, Multi-Level Marketing and Pyramid Selling (Prohibition) Act, and complex fraud cases under the Penal Code.[110] The CAD sees its role as 'to combat economic crime and to preserve the integrity of Singapore's reputation as a world-class financial and commercial hub',[111] and regards itself as the *de-facto* anti-money laundering authority in Singapore.[112]

The Financial Investigations Division (FID), which comes under the purview of the CAD is dedicated to combat money laundering The division has three branches under its wing comprising of the Proceeds of Crime Unit (PCU), the Financial Investigations Branch (FIB) and the Suspicious Transactions Reporting Office (STRO).

The STRO looks into suspicious accounts and transactions. Under Section 39 of the CDSA it is an obligation to report suspicious information which one

gathers in the course of one's work, failing which a criminal offence would be committed. The STRO acts as a central agency receiving suspicious transaction reports (STR). The office then reviews these reports for investigations if an offence under the CDSA is detected. Apart from that the office also maintains a data processing system on information obtained from STRs for analysis and intelligence purposes. The STRO is authorized under the CDSA to share information obtained from STRs with its foreign counterparts by signing of memoranda of understanding. The sharing of the information with foreign counterparts is on the principle of reciprocity and confidentiality.[113]

The enactment of the CDSA in 2000 makes making a STR mandatory for everyone if he has 'reason to suspect' that the property is connected to drug trafficking or criminal activity, and that suspicion arose in the course of his business or employment. As such statistics show that the number of STRs made has steadily increased in the last 2 years. In 1999, under the DTA regime where the reporting of STRs was not compulsory and the predicate offence for money laundering was restricted to drug trafficking offences, 189 STRs were received by the STRO. In 2000, a total of 431 STRs were made followed by 558 STRs in 2001. For 2002, around 1000 were made.[114]

The FIB's main role is investigation of various money laundering offences as well as other alleged crimes under the CDSA.

PCU conducts financial investigations into assets held by suspects who have been arrested. They are placed in charge of the seizure and management of such assets and the confiscation of the proceeds of crime. This unit frequently communicates with experts on concealed income analysis to further strengthen their professional knowledge.

Pursuant to the MAS Notices, a financial institution is required to notify the STRO of any suspicious transactions in the format provided in the MAS Notice. A copy of the notification should also be forwarded to the MAS. This dual reporting procedure therefore allows for better co-ordination and monitoring by the primary regulator of the financial institutions and the appointed law enforcement agency.

IX SUPERVISORY LAW

A MAS Guidelines

MAS has issued separate Guidelines on the Prevention of Money Laundering to the various financial sectors. As the contents of the MAS Notices are almost identical in substance, the discussion below on the Guidelines on Prevention of Money Laundering issued to banks (Notice 626) shall be applicable to all the other financial sectors unless stated otherwise.

The purpose and scope of the Notice 626 is stated in its preamble as follows:

> preservation, nationally and internationally, of the good name of the banking community in Singapore and recognizing the need to prevent the banking system from being used in furtherance of money laundering activities arising from and in connection with drug trafficking or criminal conduct and taking into account (1) the provisions of the CSDA; (2) the FATF 40 Recommendations, in particular Recommendations 9 to 20; and (3) the Statement of Principles proposed by the Basle Committee on Banking Supervision and Supervising Practices in December 1988, banks in Singapore shall comply with the Guidelines issued in this Notice.[115]

1 Application of the Notice

Singapore incorporated banks with branches or subsidiaries overseas have to ensure that the head office's group policy on money laundering is communicated to the management of their overseas offices. Standards required for verification of identity and record keeping by the branches or subsidiaries are at least to that required under Singapore law, taking into account the laws and regulations of the host country. Where there is any conflict, the laws of the host country will preside but the head office has to be informed of any departure from the group policy.

The Notice 626 describes the money laundering process and summarizes the offences under the CDSA. The Notice requires the banks to comply with the following principles:

1. Know your customer
2. Compliance with laws
3. Co-operation with law enforcement agencies
4. Adherence to the policies set out in the Notice through training of staff and implementing specific procedures for customer identification, retention of financial transaction documents and reporting of suspicious transactions.[116]

2 Customer identification

The customer identification procedure provided under Notice 626 is based on the 'Know Your Customer' principle. The Notice 626 requires that the Bank obtains satisfactory evidence of the identity and legal existence of persons applying to do business with them. Additional verification measures should be undertaken to confirm the identity of the person if initial checks fail to identify the applicant or give rise to suspicions that the information provided is false.

The 'Know Your Customer' principle is a well-established rule in the financial market in Singapore. In the case of *Choo Pit Hong Peter v Public*

Prosecutor[117] where the accused was charged with intentionally giving false evidence under the Section 193 of the Penal Code (Cap 224) the High Court in Singapore recognized that the 'know your client' is a 'front-line weapon in the regulatory system against frauds' and is part and parcel of the framework of the financial markets.

The Notice 626 provides a checklist of information and documents for the banks to verify the identity of their customers under the following categories:

1 Personal customer
2 Verification without face-to face contact
3 Corporate and other business customers
4 Clubs, societies and charities
5 Shell Companies
6 Trust, Nominee and Fiduciary Accounts
7 Client Accounts opened by solicitors or accountant
8 Transactions undertaken for non-account holders (occasional customer).[118]

The two categories which are notably missing are 'politically exposed persons' and 'correspondent banking'.

Application of the KYC concepts in a modern, branchless banking environment will no doubt pose challenges for the financial services industry.

3 Record keeping

The Notice 626 requires the banks to prepare and maintain documentation on their customer relationships and transactions such that (1) the relevant laws are complied with[119]; (2) compliance with the Notice 626 can be confirmed by the relevant authorities, internal and external auditors; (3) the reconstruction of the transaction can be done (if required); and (4) response can be provided within a reasonable time to any enquiry from the relevant authorities on *inter alia* the identity of the beneficial owner of the funds deposited with the bank.

The retention period for the financial transaction documents relating to opening of accounts or safe deposits and other relevant financial documents is six years. This is consistent with Section 37 of the CDSA.

4 Suspicious transactions

The Notice 626 requires the banks to exercise due diligence by implementing adequate systems for identifying and detecting suspicious transactions.[120]

In addition, the banks are required to institute a system for reporting suspicious transactions. A list of non-exhaustive examples of suspicious transactions is provided in the Notice 626.[121]

The Notice suggests the appointment of senior persons or an appropriate

unit to report to the STRO in the standard forms prescribed in the Notice 626.[122] A copy of the report should also be sent to the MAS.

Section 39 of the CDSA places the obligation to disclose the knowledge of the suspicious transaction on an individual (that is, any staff of the bank). If the officer reports the matter to the appointed person or unit, his duty under the Section 39 of the CDSA is fulfilled.[123]

The senior person or the compliance unit set up by the bank will be the reference point within the bank for its staff to report a suspicious transaction. The compliance officer or unit will evaluate the staff's report to assess whether there are reasonable grounds for such belief and if so, a report must be made to the STRO. If he is of the view that the suspicion is unfounded, an opinion that there are no reasonable grounds to believe that the customer engaged in drug trafficking or criminal conduct must be recorded. The bank must maintain a complete record of all suspicious transactions brought to the attention of the compliance officer/unit including the suspicious transactions, which are not subsequently reported to the STRO.

The Notice 626 reiterates the duty imposed on the informer under Section 48(1) of the CDSA not to convey to any other person information which is likely to prejudice an investigation/proposed by requiring that care be taken to ensure that the customer does not become aware that his name has been referred to the STRO.

5 Compliance and training

The Notice 626 requires the banks to advise its management and staff to adhere to the Notice and to educate them on the importance of the 'KYC' requirements to prevent money laundering. The Notice emphasizes the importance of training including refresher training for the employees of the bank by recommending different levels of training for each sector of the staff – new staff, front-line staff, staff dealing with new customers and supervisors/managers.

The effectiveness of the measures taken by the bank in preventing money laundering should be monitored by the bank's in-house audit department.

6 Scope of the notices

The Notice 626 makes it clear that compliance with the guidelines on prevention of money laundering is now a regulatory issue.

The content of the Notices to (1) merchant banks, (2) finance companies, (3) life insurers, (4) dealers and investment advisers and (5) future brokers, futures trading advisers and futures pool operators are almost identical to the Notice 626 with the relevant sections applicable only to a banking operation removed. Apart from these notices, there are no guidelines issued by the MAS to other non-bank financial institutions.

The reply from Singapore to the 2001–02 Self Assessment Exercise held by the FATF indicated that it is in full compliance with 27 out of the 28 Recommendations which requires specific action.[124] As Singapore has not extended the provisions of Recommendation 19 to all categories of non-bank financial institutions, it is therefore in partial compliance with this Recommendation.[125] For the purposes of compliance with the FATF Recommendations, the non-bank financial institutions have been defined to include as a minimum, bureaux de change,[126] stockbrokers, insurance companies and money remittance/transfer services.[127]

B ABS Guidelines and Other Guidelines

In addition to the Notice 626, the Association of Banks in Singapore ('ABS') has also issued guidelines on prevention of money laundering entitled 'Guidelines: Prevention of the Misuse of the Singapore Banking System for Money Laundering Purposes' dated September 2001 ('ABS Guidelines'). The ABS Guidelines are a revised edition of the guidelines issued in 1990, which took into consideration the changes to the anti-money laundering laws in Singapore since 1990.

The objects of ABS are *inter alia*, to promote the establishment of a sound structure in Singapore in co-operation and consultation with the MAS. ABS currently has 116 ordinary members[128] and 11 associate members.[129]

Section 7(ii) of the ABS Constitution states that the Council has the discretion to caution a member concerned or call a Special General Meeting to vote to impose penalties on the member concerned if the Council is of the opinion that the member has been guilty of any conduct inimical or prejudicial to the interest or objects of the Association. If the penalties imposed involve the suspension of the member concerned from membership of the Association, resignation or expulsion of the member concerned, notice shall be given to the MAS and facilities of the Inter-Bank Markets will not be available to the member concerned. The regulation on Bank Practices dated 4 January 1999 states that Section 7(ii) of the ABS Constitution would be evoked for any contravention of the rules and guidelines of the Association.[130]

The ABS Guidelines is similar in content to that of the Notice 626 with the additional guidelines on the verification procedures for private banking with specific reference to the Wolfsberg AML Principles and transactions involving the acquisition and take-over of banks.

1 Other guidelines

Certain professionals such as solicitors and accountants at times act as intermediaries for transactions as part of the services provided by them and as such

become target to money launderers to act as intermediaries for laundering of illicit proceeds. The Law Society of Singapore had in September 1998 issued a guideline, *Money Laundering – Guidance Notes for Solicitors* (which was based on the DTA regime) and is currently in the process of updating the same to take into consideration the CDSA regime. The Institute of Certified Public Accountants of Singapore has also issued certain guidelines on AML in its Statement of Auditing Practice 19, 'The Auditor's Role and Responsibilities in relation to the Prevention, Detection and Reporting of Money Laundering'.

X FINANCIAL INSTITUTION'S INTERNAL CONTROLS IN RELATION TO AML

The MAS Notices and ABS Guidelines provide detailed guidance on the prevention of money laundering. However, ultimately, the effectiveness of the guidelines will depend on the level of implementation by the financial institutions of the AML system and standards recommended in these guidelines.

Due to the lack of response from the banks to the questionnaire sent out for the purpose of this chapter, we are unable to obtain any information on the internal control of the banks and the level of compliance with the guidelines. The general comment from the officers of the banks who were approached is that compliance with the MAS Notice is a regulatory requirement and as such, the banks' internal AML system would be in full compliance with the said guidelines. This statement is consistent with the general reputation that Singapore has for taking a tough stand against criminal offenders.

XI AML AND BANK SECRECY

An issue of concern to the bank when it has received an order or request from a law enforcement agency for information in connection with the investigation of a criminal offence (including a drug trafficking offence or serious offence under the CDSA), is whether there was any legal compulsion to obey without any risk of being sued by the customer.

The statutory duty of confidentiality *vis-à-vis* their customers' affairs is found under Section 47 of the Banking Act (Cap. 19). Under the Banking (Amendment) Act 2001 ('Amendment Act'), amendments were introduced to the Banking Act, including the banking secrecy provisions, taking effect on 18 July 2001. Prior to the amendments, there were gaps in the banking secrecy provision and 'interpretational' problems were faced, hampering the sharing of certain information required by authorities, head offices, overseas branches and affiliates.

The 'general rule' of banking secrecy is enshrined in Section 47(1), which states that 'Customer information shall not, in any way, be disclosed by a bank in Singapore or any of its officers to any other persons except expressly provided in this Act'.

The duty of confidentiality is imposed in relation to 'Customer Information'. The term, 'Customer Information' is amended to mean (a) any information relating to an account of a customer of the bank, whether the account is in respect of the loan, investment or any other type of transaction and (b) deposit information. 'Deposit Information' in turn has been defined to mean any information relating to any deposit of a customer, funds of a customer under management by the bank, any safe deposit box maintained by, or any safe custody arrangements made by a customer.

Previously, Section 47(3) merely refers to customer information as 'information . . . regarding the money and other relevant particulars of the account of the customer'. As such, the new definition provides an easier interpretation of what falls under 'Customer Information'.

The Amendment Act attempts to relax the banking secrecy regime further by introducing additional 'exceptions' to the general rule of confidentiality, consolidated in the form of the Sixth Schedule.

The Amendment Act also addressed the bank's concern about the issue of disclosure in compliance with law. Under the previous Section 47(4)(d), when a bank receives an order or request from a law enforcement agent for information in connection with the investigation or prosecution of a criminal offence, it has to decide whether it was under a 'compulsion of law' to obey the order. The substitution of the operative word 'compulsion' with 'compliance with' would therefore address the bank's concern.

There is however, still some concern in relation to the wordings of Item 5 (A) of the Sixth Schedule, which permits a bank to disclose Customer Information to a law enforcement agent in compliance with an order or request made under any 'specified written law' (defined to mean the Companies Act, Criminal Procedure Code, Goods & Services Tax Act, Income Tax Act, Internal Security Act, Kidnapping Act and Prevention of Corruption Act[131]). By defining 'specified written law' to mean a certain number of laws, it appears that these laws are exhaustive and the CDSA is not one of the 'specified written law'.

However, the bankers should take some comfort in Section 39(6) of the CDSA which specifically provides that the party providing the information under Section 38 of the CDSA is protected to the extent that the disclosure will not be a breach of any obligations of confidentiality imposed either by law, contract or rules of professional conduct.

XII CONCLUSION

The first guideline in relation to money laundering prevention was issued by the ABS in 1990. However, the ABS guidelines have no force of law and no regulatory impact. Initial legislative efforts to fight money laundering in Singapore focused on the proceeds from drug trafficking activities. With international recognition that money laundering extends beyond the proceeds of drug trafficking coupled with calling from the Financial Action Task Force on its members to extend or take measures to extend the scope of their anti-money laundering regime to include the proceeds of serious crimes, Singapore replaces the CDA with the CDSA providing for serious penalties for persons involved in the laundering of proceeds from drug trafficking, corruption and other serious crime. There were consequential amendments to other relevant legislation. Also in 2000, MAS produced a series of notices on prevention of money laundering which has status of subsidiary legislation (instead of mere regulatory effect).

Being a reputable and important financial centre in Asia with a highly regarded banking structure and against a backdrop of the international trend to counter money laundering, Singapore has made efforts in recent years to improve the legal weaponry against money laundering. The government has recognized that as Singapore expands its role as a financial centre, there is increased scope not only for cross-border crimes but also international money laundering which now is no longer limited to drug trafficking crimes.

It appears that AML principles are however, viewed mainly as a compliance matter by banks in Singapore. A more effective implementation of an AML programme may take place if banks use the KYC principle to their own advantage. Intimate knowledge of a customer's financial circumstances and typical activities can assist the banks in marketing more effectively its products and services. In addition, having an effective AML system in place will lower the individual bank's reputational and financial risk. As such, if banks use the KYC principle to their own advantage, there may be in place a more rigorous due diligence and monitoring process of their customers.

NOTES

1. Madeline Lee, LL.B, LL.M, Advocate and Solicitor of Malaysia and Singapore, at Raslan Loong.
2. Section 14 of the MAS Act forbids the disclosure by its director, officer or employees to any person any information relating to the affairs of the MAS except for the purpose of the performance of his duties, exercise of his functions or when lawfully required to do so by any court or under the provisions of any written law. Contravention of this section constitutes an offence.
3. *Source*: Statistics Singapore website: www.singstat.gov.sg/keystats/hist/gdp1.html

4. Includes insurance and real estate services.
5. *Yearbook of Statistics Singapore*, various issues.
6. Please refer to Annex I of this chapter.
7. Tan, Chwee Huat (1999), *Financial markets and Institutions in Singapore*, 10th edn., National University of Singapore, Singapore: Singapore University Press, pp.61–62.
8. Economics Department, The Monetary Authority of Singapore, The Financial Structure of Singapore (revised edn., June 1980) pp. 1–2.
9. The Association of Banks in Singapore website: www.abs.org.sg.
10. Ministerial statement by the Deputy Prime Minister, BG Lee Hsien Loong during the discussion on banking consolidation in Parliament on 11 July 2001.
11. Please refer to Annex II of this chapter.
12. Statement by Lee Hsien Loong, Chairman of MAS, MAS Annual Report 2001/2002 p. 5.
13. MAS Annual Report 2001/2002 'Mission and Objectives'.
14. Ibid.
15. Pursuant to the Exchanges (Demutualisation and Merger) Act.
16. Press release by MAS, 1999.
17. The Notices and Guidelines set out *inter alia* in detail, the standards of governance to be observed, and other detailed reporting and regulatory requirements, together with SFA, the Financial Advisers Act (which replaces the Insurance Intermediaries Act 1999 and also came into full implementation on 1 October 2002).
18. Monetary Authority of Singapore (Amendment) Act 1972 (No. 31 of 1972).
19. Example of schemes and awards currently in place in Singapore are the Annual Reports Award, the Most Transparent Company Award of the Securities Investors Association of Singapore and BT's Corporate Transparency Index (CTI). Results of the CTI are displayed and distributed by way of postings on the SGX website.
20. Speech by Tan Siong Thye, Director of Commercial Affairs Department and a Senior State Counsel in Singapore, at the 19th Cambridge International Symposium on Economic Crime.
21. An example of such circulars issued by the MAS is the Circular No. FSG 44/2001, dated 28 August 2001 to the Life Insurance Brokers informing the updating of the list of non-cooperative countries and territories by the FATF on 21 June 2001.
22. 'Report to the Counter-Terrorism Committee on Singapore's Implementation of UN Security Council Resolution' (2001), 1373, p. 6.
23. The Egmont Group provides a forum for FIUs to improve support which includes expansion and systemizing the exchange of financial intelligence information, improving expertise and capabilities of personnel of such organizations and fostering better communication among FIUs through application of technology.
24. *MAS Annual Report 2001/2002*, p. 48.
25. Parliamentary Debates Singapore Official Report dated 20 March 1992 on the second reading of the Drug Trafficking (Confiscation of Benefits) Bill, pp. 1375–79, per Minister of Home Affairs (Professor S. Jayakumar).
26. Parliamentary Debates Singapore Official Report dated 6 July 1999 on the second reading of the Drug Trafficking (Confiscation of Benefits) Bill, pp. 1731–36, per Minister of Home Affairs (Mr Wong Kan Seng).
27. A full list of the 182 offences listed in the Second Schedule to the CDSA as 'serious offences' is attached as Annex III to this chapter.
28. Section 2(1) of the CDSA.
29. Section 64 of the CDSA.
30. Sections 43(1) and 44(1) of the CDSA.
31. Sections 46(1) and 47(1) of the CDSA.
32. Sections 46(3) and 47(3) of the CDSA.
33. Section 39(1) of the CDSA.
34. Section 48(1) and (2) of the CDSA.
35. Sections 43(5) and 44(5) of the CDSA.
36. Sections 43(3)(a) and 44(3)(a) of the CDSA.
37. Sections 43(3)(b) and 44(3)(b) of the CDSA; an example of restriction upon the disclosure

of information imposed by law is Section 47 of the Banking Act as discussed earlier in the report.
38. Sections 43(3)(c) and 44(3)(c) of the CDSA.
39. Section 48(1) and (2) of the CDSA.
40. Section 45(1) of the CDSA.
41. Section 45 of the CDSA.
42. Sections 46(1), (2) and 47(1), (2) of the CDSA.
43. Sections 46(6) and 47(6) of the CDSA.
44. Section 46(6) and 47(6) of the CDSA.
45. Section 48(5) of the CDSA.
46. Section 48(3) of the CDSA.
47. Section 48(4) of the CDSA.
48. Section 48(1) and (2) of the CDSA.
49. Section 39(1) of the CDSA.
50. Section 39(7) of the CDSA.
51. Items which are subject to 'legal privilege' are listed in Section 35(2) of the CDSA as: (a) communications between an advocate and solicitor and his client or any person representing his client made in connection with the giving of legal advice to the client; (b) communications between an advocate and solicitor and his client or any person representing his client or between such an advocate and solicitor or his client or any such representative and any other person made in connection with or in contemplation of legal proceedings and for the purposes of such proceedings; and (c) items enclosed with or referred to in such communications and made (i) in connection with the giving of legal advice; or (ii) in connection with or in contemplation of legal proceedings and for the purposes of such proceedings, where they are in possession of a person who is entitled to possession of them, but excluding, in any case, any communications or item held with the intention of furthering a criminal purpose.
52. Section 39(6) of the CDSA.
53. Section 39(6) of the CDSA.
54. Section 39(2) of the CDSA.
55. Sections 43(1), 44(1), 46(2), 47(2) and 48(1) of the CDSA.
56. Section 52 of the CDSA.
57. Speech by the Minister for Home Affairs, Professor S. Jayakumar at the Second Reading of the DTA on 20 March 1992.
58. Sections 4(1) and 5(1) of the CDSA.
59. Sections 4(2)(5)(6) and 5(2)(5)(6) of the CDSA.
60. Section 4(2) read together with Section 10 of the CDSA.
61. Section 14(1) of the CDSA.
62. Section 13(1) and (2) of the CDSA.
63. Sections 15(1), 16(1) and 17(1) of the CDSA.
64. The procedure under Section 122(6) of the Criminal Procedure Code (Cap.68) has to be followed.
65. Sections 15(2), 16(1) and 17(1) of the CDSA.
66. Sections 16(4) and 17(4).
67. Sections 12(7) and (8) of the CDSA.
68. Sections 16(3) and 17(1) of the CDSA.
69. Speech by the Minister for Home Affairs, Mr Wong Kan Seng in Parliament on 6 July 1999.
70. Section 41(3) defines 'corresponding authority: as the authority of that foreign country responsible for receiving information that corresponds to anything required to be disclosed to an authorized officer under Section 39(1) of the CDSA. In practice, the CAD will enter into a Memorandum of Understanding with the foreign country before agreeing to the sharing of information.
71. Sections 30(4) and 31(3) of the CDSA.
72. Section 31(4) of the CDSA.
73. Section 31(5) of the CDSA.

74. Section 34(2)(3)(4) of the CDSA.
75. Section 34(6) of the CDSA.
76. Section 38 of the CDSA.
77. Section 41 of the CDSA.
78. In the IAP Conference Paper, the Director of CAD stated that the STRO is actively involved in the negotiations of MoUs with several countries.
79. Media release dated 18 September 2002 by the Minister for Justice and Customs.
80. This case is unreported but referred to in the IAP Conference Paper.
81. CAD website: www.cad.gov.sg.
82. CAD website: www.cad.gov.sg.
83. Press release by CAD, CAD website: www.cad.gov.sg.
84. Judgement passed by Tay Yong Kwong in the case of *Public Prosecutor* vs *Lam Chen Fong* (CC40/2002) on 26 July 2002.
85. Speech by Minister of Law, Professor S. Jayakumar, in Parliament on 22 February 2000, at the Second Reading of the Mutual Assistance in Criminal Matters Bill.
86. Ibid.
87. Section 6 of the MACMA.
88. Section 8 of the MACMA.
89. Section 11 of the MACMA.
90. Section 9 of the MACMA.
91. Section 13 of the MACMA.
92. Section 14 of the MACMA.
93. Section 15 of the MACMA.
94. Section 19(1).
95. Under the definitions section of the MACMA, foreign serious offence is defined to be an offence against the law of the foreign country and which constitutes a serious offence in Singapore (that is, one of the 182 offences listed in CDST).
96. A full list of the required documents and information is listed in Section 19(2) of the MACMA.
97. Sections 21 to 39 of the MACMA.
98. Assistance regarded as not coercive – taking evidence for criminal proceedings (Section 21); assistance in locating or identifying persons (Section 37) and assistance in service of process (Section 38). Assistance which are regarded as coercive – productions orders (Section 22); attendance of persons in foreign country (Section 26); temporary custody of person (Section 27); enforcement of foreign confiscation order (Section 29) and request for search and seizure (Sections 33 and 34).
99. Section 7 of the MACMA.
100. A list of the situations where the Attorney General shall not accede to the request for mutual assistance is listed in Section 20 of the MACMA.
101. Section 5 of the MACMA.
102. Preamble read with Section 17 of the MACMA. The United States of America has been declared a prescribed foreign country under Mutual Assistance in Criminal Matters (United States of America) Order 2001 (S69/2001) for criminal matters in respect of an offence against corresponding drug law of the United States of America.
103. Report dated 17 July 2002, ‘An MLAT for Singapore and Switzerland’, http/ www.complinet.com/ml/dailynews/display.html
104. Section 2 read with Item 26 of the First Schedule to the Extradition Act.
105. Part IV of the Extradition Act.
106. Part II of the Extradition Act.
107. The restrictions placed on power of the Minister to authorize apprehension, or order surrender, of a fugitive for a declared Commonwealth country are more stringent (as no extradition treaty need to be in place) – Section 22 of the Extradition Act. As a result of historical ties and the close proximity between the two countries, the surrendering of a fugitive to Malaysia is comparatively easy, requiring only an endorsement on the warrant issued in Malaysia (notice from the Minister is not required). Section 33 of Part V of the Extradition Act.

108. Section 9 and 23 of the Extradition Act.
109. Sections 11(7) and 25(7) of the Extradition Act.
110. CAD website: www.cad.gov.sg.
111. CAD Mission Statement: www.cad.gov.sg/welcome.html.
112. Statement by the Director of the CAD in the IAP Conference Paper.
113. To refer to para. 5.9 of this Report.
114. The statistics have been extracted from the IAP Conference Paper.
115. Section 1.1 of the Notice 626.
116. Section 3 of the Notice 626.
117. *Choo Pit Hong Peter* vs *Public Prosecutor* (1995) 2 SLR 255.
118. Refer to the Notice 626 for the full checklist for each category.
119. Section 37 of the CDSA stipulates that financial institutions are required to retain transaction documents for at least six years from the last transaction date.
120. Section 6 of the Notice 626.
121. The list is annexed as Appendix II to the Notice 626.
122. The reporting formats are attached as Appendices III to V to the Notice 626.
123. Section 39(7) of the CDSA.
124. The Recommendations requiring specific action are: Recommendations 1–5, 7, 8, 10–12, 14–21, 26–29, 32–34, 37, 38 and 40.
125. *FATF Annual Report 2001/2002* Annex B read together with p. 5 of Annex C.
126. The money changing and remittance businesses are regulated by MAS through licensing procedures under the Money-Changing and Remittance Business Act.
127. Footnote 5 of the Self Assessment Questionnaire issued by the FATF.
128. Ordinary membership of the ABS is open to banks with full, qualifying full, wholesale or offshore licences.
129. Associate membership of the ABS is for representative offices of foreign banks which do not conduct any banking business in Singapore.
130. The front page of the Bank Practices regulation read together with the first paragraph of the regulation.
131. See definition of 'specified written law', Part III of the Sixth Schedule.

ANNEX I

Gross Domestic Product by industry. Percentage change over corresponding period of previous year

	1998	1999	2000	2001	2002	2001			2002				2003
						II	III	IV	I	II	III	IV	I
Total	–3.2	0.6	14.3	–3.6	2.4	–0.3	–7.8	–11.7	–1.5	4.6	2.4	4.2	3.9
Goods producing industries	–0.3	–3.4	18.3	–10.3	7.5	–4.5	–18.6	–20.8	–2.1	10.8	12.2	9.7	10.0
Manufacturing	–1.1	1.3	29.4	–13.1	12.7	–7.9	–23.2	–24.8	–1.7	17.5	20.1	16.8	15.7
Construction	1.4	–13.3	–11.4	–5.8	–9.7	–5.0	–5.7	–8.8	–6.7	–9.4	–11.1	–11.7	–11.0
Utilities	1.9	–12.8	6.5	21.7	–2.6	65.6	10.7	2.1	11.5	–6.9	–4.2	–6.9	–6.4
Other goods industries	–14.4	–0.1	–5.2	–6.2	–6.4	–1.3	–8.7	–11.1	–10.9	–8.4	–3.5	–2.4	–3.9
Service producing industries	–2.5	1.9	8.4	2.0	0.8	4.5	–0.6	–3.7	0.0	1.7	0.1	1.4	–0.2
Wholesales and retail trade	–7.4	5.8	16.8	–2.7	2.3	–0.7	–8.7	–8.2	–3.8	4.4	4.1	4.5	4.8
Hotels and restaurants	–10.0	–0.2	9.4	0.4	–3.8	4.0	–1.1	–6.6	–4.9	–5.2	–4.6	–0.3	–8.8
Transport and communications	–1.2	6.4	7.9	–2.2	2.9	–1.4	–6.5	–4.8	3.3	5.8	3.0	–0.5	–0.7
Financial services	2.2	–3.3	–1.0	3.6	–2.3	9.1	1.6	2.0	1.9	–3.1	–4.2	–3.8	–9.6
Business services	–4.9	–0.3	7.7	4.1	–3.1	7.1	3.2	–3.5	–4.7	–3.2	–3.8	–0.5	–1.3
Other service industries	1.3	2.4	11.0	8.5	5.8	9.8	9.1	–2.3	6.0	7.6	2.8	6.9	7.1
Owner-occupied dwellings	5.7	2.1	5.4	5.1	0.6	5.9	4.3	2.8	1.1	0.6	0.5	0.0	0.5

Notes: 1. The industries are classified according to SSIC 2000. 2. 'Other goods industries' comprise agriculture, fishing and quarrying

ANNEX II

Number of financial institutions and relevant organizations in Singapore

Type of institution	Number of institutions as at 10 June 2003
Commercial Banks	117
Local Banks	5
Foreign Banks	112
Foreign Full Banks	22
Wholesale Banks	31
Offshore Banks	59
Merchant Banks	52
Representative Offices of Banks	49
Institutions with Asian currency units	163
Finance companies	4
Money brokers	8
Singapore Government securities market	
Primary dealers	11
Secondary dealers	24
Holders of Capital Markets Services Licence	168
Holders of Financial Adviser's Licence	49
Insurance companies	149
Insurance brokers	7

ANNEX III

Second schedule to the CDSA Section 2, Serious offences

Offences	Description
1. Section 44 this Act	Assisting another to retain benefits from criminl conduct
2. Section 47 of this act	Concealing or transferring benefits from criminal conduct
Children and Young Persons Act (Cap. 38)	
3. Section 4(1), 5(a) and (b)	Ill-treatment of child or young person
Corrosive and Explosive Substances and Offensive Weapons Act (Cap. 65)	
4. Section 3	Possession of corrosive or explosive substance for purpose of causing hurt
Hijacking of Aircraft and Protection of Aircraft and International Airports Act (Cap. 124)	
5. Section 3 (3)	Hijacking
6. Section 4	Violence against passengers or crew
7. Section 5	Destroying, damaging or endangering safety of aircraft
8. Section 7	Endangering safety at aerodromes
Kidnapping Act (Cap. 151)	
9. Section 3	Abduction, wrongful restraint or wrongful confinement for ransom
10. Section 4	Knowingly receiving ransom
11. Section 5	Knowingly negotiating to obtain or for payment of ransom
Penal Code (Cap. 224)	
12. Section 130	Aiding escape of, rescuing, or harbouring such prisoners
13. Section 130B	Piracy by law of nations
14. Section 130C	Piratical acts
15. Section 161	Public servant taking a gratification, other than legal remuneration, in respect of an official act
16. Section 162	Taking a gratification in order, by corrupt or illegal means, to influence a public servant
17. Section 164	Punishment for abetment by public servant of the offences above defined
18. Section 165	Public servant obtaining any valuable thing, without consideration, from person concerned in any proceeding or business transacted by such public servant
19. Section 181	False statement on oath to public servant or person authorized to administer an oath
20. Section 193	Punishment for false evidence
21. Section 194	Giving or fabricating false evidence with intent to procure conviction of a capital offence

Offences	Description
22. Section 195	Giving or fabricating false evidence with intent to procure conviction of an offence punishable with imprisonment
23. Section 196	Using evidence known to be false
24. Section 201	Causing disappearance of evidence of an offence committed, or giving false information touching it, to screen the offender
25. Section 203	Giving false information respecting an offence committed
26. Section 204	Destruction of document to prevent its production as evidence
27. Section 205	False personation for the purpose of any act or proceeding in a suit
28. Section 206	Fraudulent removal or concealment of property to prevent its seizure as a forfeiture or in execution of a decree
29. Section 207	Fraudulent claim to property to prevent its seizure as a forfeiture or in execution of a decree
30. Section 208	Fraudulently suffering a decree for a sum not due
31. Section 212	Harbouring an offender
32. Section 213	Taking gift, etc. to screen an offender from punishment
33. Section 214	Offering gift or restoration of property in consideration of screening offender
34. Section 215	Taking gift to help to recover stolen property, etc.
35. Section 216	Harbouring an offender who has escaped from custody, or whose apprehension has been ordered
36. Section 216A	Harbouring robbers or gang-robbers, etc.
37. Section 217	Public servant disobeying a direction of law with intent to save person from punishment or property from forfeiture
38. Section 218	Public servant framing an incorrect record or writing with intent to save person from punishment or property from forfeiture
39. Section 221	Intentional omission to apprehend on the part of a public servant bound by law to apprehend
40. Section 222	Intentional omission to apprehend on the part of a public servant bound by law to apprehend person under sentence of court of justice
41. Section 225A	Public servant omitting to apprehend or suffering other persons to escape in cases not already provided for
42. Section 231	Counterfeiting coin
43. Section 232	Counterfeiting current coin
44. Section 233	Making or selling instrument for counterfeiting coin
45. Section 234	Making or selling instrument for counterfeiting current coin
46. Section 235	Possession of instrument or material for the purpose of using the same for counterfeiting coin

Annex III continued

Offences	Description
47. Section 236	Abetting in Singapore the counterfeiting out of Singapore of coin
48. Section 237	Import or export of counterfeit coin
49. Section 238	Import or export of counterfeits of current coin
50. Section 239	Delivery to another of coin possessed with knowledge that it is counterfeit
51. Section 240	Delivery of current coin, possessed with the knowledge that it is counterfeit
52. Section 241	Delivery to another of coin as genuine, which when first possessed the deliverer did not know to be counterfeit
53. Section 242	Possession of counterfeit coin by a person who knew it to be counterfeit when he became possessed thereof
54. Section 302	Punishment for murder
55. Section 304	Punishment for culpable homicide not amounting to murder
56. Section 307 (1)	Attempt to murder
57. Section 307 (2)	Other offences by convicts
58. Section 308	Attempt to commit culpable homicide
59. Section 312	Causing miscarriage
60. Section 313	Causing miscarriage without woman's consent
61. Section 315 (1)	Child destruction before, at or immediately after birth
62. Section 316	Causing death of a quick unborn child by an act amounting to culpable homicide
63. Section 324	Voluntarily causing hurt by dangerous weapons or means
64. Section 325	Punishment for voluntarily causing grievous hurt
65. Section 326	Voluntarily causing grievous hurt by dangerous weapons or means
66. Section 327	Voluntarily causing hurt to extort property or to constrain to an illegal act
67. Section 328	Causing hurt by means of poison, etc., with intent to commit an offence
68. Section 329	Voluntarily causing grievous hurt to extort property, or to constrain to an illegal act
69. Section 330	Voluntarily causing hurt to extort confession or to compel restoration of property
70. Section 331	Voluntarily causing grievous hurt to extort confession or to compel restoration of property
71. Section 332	Voluntarily causing hurt to deter public servant from his duty
72. Section 333	Voluntarily causing grievous hurt to deter public servant from his duty
73. Section 335	Causing grievous hurt on provocation

Offences	Description
74. Section 338	Causing grievous hurt by an act which endangers life or personal safety of others
75. Section 343	Wrongful confinement for three or more days
76. Section 344	Wrongful confinement for 10 or more days
77. Section 345	Wrongful confinement of person for whose liberation a writ has been issued
78. Section 346	Wrongful confinement in secret
79. Section 347	Wrongful confinement for the purpose of extorting property or constraining to an illegal act
80. Section 348	Wrongful confinement for the purpose of extorting confession or of compelling restoration of property
81. Section 354	Assault or use of criminal force to a person with intent to outrage modesty
82. Section 354A	Outraging modesty in certain circumstances
83. Section 363	Punishment for kidnapping
84. Section 364	Kidnapping or abducting in order to murder
85. Section 365	Kidnapping or abducting with intent to secretly and wrongfully to confine a person
86. Section 366	Kidnapping or abducting a woman to compel her marriage, etc.
87. Section 367	Kidnapping or abducting in order to subject a person to grievous hurt, slavery, etc.
88. Section 368	Wrongfully concealing or keeping in confinement a kidnapped person
89. Section 369	Kidnapping or abducting child under 10 years, with intent to steal moveable property from the person of such child
90. Section 370	Buying or disposing of any person as a slave
91. Section 371	Habitual dealing in slaves
92. Section 372	Selling minor for purposes of prostitution, etc.
93. Section 373	Buying minor for purposes of prostitution, etc.
94. Section 373A	Importing by fraud, brings, assists in bringing, sells or buys, with intent that any woman be used for purpose of prostitution
95. Section 376 (1) and (2)	Punishment for rape
96. Section 379	Punishment for theft
97. Section 379A	Punishment for theft of a motor vehicle
98. Section 380	Theft in dwelling house, etc.
99. Section 381	Theft by clerk or servant of property in possession of master
100. Section 382	Theft after preparation made for causing death or hurt in order to commit theft
101. Section 384	Punishment for extortion
102. Section 385	Putting person in fear of injury in order to commit extortion

Annex III continued

Offences	Description
103. Section 386	Extortion by putting a person in fear of death or grievous hurt
104. Section 387	Putting person in fear of death or of grievous hurt in order to commit extortion
105. Section 388	Extortion by threat of accusation of an offence punishable with death, or imprisonment, etc.
106. Section 389	Putting person in fear of accusation of offence, in order to commit extortion
107. Section 392	Punishment for robbery
108. Section 393	Attempt to commit robbery
109. Section 394	Voluntarily causing hurt in committing robbery
110. Section 395	Punishment for gang-robbery
111. Section 396	Gang-robbery with murder
112. Section 399	Making preparation to commit gang-robbery
113. Section 400	Punishment for belonging to gang-robbers
114. Section 402	Assembling for purpose of committing gang-robbery
115. Section 403	Dishonest misappropriation of property
116. Section 404	Dishonest misappropriation of property possessed by a deceased person at the time of his death
117. Section 406	Punishment of criminal breach of trust
118. Section 407	Criminal breach of trust by carrier, etc.
119. Section 408	Criminal breach of trust by clerk or servant
120. Section 409	Criminal breach of trust by public servant, or by banker, merchant or agent
121. Section 411	Dishonestly receiving stolen property
122. Section 412	Dishonestly receiving property stolen in the commission of a gang-robbery
123. Section 413	Habitually dealing in stolen property
124. Section 414	Assisting in concealment of stolen property
125. Section 418	Cheating with knowledge that wrongful loss may be thereby caused to a person whose interest the offender is bound to protect
126. Section 419	Punishment for cheating by personation
127. Section 420	Cheating and dishonestly inducing a delivery of property
128. Section 421	Dishonest or fraudulent removal or concealment of property to prevent distribution among creditors
129. Section 422	Dishonestly or fraudulently preventing a debt or demand due to the offender from being made available for his creditors
130. Section 423	Dishonest or fraudulent execution of deed of transfer containing a false statement of consideration

Offences	Description
131. Section 424	Dishonest or fraudulent removal or concealment of property or release of claim
132. Section 430A	Mischief affecting railway engine, train, etc.
133. Section 431	Mischief by injury to public road, bridge or river
134. Section 431A	Mischief by injury to telegraph cable, wire, etc.
135. Section 432	Mischief by causing inundation or obstruction to public drainage, attended with damage
136. Section 433	Mischief by destroying or moving or rendering less useful a lighthouse or sea-mark
137. Section 435	Mischief by fire or explosive substance with intent to cause damage to amount of S$50
138. Section 436	Mischief by fire or explosive substance with intent to destroy a house, etc.
139. Section 438	Punishment for the mischief described in Section 437 when committed by fire or any explosive substance
140. Section 439	Punishment for intentionally running vessel aground or ashore with intent to commit theft, etc.
141. Section 440	Mischief committed after preparation made for causing death or hurt
142. Section 449	House-trespass in order to commit an offence punishable with death
143. Section 450	House-trespass in order to commit an offence punishable with imprisonment for life
144. Section 451	House-trespass in order to commit an offence punishable with imprisonment
145. Section 452	House-trespass after preparation made for causing hurt, etc.
146. Section 453	Punishment for lurking house-trespass or house-breaking
147. Section 454	Lurking house-trespass or house-breaking in order to commit an offence punishable with imprisonment
148. Section 455	Lurking house-trespass or house-breaking after preparation made for causing hurt, etc.
149. Section 456	Punishment for lurking house-trespass by night or house-breaking by night
150. Section 457	Lurking house-trespass by night or house-breaking by night in order to commit an offence punishable with imprisonment
151. Section 458	Lurking house-trespass or house-breaking by night after preparation made for causing hurt, etc.
152. Section 459	Grievous hurt caused while committing lurking house-trespass or house-breaking
153. Section 460	Lurking house-trespass by night or house-breaking by night when death or grievous hurt is caused
154. Section 465	Punishment for forgery

Annex III continued

Offences	Description
155. Section 466	Forgery of record of a court of justice, or a public register of births, etc.
156. Section 467	Forgery of a valuable security or will
157. Section 468	Forgery for the purpose of cheating
158. Section 469	Forgery for the purpose of harming the reputation of any person
159. Section 471	Using as genuine a forged document
160. Section 472	Making or possessing a counterfeit seal, plate, etc. with intent to commit a forgery punishable under Section 467
161. Section 473	Making or possessing a counterfeit seal, plate, etc. with intent to commit a forgery punishable otherwise
162. Section 474	Having possession of a valuable security or will known to be forged, with intent to use it as genuine
163. Section 475	Counterfeiting a device or mark used for authenticating documents described in Section 467, or possessing counterfeit marked material
164. Section 476	Counterfeiting a device or mark used for authenticating documents other than those described in Section 467, or possessing counterfeit marked material
165. Section 489A	Forging or counterfeiting currency notes or bank notes
166. Section 489B	Using as genuine forged or counterfeit currency notes or bank notes
167. Section 489C	Possession of forged or counterfeit currency notes or bank notes
Prevention of Corruption Act (Cap. 241)	
168. Section 5	Punishment for corrupt transactions where no agents involved
169. Section 6	Punishment for corrupt transactions involving agents or use of false documents to mislead principal
170. Section 10	Bribery in relation to Government contracts
171. Section 11	Bribery of Member of Parliament
172. Section 12	Bribery of member of public body
173. Section 29	Abetment of offences
174. Section 30	Attempts
175. Section 31	Conspiracy
Termination of Pregnancy Act (Cap. 324)	
176. Section 3 (4)	Medical termination of pregnancy
177. Section 5	Coercion or intimidation
Vandalism Act (Cap. 341)	
178. Section 3	Penalty for acts of vandalism
Women's Charter (Cap. 353)	

Offences	Description
179. Section 140	Offences relating to prostitution
180. Section 141	Trafficking in women and girls
181. Section 142	Importation of woman or girl by false pretences
182. Section 145	Causing or encouraging prostitution of, intercourse with, or indecent assault on, girl below the age of 16

4. Country Report: Combating money laundering in Switzerland

Nadja Capus

I HISTORICAL DEVELOPMENT AND SIGNIFICANCE OF SWITZERLAND AS A FINANCIAL CENTRE

A The Significance of Swiss Banking Today

Although a relatively small country, Switzerland ranks as one of the major financial centres in the world. This importance is also reflected domestically with the banking industry being one of the most important sectors of the economy, employing around 5.7 per cent of the working population according to data from 2000.[1] Asset management alone accounts for over half of the banks' output which translates to over SFr. 20 bn, or more than 5 per cent of GDP; of this an estimated 85 per cent is generated by private clients. The banks also have extensive experience in cross-border asset management (that is, with customers domiciled abroad); with an estimated 30 per cent of the internationally invested private assets world-wide being managed in Switzerland.[2]

There are some 375 banks in Switzerland (of which 150 are foreign banks), only 25 per cent of these banks have total assets that exceed SFr. 1 bn, however they account for 95 per cent of the aggregate total assets of all banks in Switzerland. In international terms, the status of banks' balance sheets indicate the degree to which Swiss banks are involved in foreign business: By the end of 2000, the combined foreign assets of all Swiss banks amounted to SFr. 1175 bn and foreign liabilities amounted to SFr. 1085 bn, which constitutes 55.3 per cent and 51.1 per cent, respectively of the balance sheet totals.[3] In addition, banks managed assets that are not visible on the balance sheets: these cover private banking assets as well as fiduciary deposits and liabilities. Fiduciary contracts totalled SFr. 412 bn as at 2000. Over the last ten years, four-fifths of fiduciary deposits originated from European countries. The significance of Switzerland as a financial centre is attributable amongst other reasons, to the banking sector's competitiveness on an international scale.[4]

The banking sector is characterized by a high degree of variety of institutions which span co-operatives, cantonal banks which are partly state owned,

privately owned banks as well as the internationally active universal banks. Universal banks are a particular characteristic of the Swiss banking sector and include the cantonal banks as well as the two major banks UBS and Credit Swiss. Universal banks combine the functions of merchant and commercial banks; have broad fiduciary activities; accept deposits and make loans; underwrite and distribute securities; act as financial and corporate advisors (an activity which is currently the subject of some scrutiny by the Federal Banking Commission); advise on mergers and acquisitions; trade securities and serve as investment and trust managers and portfolio managers.[5]

Private banking has been described as being a particularly vulnerable sector of the industry because of its dependence on clients who, if they were to withdraw their business, could cause serious damage to these banks. Money can be moved easily and quickly these days, which may go some way to account for the sometimes emotional reactions to the fear of losing bank secrecy. And if bank secrecy really were to be abandoned, it is estimated that there would be a decrease in earnings of between 25 and 30 per cent.[6]

B The Historical Development of the Financial Centre

Banking activity in the confederacy can be traced back to the 13th and 14th centuries. It was during this period that the alpine passes were gradually built, while in the towns, the first trade fairs were held.[7] In the early days, foreigners were for the most part the specialists in dealing with money and in particular, north Italian traders and merchants who pursued international trade,[8] and it was Florentine bankers who controlled international high finance at that time and who then settled in Geneva and opened their doors to business there.[9]

Developments in the 15th and 16th centuries in the European financial markets saw the rise of novel structures. New centres were being developed on the Continent (Antwerp, London, Paris) and nascent states were increasing their military expenditure on a large scale. At the same time, there was a lack of precious metals in circulation, which led, in turn, to a further increase in credit business.[10] This was of decisive importance for Swiss banking, because Swiss men had, over the centuries, served the powers in Europe as itinerant mercenaries and had accumulated large amounts of cash in the process.[11] The result was an excess of capital that facilitated the financing of foreign states and monarchies.[12]

Thus the ancient confederate states may be described as 'entrepreneurial states', which were also 'tax havens' because as capital flowed out, foreign monies flowed in, to such a level that the ruling classes were able to do without a tax or administrative system.[13] It should be added that the modern concept of a banker as a specialist in money dealing hardly existed at this time. Instead they were rather more involved in the granting of trade credits to

dukes, cities and the church. In the villages on the other hand, where dealings centred on assisting the lesser aristocracy as well as artisans and farmers, they never handled large amounts of money.[14]

From the 18th century onwards, close trade and financial ties between Paris and Geneva were of significance in developing Swiss banking. These close ties may be traced to immigrant Huguenots from France. The legendary 'Huguenot International' enabled the Republic of Geneva (which only joined the Swiss Confederation in 1848) and the Confederation itself, to participate in overseas colonial expansion, namely in slave trading and developing plantations in the Antilles.[15]

The position was similar in Basel where trading houses profited from the slave trade and during the Napoleonic wars it seems that they also armed French privateers from time to time (although this proved to be none too profitable).[16] Thus a tradition of world-wide relationships was established, which however was destined to die out in the financial debacle of the French Revolution, only to be reborn shortly thereafter in the period of the early industrialization.[17]

The industrialization that characterized European development in the 19th century also ensured the establishment of modern Swiss banking as capable of sustained performance. The massive investments called for in the development of the railways in the 1850s went beyond the means available from traditional sources such as family or business partners could supply.[18] In the mid- to late-1890s, Swiss industry and thereafter the banks, expanded in the international markets which resulted in rapid development of the large banks.[19] The private bankers of Basel and Geneva were overtaken by the financial centre of Zürich.

The period 1914–45 saw two World Wars and was both a testing period for Swiss banking and the time that the real breakthrough on the international stage was accomplished.[20] Switzerland's strong orientation towards Paris was brought to an end by the First World War, and in the early years following the end of that war, Germany looked an attractive prospect in the 1920s.[21] However, following the imposition of exchange controls, Swiss banks were again to reduce their involvement in Germany.[22]

In the first few decades of the 20th century, a series of bank collapses occurred and the banking crisis of 1931 had particular repercussions for Swiss banks.[23] This was the first time that consideration was given to introducing some form of state control into the industry.[24]

Switzerland prospered as a financial centre despite world economic crises and world wars. This was due to one main reason: the continually free convertibility of the Swiss franc, which was retained even as the great depression of the 1930s swept across the world with the appended exchange control mechanism used to combat the problem, thus the franc became one of the most

sought after currencies internationally.[25] Other important factors that still continue to exert an influence are the political, social and economic stability of the country, its political neutrality, a sound legal framework and strong democratic tradition.[26]

Despite the aforementioned strong international activity, Swiss banks only had a comparatively weak network of branches abroad up until the 1960s. This changed during the economic boom years that followed the Second World War, concurrent with the Swiss economy developing ever closer ties on the international level. On the one hand, survival by relying on the limitations presented by the domestic market was not sustainable and on the other hand, Switzerland profited from liberalization of the world markets and multilateral agreements in the Western hemisphere the realization of which the Swiss government invariably took an active role.

The current political debate between Switzerland and its neighbours regarding the problems of taxation flight, actually has a long historical tradition. In the 17th century the French and Germans deposited their money in Switzerland in order to avoid the insatiable thirst of the absolutist fiscal regimes prevailing in the states at that time. In later times, a Swiss bank account was also regarded as a safe haven by those whose lives were disrupted by wars including the Franco-German war of 1870/71, the World Wars and the Russian Revolution of 1917.[27]

Up until the 1970s, capital flight was actively acquired by Swiss banks, then, in 1977 there was a policy change when the Swiss banks agreed to stop giving active assistance to capital flight. The Code of Conduct that established this principle was an agreement between the banks themselves and was entitled: Agreement on the Swiss banks' Code of Conduct with Regard to the Exercise of due diligence (CDB) and was a direct response to the capital flight scandal known as 'Texon/Chiasso'.[28]

In more recent times 'traditional' capital flight has perhaps been increasingly overshadowed by drug money scandals, deposits of wealth by foreign dictators and the discussion surrounding money laundering. The Swiss have been made aware in what has been a somewhat painful experience that their financial centres have been abused by criminals. In particular, criminal investigations against criminal organizations in the USA and Italy in the 1970s and 1980s more often than not resulted in the uncovering of a financial channel that led to Switzerland.[29] The 1990s saw an increasing number of requests to Switzerland for legal assistance often in connection with assets of former heads of state, heads of government, ministers and so on.[30]

C Bank Secrecy

Bank secrecy is an important component that contributes to Switzerland's

significance as a financial centre. Its import was reiterated by a parliamentary initiative which aims to anchor bank secrecy in the Constitution.[31]

Banking secrecy comprises – in essence – the confidentiality due by a bank to its clients and is frequently associated with Switzerland on an international level. In relation to money laundering, the points below need to be made.

Bank secrecy is lifted where there is a suspicion of money laundering, or indeed suspicion that any serious crime under the criminal law has been committed. Art. 47 para. 4 of the Bank Act[32] makes provision for federal and cantonal laws in relation to witness and information obligations to take precedence in the courts and for the authorities.

It is also possible for prosecution authorities from other countries to have bank secrecy lifted using requests for legal assistance, as long as the offence in question is both an offence in the requesting country as well as in Switzerland (principle of dual criminality). Legal assistance is generally regulated by the Federal Law or International Legal Assistance in Criminal Matters or on the basis of European Conventions on legal assistance in criminal matters or as a result of a bilateral agreement with another State.

Bank secrecy will not be waived for the offence of tax avoidance. That means that bank secrecy applies with respect to the tax authorities and only in cases of a false declaration to the tax authorities or tax fraud will a criminal investigation be possible. As a consequence only investigating authorities which pursue a case based on criminal procedures can request information directly from a bank.[33]

There is a relationship between tax evasion and money laundering insofar as the money launderer – just like the tax evader – is interested in avoiding tax liabilities on the money and for his affairs to be as non-transparent as possible *vis-à-vis* the authorities. According to the official perspective, the potential for abuse of bank client secrecy can under Swiss legislation be diminished in that an undesirable bank relationship does not have to be entered into, or if there is a suspicion of abuse the relationship may be terminated. In this connection the provisions of Art. 305ter para. 2 of the Criminal Code[34] (right to notify) and the money laundering law[35] (obligation to notify) are to be observed.

Whenever a crisis in Swiss banking occurs then very often discussions about bank secrecy are also resurrected – sometimes with good reason, but equally it has to be said that the debate is often misplaced. A fact that is frequently ignored is that Switzerland is not alone in having so-called bank secrecy laws, many other countries do.

The peculiarities of the Swiss bank and stockmarket secrecy laws, which by and large are not shared by other countries are attributable to two aspects: First, (as has already been mentioned) the way tax offences are dealt with and second, the fact that a breach of bank secrecy may constitute a criminal offence.[36] Given these elements, it may well be said that bank secrecy is a

Swiss invention not only in its content, but also in relation to the severity of sanctions for its breach. The Swiss version of bank secrecy was first copied by the Lebanon in 1965. The Swiss law was expressly cited as being the inspiration for developing the draft law and also the expectation coupled thereto that capital from neighbouring countries could be attracted to Beirut. Other countries that also followed suit are Singapore, Panama and Luxembourg.[37]

The substance of bank secrecy laws cannot however be measured in terms of the scope of its legal application or the protection mechanism in the form of sanctions. Its quality rather lies in the tools available to the banker that enable discretion to be guaranteed, this is exemplified by the possibility of opening a numbered account, using an assumed name on account or the technique of using masked correspondence ('banque restant'). While in the Anglo-Saxon systems on the other hand, the creation of a trust or a foreign legal entity may in fact be regarded as equivalent measures when getting to grips with the crux of what bank secrecy is really all about.[38]

1 The legal basis

First, a few aspects of the technical details of bank secrecy: The obligation of the bank to keep confidential the financial interests of its clients is based partly on the contractual relationship between them.[39] Where no express agreement exists between the parties, then it will be inferred by custom. Where there is an express agreement between the parties this can be curtailed by contract.[40] However, confidentiality in relation to bank clients is also to be found in Art. 28 of the Civil Code[41] (1912), which protects privacy of the individual. Confidentiality in relation to a person's financial affairs is also an integral part of the right to privacy of both natural and legal persons.[42] This aspect of protecting privacy was further strengthened by the Federal Data Protection Law of 1993.[43]

The differences between the legal bases does not as such affect the scope or extent of the confidentiality. However, if there is no contractual relationship, the client as the person having the right to depose over the secrecy may release the bank from its obligation to maintain confidentiality, but the bank cannot be forced to divulge information by the client. This explains why a Swiss bank will not give foreign judicial authorities information or assistance in such situations.[44]

2 The development of bank secrecy

The second of the aforementioned characteristics of the Swiss banking secrecy law, namely the criminal sanction, was enshrined in the Banking Law[45] of 1934. In order to understand this profound strengthening of the sphere of economic privacy through criminal law, Switzerland's position *vis-à-vis* its security policy between the two World Wars and particularly at the beginning

of the 1930s has to be considered.[46] Historical materials in context indicate that the protection of confidentiality was elevated from a professional ethos through Art. 47 of the Banking Law to the status of being a matter of public interest. It was not primarily about bolstering the existing civil law provisions, rather it was a defensive act directed at countering espionage activities by Germany and France. These countries were badly affected by the world-wide economic downturn and wanted to investigate Swiss bank accounts for possible infractions of the exchange controls in force at the time, and any possible covert flight capital activity.[47] Thus the criminal provisions were passed in order to reassure foreign clients that they could place their trust in Switzerland as a financial centre. The threat of criminal sanctions were deemed a sufficient deterrent to bank employees that might otherwise reveal confidential matters relating to their foreign clients.[48]

Eight years after the passing of the criminal provision in the Banking Law, the Criminal Code was amended with effect from 1 January 1942, with Art. 271 (prohibition against dealing with a foreign power) and Art. 273 (economic espionage on behalf of a foreign state).[49] The consequence of this was that the bank secrecy law was privileged in comparison with confidentiality as it applied to other professions such as priests, lawyers, notaries and doctors; the professional confidentiality of these groups was controversial and only came into effect as part of the Criminal Code in 1942.

Further exemplification of bank secrecy as a response to fears of espionage is to be found in the fact that it is an official offence (Art. 47 Banking Act) in complete contrast to breach of confidentiality by any of the professions mentioned above (Art. 321 Criminal Code). To put it another way, in the banking sector the prosecuting authorities do not have any discretion about deciding to pursue a criminal investigation for breach of confidentiality. And to make this protection even more effective, negligent breaches and attempting to incite are also criminalized.[50]

It was in the 1970s that the government indicated that property belonging to Jewish people and others who had been subject to racial discrimination should be assisted in order to protect them against the effects of totalitarian regimes.[51] To dispute these assertions is difficult; however, in the records of the pre-parliamentary and parliamentary debates of 1934 there are no indications that this was the rationale for passing this legislation.[52]

3 The demand for transparency

Bank secrecy has been adapted at various times since the 1960s. It is in any case not absolute; in other words there are no anonymous accounts. Even where so-called numbered accounts are opened, the identity of the account holder is known, although only to a small group of people in the relevant department. Bank secrecy is waived in criminal cases and depending on

cantonal laws also in civil proceedings, in debt and bankruptcy proceedings and also in inheritance cases.[53] Since the 1980s with growing international interdependence, there have been calls for greater transparency, in particular in the context of transnational legal and administrative assistance.[54] Furthermore, there appears to have been a loosening of the Swiss stance over recent years in relation to legal and administrative assistance in tax matters for foreign states.[55]

The applicability of bank secrecy in relation to tax matters is special in that according to the Swiss sense of justice, the tax subject is obliged to take responsibility for himself with respect to the tax authorities. Other than in serious cases, this means that where simple tax avoidance is involved, the banks are not obliged to divulge information to the tax authorities and the latter can only open administrative proceedings in the event that tax evasion is suspected. So, for example, any act or omission in relation to taxable property, which is designed to remove income or capital from the purview of the tax authorities would not oblige the banks to divulge information. In contrast to this, bank secrecy can be lifted when there appears to be evidence of tax fraud involving forged documents under the law on direct federal taxation which came into effect in 1995.[56] Thus tax fraud is a criminal offence that will be prosecuted.[57]

4 The political basis

By the very nature of things, it is clear that Switzerland will continually be confronted with calls by foreign authorities to abandon its bank secrecy laws: Following the Second World War, the allies sought to achieve this, and again during the discussions relating to the Holocaust heirless funds and dormant accounts at the end of the 1990s. And since 2000 it has once again surfaced as a topic on the political agenda, with the publication of the OECD fiscal affairs report 'Improving Access to Bank Information for Tax Purposes',[58] and since the European Union has declared it also wants to tackle the problem of tax flight.[59] But it must be said that the pressure is not all external; there are periodic calls within the country for a rethink regarding bank secrecy.

The deep roots that bank secrecy has in liberal economic thinking can be traced to the 19th century and are particularly apparent when one looks at the tempestuous parliamentary debates that were held regarding the imposition of a war tax during the First World War. In December 1915, the Social Democratic Party in the National Assembly, brought forward a motion that would oblige all financial institutions to inform the tax authorities regarding 'all useful information that would serve to give a fair indication of the obligations of those who are obliged to pay tax'. The proposal was rejected by the conservative majority and regarded as an infraction of the uncodified bank secrecy. Germany in 1918 repealed its bank secrecy law, which was virtually

identical to the Swiss law of today with retrospective effect. In 1919, the Social Democratic Party once again requested help from the banks, the aim was to obtain information relating to capital that had been entrusted to them in order to assist with the still outstanding war debts. The initiative that was rejected by the people in 1922 also had the same aim.[60]

In order to comprehend Switzerland as a financial centre and the role that bank secrecy plays therein, the main elements of Swiss policy have to be understood: What may be described as a decisive feature of Switzerland is its federal structure with its system of direct referenda as a cornerstone of its democratic traditions. In addition to this deep seated tradition is the high value attributed by society to the freedom both of the individual and the economy.[61] Thus the Swiss financial centres were allowed to thrive without being subject to state control and this constituted an important element that fostered their development. In 1914 the Federal Council drafted a law that would have set up state supervision of the banks to guarantee savings and investments. The consultation process revealed massive opposition on the part of the Banking Association as well as other sections of the economy, with the result that the proposal was not even published.

Following the world economic crisis even the banks could no longer resist the development of a law[62]; although the 1934 legislation largely left it to the banks to regulate themselves on a voluntary basis. This corresponded to the liberalism that pervaded the form and direction of economic policy in the immediate post war period.[63] In view of the fact that Swiss legislative policy was strongly oriented towards individual liberalism, this meant that not only was the private sphere given a high priority, but also the individual was to be accorded with as much freedom as possible, which goes some way to account for the existence of bank secrecy as well as the Swiss attitude towards cartels and other hindrances to competition.

Thus in the Swiss banking sector – similar to other branches – free competition for many years was constrained by horizontal agreements. The first such agreement was already in force in 1914. It regulated the price and conditions for services according to what was required. This resulted in a conformity of supply in the market and competition, or alternatively the competitive pressure only played a role in relation to the quality of service: Proximity to the client, competence and quality of service. It was only in 1989 that the competition authority gradually began to tackle the numerous cartel agreements.[64] Prior to that the preservation of the diversity of the banks – and maintaining the structure in general – appeared to be a political imperative.[65] The Swiss economic policy model in this area stands in contrast to the USA and EU. In the USA and the EU the ordo-liberal principle applies.[66] This concept was developed in the Anglo-Saxon countries where the individual's economic freedom was not originally explicitly guaranteed. This led to the passing of clear rules regarding

competition and transparency. In marked contrast thereto, Switzerland provided for economic freedom through constitutional guarantees[67]: '[. . .] to permit private industry to function unhindered by state measures'.[68]

In the meantime however, the overriding international tendency was towards more transparency and a more direct intervention in the market through regulations. Similar tendencies are to be seen in Switzerland and in order to develop a comparative stance, competition policy was also tightened up and rules on corporate governance have been introduced etc. This means that the issue of the individual oriented liberal economic order exemplified by bank secrecy is an increasingly isolated phenomenon.

5 Crises and the consequent legal developments

What emerges quite clearly from all the crises that are described below is that in each case, the political consequences ensured that either the legislator or the financial centre of Switzerland acted to deal with the matter using regulatory means. The following are some examples:

- In the wake of the Chiasso scandal the Agreement on the Swiss banks' Code (1977) came about.
- Following the 'Pizza' scandal and the Lebanon Connection the anti-money laundering article in the Criminal Code was introduced (1990).
- As a result of the Marcos Affair, the law on mutual legal assistance was revised (1997).
- Following the Abacha Affair, the entire supervisory money laundering regime was extended and the money laundering guidelines of the Federal Banking Commission of 1998 were revised (2002) and came into effect in 2003 as an Ordinance.

In the first half of 1977, three major bank crises confronted the Swiss banks. Two of which led to collapses and the third to substantial losses by a major bank, namely Credit Swiss.[69] In the latter case the following occurred. The director of the Chiasso branch founded a Liechtenstein (Vaduz) foundation in 1961 called Texon through a Ticinese lawyer's office.[70] This foundation actually functioned as a bank in that it was a recipient for capital flight from Italy and which then invested in a whole variety of subsidiaries most of which were based in Italy. This business was only brought to a halt not because of the obvious tax evasion that was going on, but because a criminal case was opened against a bank employee as a result of the damage he had caused to the bank. The reason being that the investments as so-called fiduciary investments on behalf of the investors who bore the risk, would only have negligible consequences for the bank as the possible losses would have been carried by the clients. The manager of the branch and his employee had however in many

instances, given the foreign investors a guarantee by the bank, which was not permitted under the internal rules of the bank. This probably accounts for why the transactions in question were not booked by the branch and the documentation that should have substantiated this business were not kept according to the regulations; this in turn meant that the irregularities were not unearthed by the controllers of the company for a long period of time.[71]

The consequences of the criminal investigation took on dramatic proportions for Credit Swiss. As there were fears that revelations of the affair might provoke public panic and a run on the bank, Credit Swiss was offered a liquidity facilitation by Swiss Bank Corporation and the Union Bank of Switzerland together with the Swiss National Bank in the form of a SFr. 3 bn standby credit. It seems that the outcome of this measure was to unnerve the shareholders even further.[72]

The fall out from this affair did not affect Credit Swiss alone. Once the Chiasso case was in the public domain it became the subject of a debate in parliament. The theme of the debate was not confined to the name of a single bank, but was rather the good name of Switzerland as a financial centre.[73] As more details of the Chiasso affair came to light, the pressure on the banks to take some form of action grew stronger from the public as well as the federal parliament, the Swiss National Bank and Federal Banking Commission. Thus it became a matter of fundamental importance for the banks themselves to put their house in order – quite simply because the ultimate asset that a bank has is its trustworthiness in the eyes of its customers and the markets. The result of these efforts was the agreement between the Swiss Bankers Association and the Swiss National Bank, which came into effect barely six months after the scandal broke (1 July 1977). This type of convention that established guidelines had already been considered by the National Bank for some time, and as already mentioned, corresponded to what up until the 1980s was the usual practice with respect to horizontal agreements.[74] The Agreement CDB[75]sets out what are today central obligations in the fight against money laundering: bank accounts may only be opened where the identity and name of the person can be verified.[76]

In 1984, the issue of bank secrecy was even put to the people, with voting on a 1978 bank initiative that originated from the Socialist Party,[77] which amongst other aspects envisaged extending legal assistance to the offence of tax evasion and exchange offences. But clearly the level of trust that the people had in the post-war banking system was such that the advantages of banking secrecy were deemed greater than the disadvantages. The initiative was thus defeated by 73 per cent voting against the proposal.[78]

However, the bank initiative was not entirely without consequences. Two years later the Federal Council (and supported by the Constitution regarding its competence in foreign affairs), blocked the bank accounts of the deposed

dictators Marcos and Duvalier. In earlier comparable cases (Halie Selassie, Shah Resa Pahlevi), Switzerland had categorically rejected similar measures.[79]

In the mid-1980s, a major money laundering affair came to light that would change the political and legal landscape in Switzerland. When the 'Pizza Connection' was crushed, one of the biggest heroin smuggling rings of the Italian-American drug Mafia was revealed. The connections stretched from Turkey to Sicily to the USA; there was also evidence of money laundering having taken place in Switzerland – and the repercussions were felt even in the highest echelons of government, namely to the private sphere of the then Minister of Justice, Elisabeth Kopp. Her husband Hans W. Kopp was vice-president of the board of directors of the company Shakarchi Trading AG, which for a time was under suspicion of money laundering. The resignation in October 1988 of Hans W. Kopp from the board of directors, effectively ended Elisabeth Kopp's political career. Hans W. Kopp's resignation occurred after he received advice over the phone from his wife's office – which being the Justice Ministry was being kept fully up to date with developments in the case. Elisabeth Kopp had to resign from her post and thereafter was prosecuted for breaching official secrets but she was found not guilty by the highest court in Switzerland.[80]

A Parliamentary Investigation Commission that was established to examine this case published its findings on 24 November 1989. It came to the conclusion that the federal authorities were neither corrupt nor infiltrated by organized crime. On the other hand though, serious gaps in the fight against international drug dealing, as well as shortcomings in the Federal Prosecutor's office were discovered.[81]

As further confirmation of a typical pattern of how Swiss law has been developed in this field, the anti-money laundering article came into effect in 1990. This changed the general conditions in order to guarantee discretion. The need for discretion for bank clients in Switzerland at that time was manifested by the existence of 30 000 Form B accounts. These Form B accounts enabled the holder to use a lawyer or a fiduciary to ensure that his identity was kept secret, and had been introduced in 1977 by the CDB. The new article resulted in a slightly revised version of the Form, called B1; this too had been filled out over 18 000 times in the course of a few months.[82] This large number of anonymous accounts was a thorn in the side of the Bank Commission, which resulted in its prohibition on 1 July 1991. The name of the clients using this device had to be obtained by the banks by 30 September 1992.[83] Form B was replaced by Form R, which permits notaries and lawyers to open accounts and deposits for their clients without revealing the identity of the latter only in cases where a specific connection with the lawyer acting in his professional capacity exists.[84]

Ten years after the anti-money laundering article was passed, a further step was taken. At the beginning of 2000 the Swiss anti-corruption criminal law article came into effect. Not only is corruption a criminal offence but also accepting the proceeds of corruption falls into the same criminal category.[85]

The discourse relating to money laundering took on a new dimension with the Sani Abacha case, which did not only affect the financial centre of Switzerland. In 1999 some 19 bank accounts belonging to Sani Abacha the former President of Nigeria, were found in Swiss banks. At the end of 1999 the amount of money that had been blocked came to about US$660 million.[86] From November 1999 through to August 2000 the Federal Banking Commission conducted an investigation. Following the Abacha cases the Federal Banking Commission, for the first time ever, decided to name the banks publicly which were accused of breaching their diligence obligations.[87] In addition, the revision of the 'Money Laundering Guidelines' from 26 March 1998 was initiated so that the new legal developments and knowledge that had been gained as a result of the hearings could be taken into account to deal with the weak points when looking at the regulatory system as a whole.

At the conclusion of the affair there was a parliamentary motion that demanded that the bank accounts of foreign heads of state and other foreign dignitaries should be reported to an official commission that would be subject to bank secrecy so that checks could be made.[88] The motion was defeated by parliament following an intervention by the Federal Council, who indicated that the Federal Banking Commission was currently working on this topic, namely by looking at the existing regulations in the form of the anti-money laundering guidelines and the revised criminal law in relation to corruption.[89]

Even after the anti-money laundering law came into effect on 1 April 1998 the problem of the criminal misuse of Switzerland's financial centres remains acute. Internally the political pressure has increased while ever sharper criticism has also been made by voices abroad – the most critical probably being the French National Assembly through its members Vincent Peillon and Arnaud Montebourg.[90] The Swiss government reacted to this with the establishment of an advisory council and a parliamentary commission[91]; the finance department however, rejected the allegation of negligence in relation to fighting money laundering.[92]

On 1 July 2002 a newly formed agency on International Finance and Monetary Policy commenced work. This department is concerned with the issues of financial criminality, tax questions, bank secrecy, the regulation of the financial markets and so on.[93] In addition, a comprehensive review by the Federal Police on money laundering in Switzerland is planned, which will encompass an analysis of the cantonal and federal court decisions on money laundering and will yield information on the reporting policies and behaviour of the financial intermediaries.[94]

II CRIMINAL LAW AND THE DEVELOPMENT OF THE ANTI-MONEY LAUNDERING SYSTEM

A Overview

The fight against money laundering is waged on various fronts and under different pieces of legislation in Switzerland:

- *at the criminal justice level*: money laundering was criminalized in 1990;
- *at the criminal investigation level*: a specialized Money Laundering Reporting Office was set up in 1998. The MLRO is a federal administrative body (Financial Intelligence Unit) which reports to the Federal Office for Police);
- *through administrative law*: in the financial sector uniform rules of due diligence were made in 1998 for all financial intermediaries in the banking and the non-banking sector.[95]

Hence the system to combat money laundering in Switzerland is a complex body of rules comprising preventive components in administrative law and repressive provisions in criminal law. The preventive concept integrates all financial intermediaries of the banking and non-banking sector as well as four supervisory bodies (the Money Laundering Control Authority, the Federal Banking Commission, the Federal Office of Private Insurance, the Federal Gaming Board), the self-regulating organizations recognized by the Control Authority and the Money Laundering Reporting Office. The latter serves as an information clearing-house prior to the opening of a criminal case as well as the institutionalized channel for information to the prosecuting authorities.[96]

The Swiss system to combat money laundering is a mixed system; it is based first on direct intervention by the state using criminal law, second, on direct state control at the administrative level, and thirdly by relying on private self control mechanisms. The system includes the right as well as the duty to notify. In comparing this system internationally, it is notable that in the case of unusual transactions and where there are indications that money laundering might have occurred, that responsibility remains for a relatively long period of time with the private management. The importance of private self regulation is made quite apparent in appropriate provisions of the anti-money laundering law.[97]

B An Overview of the Historical Development of the Anti-Money Laundering System

1 Money laundering as an offence according to the Criminal Code (Art. 305bis CC, in force since 1 August 1990)

It may be said that the Swiss fight against money laundering has been characterized by reactions to a series of banking scandals ('Pizza Connection', 'Lebanon Connection', see the preceding historical section), that have had a considerable effect on the reputation of Switzerland as a financial centre and its financial sector.[98] The recognition that substantial assets obtained as result of criminal activity were found to have been accepted by Swiss financial institutions,[99] led to the call for a criminal law against money laundering.[100]

a The origins of the notion of money laundering

The phrase 'money laundering' was mostly used in Europe in the 1970s in the context of ransom monies, which criminals sought to obtain through hostage taking and kidnapping. Knowing that the authorities routinely recorded the serial numbers of bank notes that were paid out to obtain the release of the victims of these crimes, the perpetrators then sought to 'wash' the proceeds of their crimes so that the money could be returned to circulation. And in many cases the authorities were successful in tracing the registered bank notes back to those laundering the money and also to the criminals who carried out the original crime.[101] The 'kidnapping industry', which was most notably a particular problem in Italy, led to the situation that 'in Switzerland money laundering had become a serious problem in a short period of time'.[102]

What was even more difficult than the search for ransom monies in individual cases was the search for money from organized crime – because here of course there are no registered serial numbers on the bank notes. This problem was particularly acute for the authorities in the fight against drugs – which had similarly taken off in the 1970s – first in the USA and then also in Western Europe.[103] It was not long before the police tactic embraced the concept of 'going for the money'. This concept consisted of confiscating the working capital of organized crime in order to squeeze their capacity to act.[104] In Switzerland at this time there were no criminal law provisions relating to the organized crime. The expression itself was first used in 1973 and it was in the framework of a legal assistance treaty between the Confederation and the USA. The criminal norm that most corresponded to the criminal coverage of money laundering was that of receiving stolen goods; but it left loopholes open. Thus under the existing law at that time, money laundering was only punishable, if the proceeds arose from a crime against property (such as theft, robbery, fraud, etc.). What was not covered was money laundering that was

connected to the rewards of crime or the proceeds from drugs, illegal trading in weapons or women, stemming from fraudulent bankruptcy, bribery and so on. Moreover, money laundering was referred to in terms of involving moveable property, not however in terms of claims. Thus the payment of money in cash was covered, but quite illogically, not the credit that lay in a bank account.[105]

At the international level the Council of Europe was the first organization to issue a recommendation in relation to measures against the concealment of money derived from criminal behaviour (1980). The Convention does not contain material rules, it is rather an agreement that sets out proposals for measures such as the identification of contracting partners, which aims to make it very difficult for criminals to use the banking system.[106]

b The first preventive applications and the call for repressive measures

The calls for a criminal measure were voiced in 1985, when the Federal Council sent a preliminary draft of a new criminal law provision relating to offences against property into the consultation phase.[107] Various political parties, cantons and organizations pushed for the question of criminalizing money laundering to be examined. The preliminary draft itself did not contain any criminal provisions regarding money laundering, and the Expert Commission had also not opined on this point in their report. In addition, the law on receiving stolen goods was so constructed, that the loopholes that have already been mentioned would have continued to exist as before.[108]

This deficit is, with hindsight, explicable. When the Expert Commission delivered their draft in 1983, the financing of drug related offences was indeed well recognized as a special aspect of the law on narcotics. Switzerland thus was gradually fulfilling its obligations in 1975[109] with regard to the UN Convention of 1961[110] which obliged the parties to the Convention to criminalize the financing of drug dealing.[111] General need for a criminal provision concerning property derived from a criminal act was not a topic of discussion at that time in Switzerland.[112] After this lacuna was recognized, the Federal Department of Justice and Police (EJPD) gave the Ticinese state prosecutor, Paolo Bernasconi,[113] the task of drafting a criminal norm.[114]

c The Swiss preliminary draft and the international position

When finally in September 1986 the Swiss preliminary draft clause on money laundering code was published, there were already recognizable beginnings at the international level of an anti-money laundering concept[115]:

The UN had a preliminary draft for an International Convention against the illegal drugs trade from 17 June 1986. This Convention contained provisions

that criminalized the acquisition, possession, the transfer or the laundering of proceeds of crime, under the proviso that the assets involved were directly or indirectly from the illegal drugs trade.

- In June 1986 the European justice ministers, on behalf of the Council of Ministers passed a Resolution relating to the criminal aspects of combating the misuse of drugs.
- And finally, the European parliament in its session on 12 September 1986, made a proposal to the European Commission that was aimed at harmonizing at the European level, the ways and means to investigate and control organized crime and the intertwined financial aspects.

Accordingly in the consultative process (that took place from 23 February until 31 May 1987), the criticism that was expressed on various sides was that Switzerland in comparison to international developments was going too far in forging ahead in this way.[116] However, in the course of 1986 specific laws against money laundering were passed in the USA, in Great Britain, in Panama and, in 1987, also in France.[117]

In general, the reactions to Bernasconi's preliminary draft were positive. The Federal Council decided to present an anti-money laundering norm to parliament in the context of a new criminal law dealing with property.

d Shortcut to the passing of the law

The rather protracted procedure that is normally involved when passing a law received an unexpected boost following the revelations of the Lebanon Connection.[118] The government decided on 28 November 1988, to separate the money laundering provision from the revision of the new criminal law on property – into which it had been integrated a year before – and to have an independent proposal by early 1989. At the same time, the Federal Justice Department was given the task of reviewing the efficiency of the laws on confiscation and to make corresponding proposals as necessary.[119] The scandal clearly revealed the need for decisive political action, so that the necessity of an additional criminal norm was not questioned. In June 1989 the draft law was put before the Federal Parliament.[120]

The consequences of this accelerated process were not all entirely positive; various limitations were necessary which created a certain incoherence:

- It was not possible because of lack of time to integrate the confiscation law into the money laundering provisions – although the correlation was clear. As a consequence the Articles 58 and 58[bis] relating to confiscation in the Criminal Code were out of the revision of the General Section of

the Criminal Code and instead put to Parliament in the revision of the criminal law relating to property in 1989.[121]

- In addition, the questions that emerged and discussed in the National Assembly relating to the criminal liability of legal entities in the context of money laundering went beyond the remit of the consultation process. In particular it was feared that the rather controversial responsibility of the draft would be over burdened and result in delays.[122]
- Finally, the introduction of the money laundering article was justified as a decisive tool in the fight against organized crime, although at that time there were no criminal provisions concerning organized crime. The offence of belonging to a criminal organization only came into effect in 1994.[123]

At that time, it was only clear that money laundering should be an offence covered by *criminal* law. What was not decided was whether a new Article should be included in the core criminal law code (and if so whether it should be in the general or specific section) or included in subsidiary offences.[124] The majority of the contributors to the consultative process agreed to the proposed definition of money laundering as an offence against the administration of justice and the placing of the offence in the appropriate section.[125] The possibility of using a subsidiary law was rejected for lack of an adequate federal law. Consideration was given to using the laws on narcotics and war materials, but both would have limited the scope of applicability.[126]

e Further international developments

The call for the creation of a criminal provision against money laundering was first addressed in the UN Convention of 19 December 1988.[127] Previously measures on this topic were undertaken in relation to the Council of Europe recommendation of 1980 which did not necessarily involve criminal justice but rather was directed towards the banking system.[128] The same logic was applied in the 1988 Statement of Principles by the Committee on Banking regulation and Supervisory Practices of the Bank for International Settlements, whereby the banking system may not be used to launder money derived from criminal activity.[129]

The Financial Action Task Force's 40 Recommendations on Money Laundering of 17 February 1990 are almost exclusively based on these two contributions.[130] At this point in time Switzerland did not yet have its first law in place, but it was already in the pipeline. In order that the new criminal provisions on money laundering could be applied, it was clear that they would need to be either amended or extended. The reason why this was so will be explained below.

The Council of Europe and the EU moved to criminalize money laundering and used the FATF approach as a template. On 8 November 1990 the Council of Europe opened the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (No. 141) for signature and it came into force in Switzerland on 1 September 1993.[131] Similarly, Recommendation No. 91/308/EEC of the European Community of 10 June 1991 to prevent money laundering.[132] In addition, this recommendation contains preventive elements, as did the first international documents on the subject of money laundering, in that they give directions to the banks on how to conduct business.

2 Lack of due diligence: Criminal aspects relating to the obligation to exercise due diligence (Art. 305ter para. 1 Criminal Code, in force since 1 August 1990)

The 1980 Recommendation of the Council of Europe as well as the 1988 BCBS Statement put the identification of the client in the foreground. Thus what was being spread at the international level, had been known in Switzerland since 1977; the duty to identify the bank client and the additional obligation to do the same for the 'beneficial owner', if there is any doubt that they are not one and the same person. These duties were anchored in the 'Agreement on the due diligence obligation when accepting money and the management of the bank secrecy', which the Swiss banks had to abide by since 1 July 1977.[133]

In addition to the reception of the Swiss preventive measures through the first international model laws,[134] the USA in 1983 similarly pointed to the due diligence agreement as a model that other states should introduce.[135] In view of the fact that hitherto banking law regulation was the primary means, it appeared logical to the Federal Council to secure the obligation to identify using criminal law.[136] The introduction of an offence in the criminal law by which financial intermediaries could be sanctioned if they failed to use the appropriate degree of diligence in identifying the client or the beneficial owner, was at the end of the day, necessary because the criminalization of negligent money laundering had clearly been rejected during the consultation process.[137]

Thus, the criminal law provision on committing money laundering with intent came into force on 1 August 1990, as well as the criminal offence of lack of due diligence when conducting financial business. At this time neither the right nor the obligation to notify was foreseen.

The reporting of a suspicion that assets may be the proceeds of crime was however recommended by the FATF in 1990 as a tool that could be used to combat money laundering. The possibility of obliging banks to notify was already mentioned in the Government Report of the Federal Council on the

anti-money laundering packet. It set out in detail how the USA, in the face of an increasing problem with the proceeds of drug trafficking, had reactivated and extended old banking regulations that obliged banks to report where cash transactions were involved. The aim primarily was to prevent the destruction of the paper trail, and illegal cash from entering the banking system. Breaching these obligations to report were even subject to criminal law sanctions.

The introduction of a general duty to notify cash transaction was categorically rejected by Switzerland, not least because at that time in Switzerland cash was a more popular method of paying than it was in the USA. Similarly, an obligation to notify whenever a domestic payment over a certain amount was received, would have produced a disproportionate number of cases. In addition it was thought that in view of the Swiss practice of identifying the client, and the buttressing of this duty through the additional criminal sanctions contained in Art. 305ter of the Criminal Code, reporting financial transactions was obsolete. In particular it was perceived that there was a risk of a clash with the bank secrecy laws, if notifications were also required beyond legal assistance cases.[138]

The FATF, in addition to notification, also recommended the introduction of a duty to clarify complex, unusual or large transactions as well as unusual forms of transactions that appeared neither to fulfil an economic or legal purpose. Here again an approach was put forward that had been formulated by the Swiss Banking Commission at the end of the 1970s and which was given legal approval by the Supreme Court in 1982, in a decision in which it was stated that, 'for business, . . . that is complex, unusual or important, the economic background has to be clarified'.[139]

In this respect, it was logical that the Swiss Banking Commission seized these recommendations and on 1 May 1992 came out with the Guidelines to Combat and Prevent Money Laundering,[140] which are today – in a revised version as an Ordinance – still in force. The goal of these guidelines was *inter alia*, to set down the most important specific criteria in relation to an unusual transaction, and includes less relevant factors, which may serve as clues to money laundering. As a general rule of thumb transactions on behalf of a client that do not, in the experience and knowledge of the financial intermediary, tie-up with what the financial intermediary knows about the client and his business, are to be regarded as suspicious. The banks themselves have further developed this precept through internal communications, and by developing departments with specialists that can make decisions in relation to specific cases and particularly how best to proceed in cases of doubt.[141]

3 Right to notify, inclusion of organized crime in criminal law and revision of law of confiscation (Art. 305$^{\text{ter}}$ para. 2 CC, Art. 260$^{\text{ter}}$ CC, Art. 58 *et seq*. CC, in force since 1 August 1994)

The strengthening of the entire regime relating to anti-money laundering was already drawn up by the preceding measures and international developments. Thus, the second packet of measures was introduced and came into effect in 1994:

- Art. 305$^{\text{ter}}$ CC was amended with an additional subsection that permitted notification for all who are obliged to identify the beneficial owner. The background of this right to notify in relation to the international developments has already been outlined. In addition, it clearly appeared necessary to the authorities to secure a special basis to justify lifting of bank secrecy *vis-à-vis* the prosecuting authorities.[142] The notion of introducing an obligation to notify was at that time not pursued with the reasoning that a duty to denounce was an alien concept to Swiss criminal law.[143]
- As already mentioned, from the very beginning the combating of money laundering was to be achieved not only through criminal law, but also by seizing property that had been illegally obtained. The details on the revision of the law of confiscation are to be found in the section on Confiscation; here just the main points are to be noted:
  - securing of the state's claim for compensation;
  - the introduction of the possibility of estimating the value of property that is to be seized (when the extent cannot be determined or only at disproportionate cost);
  - the introduction of a five-year limitation period.
- Specific rules were created to deal with the confiscation of property in connection with organized crime. This means that it is not necessary to prove in detail from which crime specific property is derived, and if a person is convicted under Art. 260$^{\text{ter}}$ then the assumption is that his entire property has been acquired through criminal acts and the burden of proof reversed.
- With Art. 260$^{\text{ter}}$, the criminal norm was introduced which was supposed to play a central role in the fight against organized crime that had already started in earlier years. The sanction of imprisonment contained in Art. 260$^{\text{ter}}$ CC threatens those who are found guilty of taking part in a criminal organization, its development, keeping the membership secret, and intend to enrich themselves using violence or other prohibited means. If a person supports such an organization then he also faces the same sanctions.

4 The federal law to combat money laundering in the financial sector (in force since 1 April 1998; AML)

The introduction of the AML took as a basis that the – already strengthened – criminal law instruments were insufficient to stop money laundering in Switzerland.[144] Administrative law procedures should also be utilized to complement the criminal law measures to combat money laundering.

Thus, due diligence obligations were in particular to be fixed by law, using as a draft the Guidelines developed by the Federal Banking Commission[145]; the obligation to notify was introduced (the EU member states had had such an obligation since 1991, with the Guidelines on Money Laundering 91/308), and in order to ensure a comprehensive assault on the problem of money laundering the rules were extended to the non-banking sector under administrative supervision which was set up in a variety of ways. The law will be addressed in more detail in section IV below.

5 The 'efficiency regulation' (in force since 1 January 2000) and federal criminal procedure law in the future

In connection with the prosecution of money laundering offences and the lack of due diligence in financial business, it is worth mentioning that in December 1999, parliament passed the so-called 'efficiency regulation'.[146] This law made it possible for the federal authorities to take over cases that are particularly complex and involve inter-cantonal and international organized crime, money laundering and corruption (Art. 340bis CC).[147] This also applies to economic crimes (Art. 340bis para. 2 CC), however the cantons maintain their competence to conduct these sorts of cases whilst in the aforementioned situation only the federal authorities are competent to act.[148] In 2002, approximately 38 per cent (corresponding to about 195 notifications) which were passed from the Swiss Reporting Office for suspicious transaction reporting were not passed to a cantonal prosecuting authority, but to the Federal Attorney General's office, or to the Federal Investigating Judge's office.[149] Out of these notifications, 15 were in connection with a suspicion of terrorist financing. Clearly even more cases were assigned to the federal level due to their complexity or international aspects. However, these cases were transferred back to the cantons where there was a link with a pending case.

The competence of the new federal agency has led to an easing of the burden of some prosecuting authorities in some cantons (canton Ticino: eight fewer notifications; Geneva: 24 fewer notifications), while Zürich registered an increase of 18 notifications.[150] It is perhaps too soon to identify any sort of trend.

It is precisely in the context of anti-money laundering that banks are expected to demonstrate a willingness to co-operate. In order to substantiate a suspicion of money laundering, it may be reasonable in some circumstances

not to simply block an account, but rather to monitor what is going on in relation to the bank account, and this may include checking electronic transactions. These types of monitoring measures correspond to the European standards of combating money laundering.[151] Similarly in Switzerland, such measures are possible, however not on the basis of a legal norm, but because of an agreement between prosecuting authorities and the bank.[152] Given that this sort of arrangement is clearly an interference in the private sphere of the client and his contracting partners, and obliges the bank to play an active role in the process, it is proposed that for the future a legal framework should be created by the Federal Criminal Procedure Law; the corresponding articles (preliminary draft Arts. 318 and 319) envisage that banks may be directed in writing by the prosecuting authorities (that is, state prosecutor or the court, not police) to monitor accounts with a view to clarifying whether a crime or misdemeanour has been committed. Only when the monitoring lasts longer than one month does a court have to grant permission for the covert monitoring to continue (Art. 319, para. 2). In addition it is hoped that greater efficiency can be achieved by the introduction of a form of 'plea bargaining'. Using a so-called shortened procedure it has been proposed that the accused and the prosecuting authorities may discuss with each other the issues of a guilty plea in exchange for a negotiated punishment.[153]

Finally, since 1 July 2002 a newly formed section of the Federal Finance Department, working on 'International Finance and Monetary Policy' has concerned itself with questions of international finance, which will also encompass combating financial crime, tax issues, bank secrecy, regulation of the financial markets and so on.[154]

6 Concluding summary

The development of the anti-money laundering system in Switzerland is characterized by a certain incoherence:

- Money laundering was made an offence in conjunction with the obstruction of confiscation, but without revising at the same time offences in relation to confiscation.
- Combating money laundering was propounded as an essential element in the fight against organized crime, without however ever making an explicit link to this offence, and that at a time when organized crime was not included in criminal law. The offence (Art. 260ter CC) was primarily introduced in order to facilitate the rendering of legal assistance, and not so much as part of a strategy with a specific criminal policy.[155] Similarly, in relation to the offence of money laundering there tends to be a discrepancy between criminal policy and its practical application. As a prime example of how far the offence of Art. 305bis CC can be

made to deviate from its supposed criminal policy goal, namely to combat organized crime,[156] is illustrated by the Swiss case FCD 119 IV 59 *et seq*.[157] In a non-representative analysis of 17 money laundering cases it was found that in 70 per cent of cases drug trafficking was the predicate offence and only in 15 per cent of the cases was Art. 260ter CC taken into consideration.[158]

Looking further at the choice of regulatory instruments, it is clear that there has been a strong weighting in favour of private law, strengthened yet further by the legislator's extremely practical approach when developing its application. This development came about on the one hand because of the various scandals that called for swift political action, which in turn contributed to the spiral of fast but poorly co-ordinated measures. Moreover the fight against crime took on an international dimension that hitherto had only been seen in relation to private law.

For a long period, knowledge about organized crime was essentially that of the US prosecution authorities perception of the problem and their state of knowledge which was limited to the fight against drug trafficking. In addition there was a rather diffused perception that was based on knowledge of the Italian Mafia and the investigatory experiences of Swiss prosecutors, which were not based on specific research, but had been acquired as a result of investigations in other matters or in connection with requests for legal assistance.[159]

From 1995–2000 a Swiss national research programme (NFP 40) was set up to examine the problem of organized crime and entitled 'Violence in everyday life and organized crime'. In the context of this programme, perceptions in relation to organized crime were researched in particular. Briefly stated, the final report published in October 2002 essentially came to the conclusion that the dangers of organized crime in society need to be relativized.

Drawing all these various aspects together, much of the Swiss system dealing with money laundering – and especially in the field of criminal law – has grown in patchwork fashion, that has caused problems in application. And given that this field is continually developing both nationally and internationally, it is conceivable that an entirely new, comprehensive system could be envisaged in the future. Given the right circumstances, it would be feasible for this to occur within a timeframe that would leave sufficient leeway so that an encompassing system could be developed that would leave behind the case-by-case reactive mode that has characterized legal developments in recent years. It would be desirable for such a system to be based on a coherent concept with a criminal policy behind it, which in turn is the result of well-founded criminological knowledge relating to money laundering and organized crime.

C The Offences

1 Art. 305bis CC

Money laundering is committed by a person who hinders the establishment of provenance, the discovery or the confiscation of assets proceeding from crime.

a Predicate offences

Right from the start,[160] the scope of application of the money laundering norm in Switzerland was not restricted to drug related offences or organized crime. The predicate offence can be any crime under the criminal code that is subject to a minimum period of imprisonment of more than one year (Art. 305bis in combination with Art. 9 s.1 CC).[161]

So, for example, theft, embezzlement, robbery, blackmail, usury, receiving stolen goods etc. and subsidiary criminal law can also be a predicate offence where the offence takes on the character of a serious crime through the penalty that may be imposed. On the other hand, the following offences are not predicate offences for money laundering: Fraud where the sum involved is less than SFr. 300[162]; subvention fraud[163]; insider trading[164]; manipulation of the stock-market.[165] In addition tax fraud[166] – as in a significant number of FATF member countries[167] – is not a predicate crime for money laundering; not even where a forged document is involved which in itself may constitute a crime.[168]

This scope of predicate offence will, however, have to be changed in a future revision in order to comply with the designated categories of offences of the new FATF-Rec. 1 (2003). This means that Switzerland will have to introduce the following offences as predicate offence for money laundering:

- trafficking in human beings and migrant smuggling
- counterfeiting and piracy of products
- smuggling[169]
- insider trading and market manipulation.

In 1990 at the international level, money laundering was for the first time extended beyond drug offences.[170] The FATF ‘Forty Recommendations’ remained confined to drug money laundering until 1996. It was only then that the extension to all ‘serious crimes’ was made and only following the appropriate amendments to laws in the first half of 1999 in Japan and Singapore did all members have a money laundering offence based on a range of serious offences.[171]

The importance of the definition of the predicate offences is particularly apparent when it comes to international co-operation, namely when other countries seek assistance from Switzerland in the context of a money laundering

investigation in their country. This issue will be addressed in section III. Predicate offences are mentioned here though, because in November 2001 the European Parliament passed an important amendment to the 1991 Directive on Money Laundering.[172] Through this amendment the definition of 'criminal activity' which served as the basis for the prohibition of money laundering was extended; in addition to drug offences and organized crime, all illegal activities that affect the financial interests of the Community are covered. However, under Swiss law, predicate offences to money laundering may only include criminal acts that are detrimental to the financial interests of the EU which may be defined as fraud under Swiss law, whereas tax – or other duty frauds[173] – are not predicate offences to money laundering under Swiss law. The result is that for such cases dual criminality will not be recognized.[174]

b The subject matter of the offence

In the definition of the subject of the money laundering offence the essence of the norm is highlighted as the obstruction of the state to confiscate. The preliminary draft from 1986 explicitly referred to money and its surrogates[175] – 'other property, subject to confiscation according to Art. 58 CC'.[176] Included are for example: precious metals, jewels, cars, aeroplanes, land and title deeds.[177]

In taking over criteria from the law on confiscation it was originally inferred that the subject of money laundering in addition to money and property that are derived from a crime, would also include property that may be suitable for committing a crime. However, these aids to money laundering that would obstruct the confiscation of property using '*instrumenta sceleris*' were not included following the negative reactions in the consultative process.[178] Hence, the offence is confined to the laundering of proceeds from illicit activity. To establish money laundering as an offence in connection with the commission of an offence – for example in relation to the financing of terrorism – would completely change the sphere of applicability of the offence.[179] For this reason the financing of terrorism was introduced as a new offence in the criminal law.[180] Thus it is a possible predicate offence to money laundering.

There are – at least theoretically – two important practical questions that have not yet been resolved in a satisfactory way: the question to what extent surrogates should be possible subjects for laundering, and how property that is partly contaminated should be dealt with by financial intermediaries. Until now it has been an unresolved issue for financial intermediaries, as to what monies they have at their disposal and to which no risk attaches, when it is clear that only a part is attributable to illicit activity. Regarding surrogates, the prevailing academic opinion, as well as practice, indicates that their confiscation is possible.[181] Nevertheless, no reasonable criteria setting limits exist as yet.[182]

c The offence

The objective element of the offence is committed if establishing the provenance of the assets or their discovery or their confiscation is hindered.[183]

The abstract formulation of the elements of the offence distinguishes from the solutions that other countries have employed, which typically involve 'contact' with assets derived from crime. The Swiss solution has been much criticized in the literature as being in contravention with the constitutional obligations for certainty in the law. The criticism relates to the lack of criteria regarding how abstract or specific the possible obstruction has to be for the offence to be regarded as committed. The legislator expressly left it open for practice to develop what would constitute the relevant offence of obstruction,[184] therefore the criminal elements of the offence will be definitive only after the Supreme Court has pronounced on this issue.[185]

There is some leeway as to the boundaries of the offence which, in practice is fully utilized. Academic opinion which favours a restrictive interpretation has been explicitly rejected by the Supreme Court.[186] Although through Art. 305bis CC the aim was precisely to deal with the anonymizing and concealing concepts by using the financial markets, the law did not envisage any explicit restrictions. Therefore in 1996, the Supreme Court confirmed that even the most basic offence can be used as a predicate to money laundering.[187]

Clear cases of money laundering are: the physical transport of criminal assets abroad[188]; the transfer from a domestic to a foreign account[189]; payments in cash; any transformation of funds from cash to any form of investment with respect to money derived from crime[190]; the use of intermediaries (domiciliary companies, persons in professions bound by confidentiality such as lawyers or fiduciaries); transactions from abroad to Switzerland, because confiscation by Swiss law enforcement agencies is difficult unless there is an application for legal assistance.[191]

There is no offence in relation to money laundering by the mere acceptance of assets, nor by the crediting of a personal bank account at the place where the account holder resides, or the passive holding of assets.[192] In addition money laundering is not committed where a transaction can be traced by a paper trail.[193] In the literature on this area the opinion at least is represented that transactions that enable the person to be shielded to the outside world has the necessary potential to anonymize a money laundering offence: So for example, fiduciary business, transactions involving numbered accounts, transfers to collective or nostro accounts or via diverse accounts in domestic transfers.[194]

d The perpetrator

Anyone can commit this offence – it is not confined to bank employees or

other financial intermediaries. The Swiss provision even permits the prosecution of a perpetrator who laundered the money derived from his own predicate offence (alternatively assisted or incited the predicate offence).[195] This is also the case in increasing numbers of FATF member countries; only five countries do not allow such a prosecution.[196]

e The subjective elements of the offence

The subjective elements of the offence have an important function. According to Art. 305bis CC, Swiss prosecutors have to prove knowledge or intent. This would however set a high barrier in relation to the standard of proof. A wider scope allows the principle of *dolus eventualis* to apply, which means that a criminal act can be construed when the circumstances indicate that the offender – *in casu* – must have known about the criminal origins of the money and must have accepted that confiscation would be obstructed through his actions.

In order to ease the burden of proof even further, Switzerland has introduced an objective element. Accordingly, it is sufficient to prove that the financial intermediary had 'reason to assume', that the proceeds were derived from illicit activity. The offender in this situation only needs to know about the predicate offence in general terms and to have reckoned in layman's terms that this behaviour could entail a heavy penalty. The financial intermediary must be assumed to have intended to commit the offence, if for example the client's need for discretion where tax evasion is involved, exceeds a certain level.[197] Swiss law however, does not go so far as to reverse the burden of proof.[198]

Negligent money laundering is not an offence as it was feared that this could have a counterproductive effect: bank employees might be averse to giving evidence in order to avoid the risk of self incrimination.[199]

f The relationship with other countries

As in almost all FATF countries, the laundering of the proceeds of a crime committed abroad is also a crime in the same terms as the laundering in a domestic offence.[200] The Swiss law provides that, 'the offender will also be punished if the principal offence was committed abroad in a jurisdiction where it is also punishable by law' (Art. 305bis s.3 CC). The explicit reference to the commission of the crime abroad is necessary because otherwise combating money laundering would only apply to domestic offences, which would not make much sense given that some 80 per cent of cases have an international dimension.[201] If the actions that were carried out abroad constitute the principal offence for the perpetration of the secondary offence in Switzerland, the judge applies Swiss law. The principal offence has to be an offence from the Swiss perspective (according to Art. 9 CC).

g The sentence

Generally speaking the *sanction* is imprisonment or a fine, which may range from three days to three years imprisonment (Art. 36 CC) or a maximum fine of SFr. 40 000 (Art. 38 s.1 CC). The preliminary draft originally envisaged up to five years prison.[202] Swiss criminal legislation includes the power for the court to impose a greater penalty in more serious cases (s.2). If the perpetrator is a member of a criminal organization (subsec. a), or the laundering has been done as part of a band (subsec. b) or as though running a business (subsec. c), then possible sanctions are: prison for up to five years and a mandatory fine of up to 1 million francs.

2 Art. 305ter CC

a para. 1: Enforcing identification of customers

This criminal code provision requiring the identification of the beneficial owner mirrors the CDB.[203] The expression 'beneficial owner' was taken from this private law agreement and transferred to the criminal law. With Art. 305ter para. 1 a CC criminal provision was created that would actually be quite suited to a federal law regarding the financial markets – if there were such a thing. It assumes the role of a substitute financial supervisory law.[204] Therefore it could be argued that the criminal law is the wrong setting for this provision, which deals with the most serious forms of asocial behaviour and exists to prohibit and not to regulate certain behaviour.

Art. 305ter para. 1, together with the money laundering article has been in force since 1 August 1990. The legal policy that was targeted is distilled in the phrase 'KYC' and encompasses prevention, easing of the standard of proof and suppression.[205] The criminal law punishment for lack of diligence is in place of a penalty for negligent money laundering which initially was going to be at least in respect of gross negligence.[206]

a The Perpetrator

The definition of the offender is very vague and requires therefore greater clarification. The range of possible offenders was therefore specified[207] in 1998 with Art. 2 of the Money Laundering Law.[208] Possible perpetrators include all professional asset managers in the financial sector, not only banks but also fiduciaries, investment advisors, money changers, precious metal dealers and commercial lawyers. In contrast, the movement of goods is an exception to Art. 305bis CC.[209]

b The Offence

With the aim of preventing money laundering, actions that are designed to conceal property are prohibited, which is why the economic point of view is obligatory in criminal law terms, where there is a trust, foundation, company, fiduciary business, commission, irregular deposits, it is necessary to ascertain for whom they have been created. If the financial intermediary wrongly assumes that the beneficial owner has been identified, if this an error of fact, it is not punishable according to Art. 19 CC.[210]

In correctly ascertaining the holder of the account, alternatively the beneficial owner, then not only does this help to counter money laundering but it also serves a useful purpose when legal assistance is requested from abroad as well as being of enormous significance when domestic prosecutions are involved; compulsory measures in relation to confiscation and seizure are only possible when the accused is also known to the bank either as an account holder or is the beneficial owner.

Art. 305ter para. 1 is not only in need of interpretation in relation to the perpetrator. What is also unclear is at what point in time is the obligation to identify to be carried out and when is an ‘identity’ to be regarded as definitively determined. In addition, the legislator has not fixed the degree of diligence that is to be exercised and permits the level to be relative ‘according to the circumstances’. Practice has developed by looking to the Money Laundering Law, the Controlling Authority’s rules and depending on the branch, on the ordinance (2002)[211] of the Federal Banking Commission, the CDB 03 or the self-regulating organization (SRO) regulations.[212]

To be more precise, on the basis of the aforementioned materials, the obligation to identify has to be carried out before a contractual relationship is entered into, and not just before executing a specific financial transaction.[213] The identification is in any case to be repeated in subsequent transactions in ongoing relationships if there are specific indicators that would suggest that this is called for.[214]

Whether or not identification according to the *ratio legis* of Art. 305ter CC is confined to the beneficial owner has so far been answered in different ways in the literature.[215] The phrase beneficial owner has been taken out of context by Art. 305ter. In the CDB it goes without saying that the identification of the immediate contracting partner is assumed to be carried out. Therefore it would contradict the *ratio legis* of Art. 305ter CC if the phrase were interpreted literally.[216]

The scope of the rule that is to be observed and the duty of diligence can also be based on Arts. 3–6 of the Money Laundering Law as well as the SRO Regulations set out in the CDB 2003 and the ordinance of the Federal Banking Commission.[217]

A further obligation to clarify, that goes beyond accepting the word of the contracting partner as to the identity of the beneficial owner (with Form A), is not derived directly from Art. 305ter CC. However, at the international level a fundamental duty to clarify identify has not been established so far.[218]

c Subjective Elements of the Offence

Art. 305ter para. 1 CC is only punishable where intent is proved, because for negligence to be covered an explicit indication would have to be necessary.[219] However *dolus eventualis* is also sufficient: 'the offender has to have known or at least to have accepted the possibility that he is counteracting the obligation to identify the beneficial owner'.[220]

d The Sentence

A conviction under Art. 305ter CC can be punished by a prison term of up to one year (Art. 36 CC), custody (Art. 39 CC) or a maximum fine of SFr. 40 000 (Art. 48, s.1 CC). Although in order to get the whole picture it is necessary to mention the other non-criminal sanctions. The Money Laundering Law envisages a maximum fine in relation to a breach of the obligation to identify of SFr. 200 000. The CDB (covers only banks), a penalty of up to SFr.10 000 000.

b para. 2: The right to notify

As already mentioned, in 1994 a second set of measures was put in place, which on the one hand included the right to notify, a revision of the law on confiscation and the introduction of article 260ter CC, which makes it a criminal offence to belong to, or support a criminal organization.

a Function

With Art. 305ter para. 2 CC there has been a right to notify since 1994 and in a sense, a special basis to justify disclosures under the professional confidentiality duty. It only applies to those who can call themselves financial intermediaries. No one else can take advantage of the right to notify.[221]

This law permits financial intermediaries to notify indications from which the conclusion may be drawn that the assets are derived from a crime. The notification is made to the domestic prosecuting authorities and the MLRO. The notification is not allowed to be sent to the Controlling Authority and also not to the SRO, and also clearly not to any foreign or domestic tax authorities – or indeed any other administrative authority.[222]

This legal precept is not limited to money laundering; the right to notify is relevant to any crime.[223]

b The Relationship Between the Right to Notify and the Obligation to Notify

Although at the time the right to notify was created there were some discussions about the possibility of a *duty* to notify, in the end the legislator confined the regulation to the former. However, it was clear even then that at some future date an administrative law concept could be used to introduce the latter.[224] And this is just what happened with the Money Laundering Law, there has been a duty to notify since 1 April 1998.[225]

With the creation of the right to notify, the academic literature already took the view that for all intents and purposes a duty to notify had been established: So that if the financial intermediary, despite the indications, did not make use of the right, the suspicion would arise that the possible criminal provenance of the money must have been known to him, or he accepted that possibility. If such an internalization has in fact taken place then this will be sufficient for criminal intent and liability according to the provisions against money laundering.[226]

The duty and right to notify are differentiated in relation to the point in time of the business relationship, the level of intensity of the suspicion and the measures associated therewith.

The obligation to notify is available to the financial intermediary even before he enters into a client relationship, for example as a result of conducting a non-binding introductory discussion.[227] The obligation to notify on the other hand, requires that a business relationship exist between a financial intermediary and the client.[228]

Moreover, there are areas where the obligation to report does not yet exist, but where the conditions for the right to notify are already given. A duty to notify exists when the knowledge or a founded suspicion of a criminal act are given; the right to notify is only possible when appropriate clues are to hand.[229]

In the context of money laundering and the existing client relationship, the practical question arises where the border between the right to notify and the duty to do so lies. Alternatively what possibility is there for the financial intermediary to disengage from the client, without thereby coming into conflict with the duty to notify or even Art. 305bis CC? The financial intermediary in these cases does not actually have an obligation to report, but a great deal of diligence is called for so as to ensure that in continuing the business relationship, assets are not transferred that later on could be qualified as money laundering.[230] Thus the financial intermediary is actually induced to adopt a risk-based approach, which involves monitoring of the development of the risk and as soon as the risk factors reach a certain level, the right to notify is the tool to use. If a suspicious transaction has already taken place, then the obligation to notify according to Art. 9 of the Money Laundering Law applies.

Of the two types of notification, it may be said that the obligation to notify takes precedence, although it is the more far reaching measure, because it involves an automatic blocking of the assets. The obligation is however clearly regulated and the financial intermediary can justify his actions to his client by referring to his legal obligations.[231]

3 Criminal liability of companies

With the passing of the money laundering provision in 1989/90 the topic of the criminal liability of companies was already thematized, and in the subsequent revision in 1994 (together with the introduction of Art. 260ter and the revision of Arts. 58–60 and 305ter para. 2) it should have been introduced, but was finally planned for inclusion in a further round of revisions in the context of a total revision of the General Section of the Criminal Code.[232]

However, by the end of 2002, Switzerland intended to ratify the International Convention for the Suppression of the Financing of Terrorism,[233] and according to Article 5 of the Convention, each State Party is required to take the necessary measures to enable a legal entity to be held liable for the financing of terrorist acts. Considering that the revision of the general provisions of the Swiss Criminal Code were not expected to be completed in time, the law establishing the criminal liability of legal entities was separated from the revision, and became part of the legislative project to criminalize the financing of terrorism.[234] As of 1 October 2003, the following articles are in force:[235]

Article 100^{quater}

1. Where any crime is committed within an enterprise in the exercise of commercial activities intra vires the objects of the enterprise and this act cannot be imputed to any particular individual by reason of a lack of organization in the enterprise, the enterprise shall be punished by a maximum fine of five million francs.
2. For offences under Articles 260ter, $260^{\text{quinquies}}$, 305bis, 322ter, $322^{\text{quinquies}}$, 322^{septies} of the Swiss Criminal Code, an enterprise shall be punished independently of liability of any individual if it can be established that the enterprise has not taken all reasonable organizational measures required to prevent such an offence.
3. The court shall set the fine in particular according to the seriousness of the offence, the lack of organization and the damage caused and the economic capacity of the enterprise.
4. For the purposes of this Article, enterprises shall include:

   a. legal entities established under civil law;
   b. legal entities established under public law except for regional corporations;
   c. companies
   d. individual enterprises.

Art. $100^{\text{quinquies}}$

1 During a criminal procedure the enterprise shall be represented by one single person authorized to represent the enterprise in civil matters. If the enterprise fails to appoint such a deputy within a proper period, the bureau of investigation or the court will appoint a deputy from amongst the persons authorized to represent the enterprise in civil matters.
2 A person representing the enterprise in criminal proceedings has the same rights and duties as an accused person. Other persons under para. 1 are not legally obliged to give evidence.
3 If the person representing the enterprise in the criminal proceeding is subject to a criminal investigation on the same or interrelated circumstances of the case, the enterprise is required to appoint a new deputy. If necessary the bureau of investigation or the court will appoint the new deputy from among the persons under para. 1 or, if none is available, a suitable third person.

Hence, according to para. 4 of the draft provision, the state or other local authority (cantons, municipal authorities, etc.) are excluded under Article 100^{quater}, but the term enterprise applies to public law companies.[236] The parliamentary draft, contrary to the former version,[237] underlines the requirement of an intrinsic link between the legal person and the offence. Currently enterprises are liable only where an offence is committed in the course of operations of the enterprise. Moreover, the condition that the actual perpetrator may not be identifiable by reason of inadequate organization has to be fulfilled. This lack may be due to negligence or intended through the organization in place.[238]

Most important though is the fact that parliament has introduced *primary liability* of the enterprise with para. 2 (besides the principle of subsidiary liability of the enterprise). This construction is based on deficient organizations as the decisive point of attachment.[239] The primary liability of the enterprise is limited to certain offences, such as participation in a criminal organization (Art. 260ter CC), financing of terrorism (new Art. $260^{\text{quinquies}}$ CC), money laundering (Art. 305bis CC), as well as offences of bribery of Swiss and foreign public officials (Arts. 322ter, $322^{\text{quinquies}}$ and 322^{septies} CC).[240] In any event the position which the offender occupies within the enterprise is irrelevant; any employee may be liable, and no intention or act by the enterprise itself is required. The proposed maximum fine of five million francs corresponds to the current maximum fine for natural persons.[241]

The decision was taken on 7 June 2001 by the National Assembly to delete the original proposal for liability where there is an act contrary to Art. 305ter CC. A very close vote (one vote difference) was also taken by the Assembly of the Cantons in October 2001 against the opinion of the Federal Council and the majority of the commission (which only came about through the casting vote of the parliamentary president), precluding the liability of the enterprise for breach of Art. 305ter CC.

In Switzerland there are already extra-criminal law measures that can be

applied to enterprises. They are mentioned here to give a whole picture of the possible sanctions. Under the current Criminal Code the sanction of confiscation of patrimonial assets (arts. 58 and 59 CC) applies to enterprises as third parties, but not as perpetrators of the offence. The sanction here is not *in personam*, but *in rem*.[242] Under article 52 of the Swiss Civil Code, the law defines that companies and entities that have an illegal purpose cannot acquire legal personality. Therefore, they must be dissolved and their assets transferred to the community (Art. 57, para. 3 Civil Code).

Furthermore, administrative law[243] deviating from the Criminal Code in Art. 6 para. 3, envisages criminal sanctions in certain circumstances being applied at least in connection with the guilty (executive) body, member of the executive body, managing director, the person who is *de facto* running the entity or liquidator. On a private law basis there is again the possibility of a conventional penalty being agreed, such as envisaged by the Agreement on the Swiss banks' code of conduct (CDB, 2003),[244] where a serious lack of due diligence could result in a conventional penalty of up to SFr.10 million. According to the Swiss Banking Association's Report, between 1998 and 2001 the Supervisory Board imposed a fine of SFr. 500 000 and in 31 out of 61 cases the fines must have been well over SFr. 10 000.[245]

The Swiss legislator by passing the Money Laundering Law in 1997 added an in-between form to the state penalties (in the form of a criminal, or an administrative law) and the purely private sanctions (by means of a conventional penalty and other measures in relation to laws of associations). Under this legislation, private law organizations were required to establish appropriate sanctions for contraventions of the Money Laundering Law in which their membership might engage, and also in case of breaches of the regulations the private law organization itself might have passed.[246]

4 Ancillary offences

Possible predicate offences are not only crimes that have been carried out or attempted, but also preparatory acts, where they are designed to help in the execution of any of the following criminal offences: wilful homicide (Art. 111 CC), murder (Art. 112 CC), grievous bodily harm (Art. 122 CC), robbery (Art. 140 CC), kidnapping (Art. 183 CC), taking of hostages (Art. 185 CC), arson (Art. 221 CC), genocide (Art. 264 CC). If any of these offences are to be carried out in Switzerland and the preparations are carried out abroad these would also be subject to Swiss criminal law provisions.[247]

As already mentioned, in 1994 in the second packet of measures – together with the revised law on confiscation and the additions to Art. 305ter (lack of diligence in financial business) also introduced Art. 260ter through the obligation to notify.[248]

The law defines an organization as criminal, where it pursues the aim of

committing a violent crime or enriches itself through criminal means. It punishes in Art. 260ter, paras. 1 and 2 any participation in a criminal organization or any support of such organization. The penalty envisaged is imprisonment for up to five years. According to Art. 260ter s. 3 CC, if the offence is committed abroad this is also punishable in Switzerland if the organization carries out its criminal acts wholly or partly in Switzerland or intends to do so.

Before this provision came into effect, the only definition of organized crime existed in the 1973 legal assistance treaty between Switzerland and the USA.[249] The introduction of the offence of participating in a criminal organization into the Swiss Criminal Code, collapsed some years later with the revision of the violence offences in 1981. Only towards the end of the 1980s was there acceptance that it is of paramount importance in terms of effective international legal assistance, to include criminal organizations in the criminal law.[250]

Thus the significance in practical terms of Art. 260ter was above all in relation to international legal assistance in criminal matters,[251] and this provision closed an important gap because legal assistance is related to dual criminality considerations.[252]

The implications of deciding that a criminal organization is involved, are several. Along with FATF member countries such as Canada, France, Germany and Luxembourg,[253] Switzerland has a provision making it a qualified case of money laundering, where money is laundered by a member of a criminal organization – and this provision existed even before Art. 260ter CC had been introduced.[254]

Moreover, in cases of confiscation, no proof is required that the property being laundered constitutes the proceeds of an offence, and it is sufficient if the property belongs to a member of that criminal organization, even if it has a legitimate origin. In the case of assets belonging to a person either who belongs to a criminal organization or who supports it, the supposition is that he has power to dispose of the property on behalf of the organization until the contrary is proved.[255]

In addition to money laundering, the offence of corruption has also developed into a subject of international criminal law policy. In several international organizations various conventions have been drawn up. One of the earliest with a broad scope of applicability is the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Switzerland signed the convention on 17 December 1997 and its ratification and implementation was approved by parliament on 22 December 1999. In order to be able to do this, a reform of the law was required which entered into force on 1 May 2000. The provisions of the Swiss Criminal Code dealing with bribery have been revised and reorganized under a new 'Title Nineteen' entitled 'Bribery'. The main modifications are the changing of active bribery into

a serious indictable offence the same as passive bribery. This modification entailed an extension of the period for criminal prosecution as well as the application of the law on money laundering. Moreover, a new offence in relation to the bribery of foreign public officials (Art. 322^{septies} CC) has been introduced, which corresponds to bribery of Swiss public officials (Art. 322ter CC). Until the new law entered into force, Swiss law did not formally cover all cases where the advantage granted to the public official was granted for the benefit of a third party.[256] This is now remedied by article 322ter CC (and article 322^{septies} CC for the bribery of foreign public officials).[257]

Another new development – which has already been mentioned – was the introduction of the terrorist financing provision.

It is important therefore to note that money laundering, once exclusively defined as the laundering of proceeds from illicit activity – primarily drug trafficking – is now being expanded to include funds used in the financing of terrorism or payments made for corrupt purposes.[258] These funds may not originate from illicit activity, a requisite element of most money laundering offences and the transaction patterns inherent in terrorism funding may not correspond to common money laundering techniques. Financial intermediaries will find it extremely challenging to comply with this forthcoming legislation.

5 Seizure and forfeiture

In connection with the creation of the money laundering norm 1989/90, the concurrent necessity of revising the regulations in respect of confiscation became apparent. For political reasons it was however decided to do this separately. The revision was therefore put into the so-called ‘second packet of measures to combat organized crime’.[259]

One of the main problems in money laundering cases is the difficulty of linking the proceeds to specific prior criminal activity, and of proving to the criminal standard that the defendant has engaged in prior criminal conduct from which he has profited or obtained certain property. Even before the international introduction of money laundering as a criminal matter, these difficulties were already an issue at the International Conference on Drug Abuse and Illicit Trafficking at the United Nations in 1988, where the forfeiture of the tools and proceeds of illicit drug trafficking were one of the targets.[260]

In line with most of the FATF member countries,[261] Switzerland has given close consideration as to how to make its confiscation systems more effective. The revision in 1994 has led to a tightening of the relevant articles in order to strengthen the fight against organized crime.[262] In the current revision of the General Section of the Criminal Code there are no material changes envisaged, only revising the structure of the text into several articles should achieve greater clarity.

The Council of Europe Convention on Laundering, Search, Seizure and

Confiscation of the Proceeds from Crime from 8 November 1990 (No. 141) is authoritative when it comes to confiscation and forfeiture law and sets minimum standards. The State Parties are obliged to confiscate or to ensure that legal assistance is rendered effectively. For Switzerland, the Convention came into force on 1 September 1993. The provisions relating to confiscation in the Swiss Criminal Code are applicable via Art. 333 of that code to the entire federal subsidiary law. If the provisions of the subsidiary laws go further than the federal rules then according to Arts. 58 and 59 of the Criminal Code, they take precedence. So for example, it is possible for the proceeds of drug trafficking from abroad (Art. 24 Narcotics Law)[263] or assets that are derived from administrative crimes (in particular fiscal offences) (according to Art. 2 Administrative Law)[264] to be confiscated.[265]

a Security confiscation (Art. 58 CC)

Security confiscation is an intervention in the right to the free enjoyment of property, which may be justified as being necessary to protect society from offences and dangerous implements.[266] In contrast to the confiscation of assets under Art. 59, security confiscation under Art. 58 covers dangerous tools that could be relevant to the commission of a crime.[267] Objects for confiscation under Art. 58 can therefore only be a physical (moveable but also an immovable) thing, and would also include computer software. Thereby not only are property laws and the law of obligations irrelevant but also any possible existing, limited third party rights in relation to the object to be confiscated. The same applies to confiscation under debtors and bankruptcy law on a compulsory order obtained abroad.[268] If the security confiscation measure is also a security policy measure,[269] then this measure is only possible where there is a sufficient connection to the crime. What is not disputed is that the confiscation of objects that are in Switzerland are also able to be confiscated even if the offence was committed abroad. The academic literature takes differing stances on this point and practice requires that there has to be a point of attachment according to Art. 3 *et seq*. CC, other opinions cite the Council of Europe Convention 141 where dual criminality is sufficient.[270]

b Confiscation of assets (Art. 59 CC)

This Article provides in fig. 1 para. 1 that 'the court shall order the confiscation of patrimonial assets derived from an offence or which were intended to persuade or reward the perpetrator of the offence, if they do not need to be restituted to the victim in re-establishing his rights'.

The phrase 'patrimonial assets' as used in Art. 59 covers not only property such as money, precious metals, jewels, real estate etc., but also all property or

pecuniary benefits, that are of economic value (such as a bank balance, securities etc.). The advantage does not have to be immediate but can also be something that is deferred to the future. This means that all pecuniary benefits are included that involve future cost savings for the person in question, the receiving of services, or where services do not have to be rendered by the person himself. In any event these intangibles have to be capable of being calculable, so that mere promises or undertakings are insufficient.[271]

According to the phrasing of the law, confiscation is a matter of judicial discretion and is primarily a practical measure. Although the Supreme Court has decided however, that confiscation is compulsory.[272] The real pecuniary punishment is revealed, when for example the Supreme Court speaks in terms of the repressive character of confiscation.[273] The function of confiscation is therefore to deprive comprehensively: Crime should not pay.[274]

A central point of the revision of 1994 was the introduction of provisions that permit the enforcement of the substitute claim, an option open to the state when the property to be confiscated from an offender or a third party who has not obtained it in good faith, is no longer to hand (fig. 2, para. 1). The authorities are permitted – with this particular provision in mind – to confiscate other property from the person concerned as a temporary form of security (fig. 2., para. 3).

A further new provision permits the extent of the property to be confiscated to be estimated when its precise scope is not ascertainable or it could only be done at unreasonable expense (fig. 4).

Along with other FATF member countries such as Austria, Canada, France, Germany and Luxembourg, Switzerland has a provision making it an offence to launder money for a criminal organization (Art. 305bis fig. 2 para. 2 lit. a CC).[275] The central point of the new law on confiscation is the basic principle that where the property of a criminal organization (according to Art. 260ter CC) confiscation should be possible without having to prove in detail from which specific crime the property was derived or through which it was acquired (fig. 3). The fact that property is under the control of a criminal organization is sufficient for it to be tainted by association, even if it has purportedly been obtained legally.[276]

This form of confiscation – that attaches regardless of the provenance of the means – was incorporated in 1995 as a ground breaking novelty by the UN in its model legislation on money laundering.[277]

If a person is convicted according to Art. 260ter CC, the supposition will be that his property is under the control of a criminal organization. If the convicted person seeks to dispute this, he bears the burden of proof. This law also facilitates the provision of legal assistance where decisions on confiscations have been taken abroad. Switzerland can execute a foreign judgement, so for example property belonging to a foreign drug cartel, which is in

Switzerland, can be confiscated although no criminal prosecution can be brought because Switzerland lacks responsibility in legal terms.[278]

Also, the right to dispose over property in relation to an asset is not to be put in legal, but in economic terms,[279] insofar as the importance of ascertaining the beneficial owner will be clear because only on the basis of these specific attributes can action be taken.

c Confiscatory seizure

This compulsory measure concerns those objects that may be confiscated as a security measure or as illegal property, and aims to prevent – as a pre-emptive measure – the accused from hindering the confiscation or security measure by selling or concealing the property.[280] This provision covers the patrimonial assets that have been obtained as a result of the crime (*scelere quaesita*), or also that serve the crime (*pretium sceleris*).[281]

In order to confiscate property in a criminal procedure concerning money laundering under Art. 59 CC, there has to be a strong suspicion that a crime is imminent. This means that according to the current state of their investigation, the prosecuting authorities have to have sufficient grounds to confiscate, which they can later justify, if so required. A simple suspicion, or a mere supposition is not enough. In addition, in money laundering cases the strong suspicion also has to relate to the criminal nature of the predicate offence (as per Art. 9 para. 1 CC).[282] These requirements must therefore be recorded in the decision or the decree on confiscation. Which not surprisingly, can entail problems right at the start of the case for the prosecution.[283]

6 Statistics

According to the police data of the Canton of Zürich, investigations into money laundering cases have a very high clear-up rate, because the investigations are always based on indicators in relation to specific people.[284]

In the period 1991–97, there were 243 verdicts handed down in relation to money laundering (Art. 305bis CC), and with only two judgements in 1991 and 57 judgements in 1997 the trend is clearly that prosecutions are on the increase.[285] According to the MLRO's statistics, the sanctions that have been imposed are significant in that in 40 per cent of the cases a term of imprisonment of several years has been imposed. This is partly explicable by the fact that even in minor cases of money laundering sentences are also imposed in respect of other more serious crimes.[286]

Overall, the statistical information in relation to the criminal prosecution and court practice on money laundering is not very informative, which is the reason why the Federal Police are planning a comprehensive study that will analyse the cantonal Courts – and the Supreme Court decisions on money

laundering, and will also look at the notification and reporting procedures and practices of the financial intermediaries.[287]

Between 1991 and 1997 there were only two convictions on lack of diligence in financial business (Art. 305ter CC), and since the provision criminalizing organized crime has been in force there have been just 10 convictions for offences against Art. 260ter CC.[288]

III INTER-CANTONAL AND INTERNATIONAL CO-OPERATION

International co-operation takes place on two levels. On one side is mutual legal assistance in criminal matters and on the other is direct co-operation between administrative authorities regardless of pending or foreseeable court proceedings. Both mutual legal assistance and administrative assistance appear to be increasingly used as instruments for reaching similar goals. This is particularly true in the finance market; supervisory authorities today use functions that also support resistance to money laundering, while the role played by the criminal authorities also belongs to protecting the functioning of the market.[289] Legally speaking, international mutual legal assistance and administrative assistance belong to international legal proceedings assistance. International mutual legal assistance, however, is in principle carried out according to the rules of criminal procedure.[290]

A Mutual Legal Assistance

1 Inter-cantonal co-operation

Until 1992 mutual legal assistance inside Switzerland was the normal mode of co-operation. Thereafter Switzerland found ways to establish a ‘Switzerland of judges’; the adoption of the ‘Concordat on Mutual Legal Assistance and Inter-cantonal Co-operation,’ dated 2 November 1992, empowers investigatory and judicial authorities to directly intervene in other Cantons on the basis of their own law and to engage the local police and use their official procedural language. In ordinary cases, they would inform the authorities of the Canton where the enforcement action will take place prior to the action, but in matters of urgency they may intervene directly without prior notification.[291] Nevertheless, the local competent authorities, in every case, would be informed at least *post factum*. Moreover, their consent is required pursuant to Art. 6 of the Concordat.

2 International co-operation

‘International mutual legal assistance’ encompasses all measures used by the

authorities of a state to facilitate the enforcement of criminal standards in a foreign country. It particularly involves the extradition of accused persons, measures for assisting foreign criminal proceedings (in Switzerland known as 'ancillary', 'small' or 'other' mutual legal assistance), acting on behalf of the criminal investigation authorities, and the enforcement of foreign criminal judgements.[292]

Accessory mutual legal assistance is primarily comprised of examining witnesses, persons with information, accused persons, or confrontations. Moreover, evidence can be surrendered or secured, searches and seizures can be carried out, official orders such as summons, judgements and other judicial action can be issued, as well as assets being surrendered.[293]

As discussed above in part II, under Swiss law, participation in a criminal organization and money laundering are also punishable offences when a related prior offence was committed in a foreign country. Thus, the Swiss authorities can also include proceeds from such related prior offences when they are found in Switzerland. A considerable portion of proceeds seized actually involves proceeds from crimes committed on foreign territory.[294]

In the context of the proactive fight against money laundering, however, the tendency, at least in certain Cantons, of opening multiple local money laundering proceedings by a request for mutual legal assistance (bypass system) has been observed.[295]

Switzerland receives requests for mutual legal assistance in approximately 1500 cases each year.[296]

a Legal framework

The main sources of Swiss law in the area of mutual legal assistance are the Federal Act on International Mutual Assistance in Criminal Matters ('IMAC')[297] and the related Ordinance,[298] together with various international treaties.[299]

In essence, the function of IMAC is to outline standards of optional legal assistance independently of bi- or multilateral treaties and to define the competencies and internal procedures of federal and cantonal authorities regarding mutual legal assistance. It also regulates international mutual assistance in a broad way, including extradition, 'ancillary' assistance, prosecution on behalf of a foreign country, and execution of foreign judgements. Whereas treaties impose obligations on Switzerland, regulation by national law allows a unilateral approach.[300]

In the aftermath of the Second World War, Switzerland ratified the European Convention on Extradition of 1957,[301] on Mutual Assistance in Criminal Matters of 1959,[302] and the European Convention on Human Rights.[303] In addition, Switzerland ratified other specialized multilateral

treaties containing provisions on mutual legal assistance and extradition (for example, on hijacking (1979) and on money laundering, search, seizure, and confiscation of proceeds from crime (1990)). Apart from these conventions and multilateral treaties, several bilateral treaties, in particular with neighbouring countries, that complement the European structure, as well as treaties on double-taxation have been concluded.[304]

Since the Mutual Legal Assistance Treaty with the USA[305] was concluded in 1973, predating the IMAC, Switzerland enacted a separate law for its implementation.[306] For the USA, this was an important element in their struggle against drug trafficking and the infiltration of organized crime into legal companies.[307]

In principle, IMAC has a subsidiary application in relation to existing treaties. The law becomes a primary basis when Switzerland voluntarily provides mutual legal assistance without an inter-state basis for the provision of mutual legal assistance existing.[308]

As the legislation at first attempted to preserve as much of the local rights – procedural legislation being a cantonal competence in Switzerland – as possible, the consequence was a procedure that was notoriously slow and inefficient.[309] The concept of the protection of individual rights – the orientation of legal protection toward the individual – inevitably brought with it a certain heaviness. This burden grows as the relevance of administrative co-operation increases, since the classical distinction in international relations between mutual assistance in criminal matters and mutual administrative assistance has become blurred. After a series of important cases with a high degree of visibility involving Heads of State (Haile Selassie, the Shah of Persia, Ghandi, and especially Marcos), and an influx of requests from Italy concerning corruption cases, the Swiss government decided to amend IMAC.[310]

In February 1997 the revised text entered into force bringing with it some major changes. The mutual legal assistance procedure, to a large extent, has been nationally unified and appeals have been drastically reduced by only allowing an appeal against the final decision, except for a limited number of appeals against incidental decisions that might entail irreversible damage.

Rules on the surrender of objects and funds have also been changed in order to allow early release (possibly imposing conditions) even before a final court decision by the requesting country has been delivered.[311] In fact, it is now sufficient when a future application is announced by phone call.[312]

Article 18 IMAC states[313]:

1 At the express request of another state, the authorities responsible may order interim measures to maintain the existing situation, to safeguard legal interests subject to threat, or to secure endangered evidence, provided the procedure provided for by this Act does not clearly appear to be impermissible or unsuitable.

2 If there is a prospect of danger and there is sufficient information available to assess the requirements, these measures may also be ordered by the Federal Office as soon as notice is given of an application. Such measures shall be suspended in the event that the foreign state does not file an application within the stipulated period.

3 No appeal against a decision made under this article shall have the effect of suspending the proceedings.

The concept of precautionary measures – statutorily regulated since the 1997 amendment of IMAC – has already been used during several 'dictator cases' in the past decade.[314] For example, it was first used in a case involving the former Philippines ruler, Ferdinand Marcos, and those in a close circle around him. Shortly thereafter, it was used in a case involving the former Haitian ruler, Duvalier.[315] Their accounts were then blocked by the Federal Council, based upon its power to safeguard Swiss interests in foreign affairs granted by the Swiss Constitution.[316]

Furthermore, since the 1997 amendment, Swiss authorities could voluntarily (without presentation of a request for mutual legal assistance) forward information on illegal foreign assets and evidence that become known during criminal investigations in Switzerland to foreign criminal investigation authorities so that they can initiate or deepen a criminal investigation.[317] The Federal Supreme Court has denied the possibility of appeal in this regard and has also established that the affected party need not be informed of the transfer of information – entirely within the spirit of a goal-oriented, un-bureaucratic, and swift information exchange.[318]

b International mutual legal assistance against money laundering: the responsible authorities

Pursuant to Art. 16 IMAC, the provision of international mutual legal assistance is the responsibility of the Cantons, which apply Federal law as well as cantonal standards (in particular, cantonal procedural regulations).

The Federal Office of Justice,[319] however, has the duties of leading, negotiating, and deciding. It can also task the federal prosecution office with the execution of mutual legal assistance from foreign proceedings, which would have been within their area of responsibility if it had taken place in Switzerland.[320]

Since the 1990s the Federal Prosecution Office has often been used, because its area of competence is very broad based upon the statutory basis. Since the so-called 'Efficiency Regulation' ('*Effizienzvorlage*') took effect on 1 January 2002, the number of criminal acts for which the Federal Prosecution Office is responsible has further increased.[321] Pursuant to the new Art. 340bis of the Criminal Code, organized crime, economic criminality, corruption, and

money laundering are the subject of federal jurisdiction under certain conditions. Moreover, Art. 7 of the Federal Act on the Central Authority of the Police gives new powers to federal authorities through which they can be entrusted with the hearing of evidence in the context of mutual legal assistance proceedings.[322]

As for mutual legal assistance in relation to the USA, the Federal Office is responsible in all cases.[323] This applies even to cases that are not based on a treaty, but rather in the IMAC, such as requests regarding tax fraud.[324]

c Key features: restrictions and exceptions

Several key features of the Swiss rules on co-operation must be mentioned: dual criminal liability[325]; refusal of co-operation on the grounds of political, military, and economic crimes; the principle of speciality,[326] a preference for domestic law enforcement[327]; and non-extradition of nationals.[328] These principals were developed in the 19th century, when extradition was at the forefront of mutual legal assistance in criminal matters in foreign countries.[329] Similarly, no mutual legal assistance is provided when basic freedoms and human rights are violated in the foreign proceedings,[330] when the foreign proceeding is disproportionate to the act at issue, when the criminal claim ceases, or when the provision of mutual legal assistance would violate the Swiss *ordre public*.[331]

Moreover, Switzerland does not provide mutual legal assistance in fiscal matters or in matters regarding injury to currency, trade, or economic political measures,[332] although it will do so in matters involving tax fraud.[333] This principle is based upon the distinction between simple tax evasion and tax fraud, which is integral to the Swiss legal system.[334]

a The Distinction Between Tax Evasion and Tax Fraud . . .

Fraud in connection with taxes is addressed in three different federal laws. In the DBG[335] and StHG[336] tax fraud is characterized as an offence by commission (*Tätigkeitsdelikt*), while for the remaining federal taxes – indirect and withholding taxes – administrative criminal law requires a success (*Erfolgsdelikt*).[337]

A person who is under a duty to pay taxes but improperly causes an assessment to not occur or causes a final incomplete assessment (because for example, the tax declaration forms are false or incomplete), commits tax evasion.[338] A person who for the purpose of tax evasion uses falsified or substantively untrue documents commits tax fraud. The tax declaration is not itself a document in this context. On the other hand, the statute lists as examples company accounts books, balance sheets, profit and loss statement, or earnings statements and

other third party documents – to which bank statements also belong.[339] This broad description of the term 'documents' leads to the case that, whenever in the context of tax evasion balance sheets and profit/loss statements are submitted, the objective elements of tax fraud are fulfilled at the same time.[340]

Fiscal fraud (*Abgabebetrug*) (in the context of indirect or withholding taxes) occurs when a significant sum is involved (at least SFr. 15 000)[341] and deceptive behaviour ('fraudulent manoeuvre') is involved.[342] Pursuant to decisions of the Federal Supreme Court, the criteria for European common law fraud under the Criminal Code is transferable to fiscal fraud.[343] Also, cases involving the submission of inflated invoices and kick-backs qualify as fiscal fraud.[344] Additionally, it has been determined that the use of shell corporations to evade taxes could well be a fraudulent manoeuvre, although shell corporations are not an automatic indicator of fraud.[345]

b . . . and the Consequence of this Distinction in the Context of Mutual Legal Assistance

In the context of money laundering and the possibility of mutual legal assistance it is crucial to ensure that, in accordance with the Swiss legal system, not only tax evasion, but also tax and fiscal fraud are crimes under the Criminal Code, sanctioned with a prison term or fines and not with penitentiary. With this, these offences do not constitute a related prior offence to money laundering, since under Art. 305bis Criminal Code only a felony can be a related prior offence. Regarding tax fraud, the 2003 revision of the FATF Forty Recommendations is relevant in that smuggling has now been introduced as a predicate offence. Switzerland's interpretation of smuggling is that only the more serious form of tax fraud (*Abgabebetrug*) is to be understood thereunder; tax fraud, as conducted by criminal organizations on a large scale[346] and involving large sums.[347]

The same also applies to offences involving documents (*Urkundendelikt*) that are committed solely for tax purposes, since they are absorbed by the tax criminal law standards. Because of this the requirement of mutual criminal liability is not fulfilled, which hinders all mutual legal assistance regarding money laundering concerning the proceeds of tax offences – including also immediate or future saved taxes.[348]

ETS No. 141 also does not change this, since the treaty leaves the definition of the related prior crime of money laundering to national law.[349]

There are three exceptions to the principle that Switzerland will not provide legal assistance in fiscal matters; first, pursuant to Art. 63 subsec. 5 IMAC regarding the defence of the accused on the basis of a written waiver; second, in relation to the USA, in cases of involvement in organized crime (Art. 2, No. 2 TUS)[350]; and third, in cases of fiscal fraud (Art. 3 subsec. 3 IMAC).

For qualification of the accused behaviour as fiscal fraud only the Swiss view is decisive.[351]

As Art. 3 subsec. 3 IMAC only provides that Switzerland 'may' grant mutual legal assistance in the event of tax fraud, the Federal Court went beyond it and stated in 1991 that Switzerland is obligated to grant mutual legal assistance if the preconditions therefore are fulfilled.[352] Seven years later, this obligation was for the first time explicitly set out in an agreement on international co-operation between Italy and Switzerland.[353] When all prerequisites are fulfilled, the competent authority must implement the measures foreseen in the IMAC – to which belongs, in addition to others, the revocation of bank confidentiality.[354]

In order to increase the ability to grant mutual legal assistance, the Federal Supreme Court has extended the domestic limitation of tax fraud to the use of specific fraudulent means such as falsification of documents and qualified false documentary statements.[355] It is not a requirement for fiscal fraud, however, according to the view of the Federal Supreme Court, that false or forged documents be used, but rather also other cases of fraudulent misrepresentation to the tax authorities are conceivable, for example through a combination between the taxpayer and third parties that is not transparent to these authorities.[356] Nevertheless, it still requires somewhat more than simply lying to the tax authorities. The use of shell corporations, for example, though not an automatic indicator of fraud, could be a 'fraudulent manoeuvre'.[357] On the other hand, in certain circumstances even mere silence may be deceptive, when the deceiver prevents the deceived from possible scrutiny or foresees that he will forego scrutiny because of a particular confidential relationship.[358] Because of the extensive case law of the Federal Supreme Court, the relevance of the distinction between tax fraud and tax evasion is diminishing in practice.[359]

The main practical difficulty is the substantiation of requests; they must be as precise as possible since the Swiss authorities reject mere 'fishing expeditions'. [360] Moreover, although the authorities generally do not discuss whether an accusation was well-founded, in relation to tax fraud the requesting state must specify whether tax fraud or tax evasion is suspected and must also provide significant grounds for its suspicion, detailing the qualified forms of fraudulent behaviour at issue.[361]

In any event, no mutual legal assistance will be provided for acts that are directed toward a reduction or unjustified reimbursement of taxes when the elements discussed above – document falsification or lying for the purpose of intentionally and deceptively misleading the tax authorities – are present. A mere non-declaration of income or assets in tax proceedings does not qualify as fiscal fraud.[362]

In the event, the Swiss view in this respect is changed in the future, so that

tax evasion also qualifies as fiscal fraud, the provision of mutual legal assistance would be absolutely required – according to the view today – also in cases of tax evasion. Such an extension of the term 'fiscal fraud' requires, however, a statutory amendment.[363]

Regarding subsidy fraud, it must be clarified that it will not even be considered as a fiscal issue. Indeed, Swiss authorities have limited the meaning of *fiscal affaires* to the receipt side; to taxes, customs levies, and other public law payments due to the state. Therefore, subsidy fraud and crimes related to the expenditure side are not encompassed by the restrictions of Art. 3 subsec. 3 IMAC. Thus, according to the concept of dual criminal liability, mutual legal assistance will usually be provided.[364]

The current *Schengen Acquis* of the European Union do not yet address mutual legal assistance regarding direct taxes. However, in connection with the further development of the Schengen Acquis by the EU, it is likely that in the future the EU will also regulate mutual legal assistance for direct taxes. This will lead to renewed complications; already the current form of the Schengen rules contain an innovation for Switzerland that it must provide mutual legal assistance in the area of indirect taxes even in cases other than fiscal fraud. After the adoption of an expanded *Schengen Acquis*, Switzerland in the future must provide mutual legal assistance also in cases of excise duties, VAT, and in the area of customs, and, new in this area, also ensure extradition. In the case of an offence amount of less than Euros 25 000 or 100 000, however, mutual legal assistance is excluded because the case is considered minor.[365]

d Principle of favourability (Günstigkeitsprinzip) and dual criminal liability, principle of proportionality, and forbidden 'fishing' for evidence

In principle, mutual legal assistance and extradition are to be granted to the extent possible, even if the described criminal act would not be punishable in Switzerland.[366] This position, which has been significantly developed by the international community of states in the past few years, can also be described by the phrase, '*in dubio pro rogatoria*'.[367] As a rule, the requested authority refrains from decisions regarding guilt and questions of fact. Furthermore, the depiction of the facts by the foreign authorities is binding on the Swiss authority to which the request is made, unless the depiction contains apparent mistakes, gaps, and inconsistencies that make the request for mutual legal assistance appear tainted.[368]

However, compulsory measures can only be applied under the assumption that the committed act would also be punishable in Switzerland.[369] An example of a consequence of this is that bank confidentiality can only be revoked when dual criminal liability exists.

For this assumption it is sufficient that the particulars of the charge would fulfil the *actus reus* of any offence penalized in Switzerland.[370] It is not necessary, however, that an identical provision exists.[371] In addition, the foreign criminal law provision need not protect the same legal interest as the Swiss one: for the granting of mutual legal assistance it is not necessary that the protected legal interest be identified.[372] It is sufficient that the facts set forth in the request for mutual legal assistance at the time of the compulsory measures are encompassed by any common law criminal provision under Swiss law.[373]

Evidently the predominant doctrinal view as well as in legal decisions is that the examination of dual criminal liability as a correlate of the principle of favourability (*Günstigkeitsprinzip*) is to be given an extensive interpretation.[374]

The condition of dual criminal liability in combination with the principle of favourability is problematic in two ways: on the one side new provisions are brought into the Criminal Code in a legislative way with the main goal of increasing the ability to provide mutual legal assistance – and only secondarily based upon criminal political considerations. On the other hand, the pressure to be able to provide mutual legal assistance also influences courts in the interpretation of existing provisions.

This results in an international harmonization of national criminal law provisions. Accordingly, Swiss legislators enable mutual legal assistance with the – in regard to mutual legal assistance stop-gap – introduction of the following new offences in material criminal law: insider trading (Art. 161 CC), stock price manipulation (Art. 161bis CC), and offences by criminal organizations (Art 260ter CC).[375] The tendency toward international harmonization would be further strengthened if the principle of norm identity (*Prinzip der Normidentität*) received wide recognition.[376]

As for the application of the law, the pressure to be able to provide mutual legal assistance increases the tendency that offences under the Criminal Code will be expansively interpreted in mutual legal assistance proceedings (as previously described in the example on tax fraud). This is also the case when the offence only has marginal meaning for Swiss criminal law. It can even result in interpretation variations between the practical application in mutual legal assistance and criminal law matters – all the more as the Federal Supreme Court adjudicates as an administrative rather than a criminal instance in mutual legal assistance matters.[377] Further, this pressure can lead to the principle of dual criminal liability being questioned; and some advocate its elimination.[378] This would be, in principle, possible, since the principle is not binding under international law.[379] The European Council Treaty (Art. 5 EUR) for example, leaves it to the contracting states whether they wish to proceed thereupon or not.

There is a criminal and legal political argument in favour of maintaining dual criminal liability; according to this it is illegitimate to actively assist in the prosecution of behaviour in another country through mutual legal assistance, when that behaviour is legal in one's own country or at least not seen as criminally punishable or is subject to mild criminal punishment.

Contrary to this in particular, is the pragmatic stance of international criminal political commonality; mutual legal assistance is generally provided for the purpose of a criminal proceeding, at a point in time when there is typically no certainty regarding the criminal law relevant conduct and the criminal law provisions to be applied, as well as when nothing can definitively be stated regarding the criminal liability.[380]

With regard to the provision of mutual legal assistance in cases of money laundering, based upon the previous discussion, the application of compulsory measures for fulfilling a request for mutual legal assistance is only possible when the corresponding objective and subjective elements of the offence are fulfilled.[381] The condition for dual criminal liability is only fulfilled when the prior related crime of money laundering qualifies as a felony as foreseen under Art. 9 subsec. 1 CC. In practice, the Swiss authorities make an effort, however, to find the required qualification under Swiss law, which satisfies the condition for dual criminal liability.[382]

The condition for dual criminal liability would be fulfilled when the request for mutual legal assistance for a criminal proceeding due to the laundering of proceeds from a foreign principal criminal act is made by a country where money laundering is not criminally punishable, since pursuant to Art. 305bis subsec. 4 CC money laundering is also criminally punishable when the prior related offence was committed in another country – under the condition that Swiss law also foresees criminal liability.

On the other hand, the condition for dual criminal liability is not fulfilled when mutual legal assistance due to negligent money laundering is requested. Swiss law penalizes only intentional or indirectly intentional money laundering.[383]

Particularly in cases of criminal organizations and money laundering, the criminal law investigation usually involves expanded investigation regarding all possible objectively connected financial transactions (so-called 'paper tracing').[384] During the execution of a foreign request regarding money laundering or criminal organization it may become necessary to allow the surrender of the documentation of dozens of accounts. In this regard the question often arises regarding the proportionality of the co-operation to be provided, especially regarding the protection of uninvolved third parties.

Usually the density and complexity of the activities and financial transactions to be examined is so high that an extremely broad investigation appears to be justified. In consideration of the danger connected with a forbidden fishing

expedition,[385] a careful distinction must be made between this danger and the need for a broad examination.[386]

e Assets: Seizure, confiscation and surrender in the context of mutual legal assistance

In the context of mutual legal assistance, the following legal measures are also possible: confiscation, the temporary or final surrender during mutual legal assistance or extradition (of objects) proceedings, as well as seizure and impoundment as provisional measures.[387]

These instruments pursue the following goals:

- criminal offenders and organizations should have the proceeds of their crimes withheld from them, so that do not benefit from their crimes and so that they cannot pursue them further
- property should be reinstated to crime victims or they should be compensated for their loss
- objects should be made available as evidence for foreign criminal proceedings.

The new regulation regarding the surrender of assets was one of the main purposes of the 1997 amendments. Since then a distinction is made between surrender for the purpose of providing evidence[388] (*séquestre probatoire*, normally with eventual return to Switzerland) and surrender for the purpose of confiscation or return to the rightful party in a foreign country (*séquestre conservatoire*).[389] A third possibility is the surrender of assets (and objects) in the context of an extradition proceeding.

The introduction of this distinction was necessary because the surrender of assets is not regulated internationally. Thus, there was always a question as to whether Art. 3 of the European Mutual Legal Assistance Treaty covers evidence seizure along with confiscation. These gaps were also not removed by the treaty on money laundering, as well as investigation, seizure, and confiscation of proceeds from criminal acts. It does provide precautionary measures (whereby far-reaching reservations in favour of domestic law are allowed); but it only regulates support for investigations, and with regard to the confiscation of criminal money, not its surrender.[390]

The legislative solution of surrender for return or confiscation is significantly derived from the solution of the Federal Supreme Court in two well-known cases, PEMEX[391] and Marcos.[392] The earlier IMAC provisions were too imprecise for the Federal Supreme Court, which is why they made them far more specific.

The regulation applicable today provides that a state that is requested to,

may surrender assets that are subject to confiscation[393] to the requesting state for the purpose of the confiscation and for return to an injured party. This can take place in connection with an extradition or on its own.[394] As accessory mutual legal assistance, it is usually only first allowed when a final and enforceable decision exists,[395] while in the case of the extradition of objects – that is, regarding those objects that are found with the person to be extradited[396] – is possible at any time, without the need for a relevant foreign resolution.[397] In addition, the extradition of objects is available and can be executed without a specific request therefore.[398]

Nevertheless, there are two concessions to the condition that a final and enforceable decision must exist. First, it need not always involve a final and enforceable judgement, but rather can be surrendered before this, for example, when a simple type of order such as a confiscation notification exists. Additionally, the condition is not obligatory; in particularly clear cases, no notification is required.[399]

The party of whom a request is made can freely choose whether it wants to conduct the confiscation or whether to enable the confiscation for the foreign state through surrender or execution of the corresponding confiscation notification in the context of an international mutual legal assistance proceedings.[400]

Assets or objects under Art. 59 subsec. 1 (extradition of objects) can be retained in Switzerland for as long as they are required for a criminal proceeding taking place in Switzerland and for a separate confiscation proceeding.[401] Indeed, principally national measures remain in reserve.[402] Since, however, criminal proceedings in different countries often take place at the same time against criminal organizations and money launderers and therefore numerous requests for the extradition of the same assets (and objects and the same accused persons) are submitted, decisions must be reached on the priority of the requests received concerning the extradition of objects.[403]

If the request for surrender from the foreign authorities is aimed at restoring property to the injured party, it will usually be complied with.[404] In cases where there is no direct injured party (for example, regarding proceeds from trafficking in drugs or human beings), the assets must be collected in accordance with national law.[405] In this case, the foreign request for surrender for the purpose of confiscation will not be satisfied, since confiscation by the Swiss authorities has priority.

f Sharing

In cross-border matters, it has been established through practice that judgement in the case will be completely left to the justice system of one country, while the authorities of the other country, through the use of sharing – that is, the division of the assets collected – will participate in the proceeds.

This process has its international law basis in Art. 15 of the Council of Europe Convention No. 141.[406]

Since, however, the return of assets often runs up against complex problems, such as the difficulty of defining the circle of those entitled to reimbursement, a federal law regarding the division of collected assets ('TEVG') is being drafted. This law should set out for national as well as intercantonal cases a simple key for division.[407] The key for division foresees, in particular, that even cantons whose work on the matter was limited will receive a share. This should hinder their initiating a confiscation proceeding based upon their jurisdiction over assets situated in their canton.

In the international area, the law should empower the Swiss authorities to enter into sharing agreements with foreign states, when assets are impounded by Swiss authorities in co-operation with the foreign ones (active international sharing) or from the foreign authorities in co-operation with the Swiss (passive international sharing).[408] A division is, in principle, only possible when an adverse right is granted.[409]

The law should also apply when the foreign law does not foresee confiscation, but rather a similar measure. In the USA, for example, independent confiscation has a civil law nature (civil forfeiture).[410] In Germany, on the other hand, the imposition of a property fine (*Vermögensstrafe*) is usually recognized.[411] The determining factor, however, is that it involves a criminal matter within the area of application of the mutual legal assistance law.[412]

At the national law, no figures have been collected on the combined number of seizures and confiscations. Since official statistics do not exist, the Swiss Financial Administration conducted a survey of the cantons in 1998. It does not appear that all cantons answered, nor do there appear to have been uniform survey methods.[413] In any event, there are significant differences between the information provided by the authorities and the numbers reported in the press.[414]

B Administrative Co-operation

1 General

International administrative assistance is the co-operation between administrative authorities of different countries (for example, supervisory authorities, customs and tax administration), independent of ongoing court proceedings. Mutual legal assistance in civil matters is considered in Switzerland to be rather administrative assistance.[415]

Based on the circumstances, it can take place formally (written, adhering to modes of certification, etc.) or without formalities (orally, without adhering to any files, etc.). A request for administrative assistance in written form is essential when it is foreseen that a formal proceeding will be based on administra-

tive assistance that involves the data of customers of financial intermediaries.[416]

The Federal Supreme Court has in the area of bank supervisors again declared that the rules (provisions and legal decisions) of international mutual legal assistance in criminal matters are analogously and logically applicable.[417]

It was noted as a distinctive feature of administrative assistance proceedings – in contrast to mutual legal assistance – that the data protection statute is applicable.[418] This means that the provision of personal data in the context of administrative assistance is encompassed by the term 'data handling' ('*Datenbearbeitung*') within the meaning of the DSG. Personal data in this context is all information related to a certain or ascertainable[419] natural or legal person.[420] In the context of combating money laundering, the documents, information, or reports received from a financial intermediary contain personal data in many respects; it can be about customer data or other information that is not generally available to the public, which does not concern customers but nevertheless can similarly form personal data.[421]

Similar to mutual legal assistance, unsolicited assistance for the benefit of foreign authorities conducting administrative procedures is also possible (so-called 'spontaneous administrative assistance'). Such administrative assistance is based upon explicit agreements (treaties or Memoranda of Understanding), but could also arise from the function of the affected administrative authority and the need for internationally applicable supervision. A legislative basis is not required by the Swiss Federal Supreme Court.[422] Complete legal protection of third parties is neither ensured in the framework of spontaneous mutual legal assistance nor in the practice of spontaneous administrative assistance.[423]

Until now, the Swiss Reporting Office has executed three Memoranda of Understanding; with Belgium, Finland, France and Monaco.[424] With these agreements, the authorities have swift and direct access to case-specific foreign information in the fight against money laundering. The information is used for judging incriminating factors by the Reporting Office. If the suspicion of money laundering is confirmed, the Reporting Office forwards the suspicion report to the federal or cantonal criminal investigation authorities.[425]

2 Sources of law and authorities

As international sources of law, in which administrative assistance in regards to criminal organizations and money laundering[426] is partly regulated, the following can be cited:

- the United Nations Treaty against Trans-National Organized Crime[427]; in addition to an intensification of international mutual legal assistance,

it also envisions new forms of co-operation between non-court authorities.

- The 'Forty Recommendations' of the FATF set out that an efficient programme for combating money laundering should contain improvements to mutual legal assistance, extradition, and multilateral co-operation in investigations and prosecution.[428]

International administrative assistance in the area of money laundering is regulated in Swiss law by federal law special statutes such as the Bank, Stock Exchange, Investment Funds and Casino Commission laws and in particular, by the MLA.[429]

Despite the various legal bases and the variety of functions of the authorities involved, the development of a uniform practice in the provision of administrative assistance for reasons of legal certainty would be desirable. This is becoming more pressing because of the similarly formulated legal bases. Moreover, the administrative assistance practices of the Swiss Banking Commission and the corresponding Federal Supreme Court decisions (which until now concerned primarily the international stock exchange supervisor) have a significant influence on the methods of international administrative assistance in the area of money laundering and criminal organizations through additional federal offices.[430]

The provisions in Art. 31 and 32 of the MLA apply to the Control Authority and the Reporting Office for combating money laundering.[431]

Only the Control Authority, as supervisory authority in the area of money laundering, is allowed to provide information to foreign finance market supervisory authorities. In this regard they are subject to the same conditions as the Banking Commission.

The conditions for the exchange of information by the Reporting Office for Money Laundering correspond to those in Art. 13 subsec. 2 of the Federal Act on the Central Authority of the Police[432] and Art. 10 of the MGwV[433] regulate administrative assistance in regards to the personal data stored in the GEWA system (the computer data bank of the Reporting Office).

This means that the Reporting Office can forward personal data to foreign criminal investigation authorities when a statute or international treaty foresees it, or in the following cases:

- when the information is necessary to avert or clear up a criminal activity in the area of competence of the Reporting Office
- when information for the basis of a Swiss request is required
- when it is in the interest of the affected person and they have agreed thereto or their agreement can be assumed under the circumstances.

The legal basis for administrative assistance by finance market supervisory authorities (in particular, bank and stock exchange supervisory) were created in the supervisory laws by Art. 23^{sexies} of the Federal Law on Banks and Savings Banks,[434] Art. 38 of the Federal Stock Exchange Law,[435] and Art. 63 of the Federal Law on Investment Funds.[436] Administrative assistance by these supervisory authorities should not only serve control of the institute, but also the exercise of control over market activities, and, therefore, the implementation of the prohibition of insider trading and stock price manipulation as well as combating money laundering.[437]

Based upon the restrictive rulings of the Federal Supreme Court and legislative regulation (especially Art. 38 of the Federal Law on Stock Exchanges and Securities Trading[438]), however, the view of the Swiss Banking Commission is that no reasonable information exchange regarding insider offences and other market abuses with foreign supervisory authorities is possible.[439]

The decisions of the Federal Supreme Court since 1998 show that a high degree of parallelism between criminal law assistance and the new administrative assistance is strived for as to the provision of administrative assistance by the Swiss Banking Commission. In the end international mutual legal assistance in criminal matters should not be bypassed through international administrative assistance or through local controlling (*Vor-Ort-Kontrolle*).[440]

Local controlling is a new supervisory instrument that enables the supervisory authority of the home country of the parent company to undertake direct examinations of foreign branch offices and subsidiaries.[441] In the fight against money laundering it is important for this supervisory instrument to be increasingly used along with international administrative assistance, since subsidiaries have been seen up until now as legally independent entities only for the purpose of consolidation as to supervision of the authorities of the home country of the parent company.[442]

3 Police

International police co-operation has its legal basis in the Criminal Code,[443] in the Mutual Legal Assistance Law,[444] in the previously addressed Federal Law of 7 October 1994 on Criminal Police Central Offices of the Federal Government (Art. 2 and Art. 13 of the Federal Act on the Central Authority of the Police),[445] the ordinances relating thereto (Art. 6 of the Federal Act on the Central Authority of the Police),[446] and the JANUS Regulation (Art. 17).[447]

The significant difference to mutual legal assistance is that it encompasses measures that do not have a character of procedural coercion and that there is not legal proceeding for the benefit of the affected party. To reach a particular result, both methods are sometimes available.[448]

Up until now there has been little practical experience in the area of

administrative assistance.[449] The statute on criminal police central offices of the federal government took effect in 1995, but was amended in the context of the measures for improving efficiency and due process in criminal prosecution (so-called 'Efficiency Regulation'). The Efficiency Regulation has been in effect since 1 January 2002.

Spontaneous administrative assistance is possible for the police when they, for example, forward information voluntarily given by a financial intermediary to the appropriate foreign authorities – without the affected party lodging a complaint and without the need for a corresponding request for foreign mutual legal assistance.

It should be noted that the provisions on administrative assistance regarding the Federal Police Office are conspicuously different from those of the Control Authority, Federal Banking Commission, Federal Office of Private Insurance and Federal Gaming Board. In particular, the protection of official or professional confidentiality is not mentioned in the police provisions. Contrary to the provisions regarding the Reporting Office those provisions also do not explicitly contain a requirement for adhering to the regulations on international mutual legal assistance. It is, however, clear that the principles of international and constitutional law are applicable in every case to the activities of the police. Furthermore, the principles of mutual legal assistance apply to criminal matters insofar as they may not be bypassed.[450]

A tendency can be observed of increasing interaction among national enforcement agencies supported by automated systems – exchange of enforcement data, performance of acts of investigation. Switzerland, in order to more quickly and efficiently arrange cross-border police co-operation in the fight against internationally active criminals, has also in a first phase executed bilateral agreements on co-operation with all of its neighbours. The next step to be pursued is access to the European police authorities (Europol).[451]

4 Customs law

Regarding customs issues, Switzerland has made considerable concessions in administrative assistance – specifically in relation to the EU: on 9 June 1997 Switzerland and the European Community signed a Treaty on Reciprocal Administrative Assistance in the Area of Customs.[452] This treaty, which took effect on 1 July 1998, augmented the Free Trade Treaty of 22 July 1972 and enabled a direct information exchange prior to use of mutual legal assistance, which did not experience any change by this treaty.[453]

It is applicable to all cross-border traffic in goods, including agricultural products. Even though the scope is restricted to administrative assistance in customs matters and does not extend to genuine coercive measures, it is highly relevant for the protection of the financial interests of the EU and Switzerland, since, both upon request (Art. 3 subsec. 1 and 2) and spontaneously (Art. 4),

all relevant information concerning the prevention and suppression of customs laws violations are to be exchanged directly between the competent authorities. Additionally, upon request, persons, companies, warehouses, etc. will be placed under surveillance and movements of goods will be observed in cases of relevant suspicion.[454]

Based upon this treaty, the Swiss Customs Administration and the regional customs authorities receive more than 1000 requests for administrative assistance per year.[455]

Nevertheless, Swiss administrative assistance has been criticized especially from the EU Commission and the EU Unit for Combating Fraud OLAF (Office Européen de Lutte Antifraude). Switzerland has been accused of being the financial and organizational hub of illegal cigarette trading.

Particularly criticized are: the duration of proceedings, strict business secrets, the stricter Swiss definition of fraud in comparison to the EU, the impossibility of implementing coercive measures as well as the non-application of the treaty discussed above in administrative assistance in Switzerland when the smuggled goods did not have contact with the Swiss territory.[456]

In cigarette smuggling, two different offences can be fulfilled: tax evasion or fiscal fraud. In the area of international co-operation it is decisive which offence is applied to a case; if fiscal fraud is involved, mutual legal assistance can be provided, but with tax evasion only administrative assistance is possible.[457] This has the consequence that it must proceed without application of coercive measures, and in particular, without revealing bank and business secrets.

When tax evasion rather than fiscal fraud is involved, instead of IMAC, the above-mentioned treaty applies to reciprocal administrative assistance in the area of customs.

It is specifically this distinction between mutual legal assistance and administrative assistance that causes tension with the EU. It is true that the EU often demands part of administrative assistance measures, the execution of which are only allowed under Swiss law in the context of mutual legal assistance. Administrative assistance under this treaty, however, allows as previously described 'only' the exchange of information on potential violations against customs law and application for the surveillance of companies and persons.[458]

Switzerland, on the other hand, provides administrative assistance and mutual legal assistance when the cigarette smuggling can be ascribed to organized crime. Since the end of 1999 task forces together with the EU were established. Further, Switzerland electronically reports to the EC Commission and the customs authorities of the EU destination country every cigarette transport that leaves Switzerland in transit.

By these measures, smuggling from the Swiss duty-free stock has practically come to a standstill; new however – according to accusations by the EU – is that Swiss firms have taken over the smuggling business.[459]

The Federal Council intends, among others, to make the administrative assistance measures more efficient and to apply them in cases of fraud and commercial smuggling. Moreover, the strengthened co-operation should also apply when the smuggled goods have not come into contact with Swiss territory. Finally, the EU Ministers Council agreed to a mandate for the EU Commission to negotiate with Switzerland a 'Co-operation Treaty for combating fraud and other crimes that damage the financial interests of the European Community and its Member States as well as Switzerland'.[460]

Although improvements have been achieved in individual questions, Switzerland up until now still has not agreed with the EU on a common formula for combating fraud. That is, the two delegations have not yet been able to agree upon the scope of application of this co-operation treaty. The EU wants to include all situations that go against the financial interests of the EU. Switzerland, on the other hand, wants to limit it to transport of goods, fiscal fraud, and commercial smuggling.

In general, the EU strives for the *acquis communitaire*; the legal principles of the EU should be acceded in the treaty. However, this would jeopardize Swiss legal principles such as dual criminal liability and the suspensive effect of appeals, which Switzerland, as a non-EU member, does not want to give up to the EU.[461]

5 Fiscal law: limits and exceptions

In principle, international administrative assistance in tax matters is regulated in the double-taxation treaties, which should also help in preventing tax evasion. The efficiency of these treaties, though, is drastically limited by a reservation that Switzerland placed in Art. 26 of the OECD Model Convention[462] regarding income and property taxes; it limits the exchange of information to information that is necessary for the proper application of the convention. No administrative assistance will be provided for the enforcement of foreign national law.[463] International administrative assistance, moreover, is provided – except in relation to the USA – always only in the form of an official report, whereby no documents are transferred nor are measures to secure evidence implemented. These actions are only possibly in the context of mutual legal assistance.[464] As to persons who are not registered in any of the nations to the treaty, an exchange of information is excluded – an exception in this regard is foreseen in the treaty with the USA.

This is mitigated by the fact that Switzerland only provides minor administrative assistance by making available accessory mutual legal assistance pursuant to Art. 3 subsec. 3 IMAC when the offence in a foreign country fulfils the objective elements of the crime of fiscal fraud.[465]

Switzerland signed a treaty with the USA on 2 October 1996, which took effect on 1 January 1998.[466] This treaty contains, as previously mentioned,

numerous exceptions to the principles of Swiss treaty practice. For example, it contains an expanded information clause, which allows administrative assistance to also be provided for American information requests in cases of tax fraud or similar crimes. As tax fraud, pursuant to section 10 subsec. 2 of the Protocol, the following deceitful conduct is understood: '. . . when a tax payer for the purpose of deceiving the tax authorities uses or intends to use a false or forged document (e.g. double bookkeeping, a falsified bill, a substantively incorrect balance sheet or profit and loss statement, a fictitious order or generally false proof) or a web of lies'.[467]

Additionally, information regarding non-residents can also be exchanged. The competent authority provides information via the transmittal of certified copies of unaltered original papers and documents upon an explicit request. Information will be held back that is covered by a business, commercial or professional duty of confidentiality – although on the other hand the provision of information in the case of tax fraud is reserved.

Bank confidentiality does not stand in the way of administrative assistance under the Swiss-American Treaty in tax fraud cases.

Also in the context of the international transmittal of information to other treaty nations, information protected by bank confidentiality is generally excluded – except in those cases in which bank confidentiality can be rescinded pursuant to Swiss national law (for example, in cases of tax fraud).

While approximately 30 requests for mutual legal assistance in tax matters are made of Switzerland annually, approximately 80 requests for administrative assistance are made, more than half of which are based upon the German Double-Taxation Treaty (Art. 23, subsec. 4).[468]

C Banking Secrecy Strategies

As described in the first section, although the protection of banking secrecy is strong, it is not absolute.[469] The obligation to co-operate with domestic law enforcement extends to mutual legal assistance cases.[470]

Banks can be ordered by a judge to produce information: bankers do not have a right to refuse to give evidence. They are obliged to testify as witnesses in criminal proceedings and to provide information on client relations.[471] Hence, foreign prosecution authorities – as with domestic prosecutors – are able to obtain documentary evidence, including the names of persons connected to an account or safe and to obtain information regarding those persons authorized to sign documents, as well as statements of account, records of transactions, contracts between customers and the bank, etc. Moreover, assets deposited in the bank may be blocked or confiscated.

Additionally, the provisions on money laundering (Art. 305ter subsec. 2 CC) expressly state that financial intermediaries are allowed to notify suspicious

transactions even before the duty to report attaches without risking sanctions for breach of confidentiality.

Obviously, additional problems arise in the context of administrative assistance. The process of sharing information between Swiss and foreign regulators is highly regulated when it touches confidential information about a client's account. The legislative regulation requires a careful weighing of the interests of bank customers in bank confidentiality and the interest in functioning and efficient international co-operation among supervisory authorities.[472] This has already lead to numerous Federal Supreme Court decisions in administrative assistance matters (especially regarding customer interests in stock exchange matters).[473]

Briefly stated, Swiss law places the following conditions on the provision of non-public information on customer accounts. If the information to be transmitted concerns individual customers, a formal administrative procedure applies to which the customer is a party. He has the right to be heard and he may request that the Commission issue a formal decree, which he can appeal to the Federal Court. Under normal circumstances, such an appeal will have a suspensive effect until the final ruling by the Federal Court.[474] The foreign supervisory authority must use the information exclusively for the purpose of direct supervision (principle of speciality).

It is true that according to decisions of the Federal Supreme Court, the group of persons involved in the matter to be investigated (Art. 38, para. 3 Stock Exchange Act) should be kept small, but on the other hand, the spontaneous right to information, in particular in relation to beneficial owners, provides an affirmative answer and the right to information is expansively interpreted.[475]

The transmission is bound by official or professional secrecy (principle of confidentiality). The consequence of this is that the Federal Supreme Court had to decide in many cases which foreign authority is recognized as fundamentally capable of receiving administrative assistance.[476] Further, it is not possible to grant administrative assistance to foreign authorities when their procedures would be public, thus violating the principle of confidentiality and indirectly the principle of speciality.[477] The foreign supervisory authority may forward the information to other authorities only upon prior consent of the Banking Commission (principle of long arm). The Federal Supreme Court has taken into account that even though fishing expeditions are not allowed, mere initial suspicion must be sufficient for a transmission of the customers.

However, it is impermissible to forward information to law enforcement authorities or criminal courts if mutual legal assistance in the criminal matter would be excluded.[478] Contrary to mutual legal assistance in criminal matters, the principle of proportionality is not fixed in the legislative regulations for administrative assistance. Nevertheless, this principle applies to all of the

administrative activities. However, the effort explicitly tied to the procedure will not be weighed according to the principle of proportionality.[479]

It is questionable whether the high demands for the benefit of protecting confidentiality can remain politically supportable, since administrative assistance has in any case been significantly interfered with in the context of the Stock Exchange Act (BEHG) as far as bank and stock exchange confidentiality, and it is foreseeable that the ability of administrative assistance presents one of the most important prerequisites for the integration of Switzerland into the European markets (and not only in these).[480]

One important gap in the existing control net is, however, the private banking carve-out of Art. 23^{septies} Banking Act.[481] This provision considerably blocks the information flow between Swiss subsidiaries and their home supervisory authority abroad, as it excludes the direct access of the foreign supervisory authority to the identity of individual private banking customers or depositors. However, according to the Swiss supervisory authority, one simply cannot adequately verify compliance with KYC (and consequently, with anti-money laundering) standards without having full access to at least a random sample of accounts.

This loophole becomes even more important when we consider that most foreign banks are mainly active in asset management for wealthy individuals or institutional investors. Where such a carve-out legally does not exist, but is nevertheless applied in practice – presumably because of some misconceptions – is within the purpose of group internal controls and consolidated supervision. According to Art. 4^{quinquies} of the Banking Act, bank confidentiality is waived *vis-à-vis* the group and the customer's consent is not required nor does he have to be informed. Internal and external auditors of the group have full access to customer-related information.

However, the issue about the extent to which information is needed for consolidated supervision remains. Moreover, this attractive channel is indeed not useable by foreign prosecutors or other law enforcement authorities in cases where they would request that the parent bank obtain information from its Swiss subsidiary.

In 2001 Swiss subsidiaries and branch offices abroad have been examined by external audit firms mandated by the Swiss supervisory authority to go on-site and obtain access to individual customer files and identities. The task was to verify compliance with Swiss KYC standards.[482]

IV SUPERVISORY LAW

Under the Swiss system for combating money laundering, in addition to *criminal law* instruments, the *administrative law* area is also significant. Because

self-regulation is especially important in this area, alongside public law ordinances, private law regulation also deserves special attention. In this chapter, state intervention is examined. Private law regulations and their internal implementation by financial institutions are addressed in the following chapter, 'Customer Due Diligence'.

A The Money Laundering Law

A set of comprehensive provisions for obstructing and combating money laundering were established by the enactment of the Federal Law on the Prevention of Money Laundering in the Financial Section, dated 10 October 1997 ('MLA').[483]

1 The objectives of the Money Laundering Law

The money laundering act entered into force on 1 April 1998, bringing with it three important innovations:

- It imposed a uniform standard of diligence, which is already in place for the banking sector for the purpose of combating money laundering, onto all professional financial intermediaries.
- A duty to report was introduced.
- The duty to block assets for at least five days after reporting was also introduced.

As is typical for framework legislation, the MLA goes no further than establishing the scope, the due diligence obligations, and the principles of supervision of those affected by it. The implementation details are left to the enforcement authorities.

2 Scope of application

Similar to other FATF member countries, initially Switzerland's main emphasis was on ensuring that the necessary money laundering counter-measures were in place in the banking sector. Since the Money Laundering Act took effect on 1 April 1998, increasing attention was focused on non-bank financial institutions. The MLA definition of the professionals subject to its anti-money laundering obligations encompasses the entire financial sector, including financial activities carried out on a professional basis by attorneys. Few other FATF member countries have extended their anti-money laundering measures to these professionals.

In 1999 the EU commission issued a proposal for an amendment to the 1991 Money Laundering Directive. The new directive came into force on 28 December 2001, extending the scope of the previous directive (which was

limited to the financial sector) to a series of non-financial activities. The financial intermediaries recognized in the directive as being vulnerable to misuse by money launderers are, for example external accountants, auditors, lawyers, real estate agents, and dealers in high value goods, such as precious stones and works of Art.[484] Whereas in Switzerland the discussion remains centred on the question of the scope of the narrow definition of 'financial intermediary' in the context of the Money Laundering Act, the EU clearly intends a much broader scope in the new directives.[485] However, after the revision of the FATF's Forty Recommendations, Switzerland has to adapt its scope of application and to include real estate agents and dealers in precious stones.[486]

The following entities in Switzerland require specific money laundering supervision: banks, fund managers, insurance institutions, securities dealers, and casinos.[487] In addition, those persons who, on a professional basis, accept possession or custody of the assets of others or who help to invest or transfer them are subject to the provisions.[488] In this context, the statute lists seven 'typical bank' services, the providers of which are required to adhere to the provisions: credit transactions, payment services, trade (for one's own account or for that of third parties) in bills or coins, money market instruments, foreign currency, precious metals, raw goods, securities, as well as derivatives, investment advice, deposit or administration of securities.[489] The list, however, contains only examples and is not intended to be exclusive.[490]

Non-financial institutions that do not conduct financial transactions on a professional basis are not subject to specific supervision. On the basis of criminal-political considerations, it is presumed that the possible contribution to money laundering is quantitatively too insignificant to be relevant. Clearly, however, they are also subject to the prohibition of money laundering pursuant to Art. 305bis of the Swiss Criminal Code.

More than one year after the deadline for the transition has passed, and despite the enactment of a concretizing regulation, it still has not been clarified for all professional groups whether they are actually subject to the provisions or not, the competent control authority will need to reach numerous fundamental decisions that more precisely delineate the statutory text. On the one hand, these implementation problems were caused by the vague formulation of the wording of the law. On the other hand, difficulty also lay in the fact of subjecting thus far unregulated areas of the financial market to the supervision of the newly established Control Authority.[491]

The question whether a financial intermediary is subject to the Money Laundering Act or not is important for three main reasons:

If it is subject to the Money Laundering Act:

- the duties of diligence set forth therein apply
- the supervisory system prescribed in the statute applies

- the duty to report applies, otherwise, only the right to report pursuant to Art. 305ter para. 2 of the Criminal Code applies.

Clearly money laundering is punishable in every case, whether the financial intermediaries and other persons involved are subject to the Money Laundering Act or not. However, when they are so subject, the concept of the money laundering fight is considerably strengthened by the supervisory law components.

The following section looks at several problem areas that can be especially relevant regarding money laundering.

a Professional activities and regulation of minor offences

The Money Laundering Act covers all activities carried out by financial intermediaries on a professional basis (that is, as a commercial undertaking), but does not define the scope of the notion of 'on a professional basis'. The Control Authority has published an implementing ordinance on the subject, to clarify the extent to which an activity falls into this category.[492]

According to the text, 'activities carried out on a professional basis' include all activities subject to the provisions of the Money Laundering Act having a gross annual turnover in excess of SFr. 20 000. This category also includes financial intermediaries having long-term business relationships involving more than ten contracting parties, financial intermediaries holding financial assets belonging to others and amounting to over SFr. 5 million and financial intermediaries transferring assets amounting to a total volume exceeding SFr. 2 million in the course of a calendar year. These criteria are alternative, which means that if a financial intermediary fulfils one criterion, he is obligated to be licensed by the Control Authority or to seek membership if an SRO applies.

The Control Authority takes the position that for this qualification as a financial intermediary on a professional basis, only that income based on activities subject to the Money Laundering Act is relevant. This interpretation assumes that the financial intermediary has a clean and clear separation between those activities that are subject to the law and those that are not. The financial intermediary must assess his activities that are subject to the provisions at 'fair value' and the division of the income from both activities must be appropriately comprehensible to the Control Authorities. Otherwise, the assessment of 'on a professional basis', would have to be based upon the total income from a business relationship.[493]

The legislature did not intend activities of secondary importance to be encompassed by the Money Laundering Act. Therefore the Control Authority issued an Ordinance[494] in August 2002 in order to define the criteria for carrying out 'professional' financial intermediation in the non-banking sector. The

criteria relate for example to a turnover of SFr. 20 000 per annum in a regulated activity, or when a financial intermediary has ongoing professional relations with more than 10 contracting partners per annum.

b Independent asset managers and investment advisors

Independent asset managers are only allowed to open an account with a bank or a securities dealer in the name of the client. If they do so in their own name, they become a securities dealer requiring the corresponding approval from the Swiss Federal Banking Commission and subject to the Stock Exchange Act. This means that the clients of independent asset managers are usually also the clients of a bank. Under the current regulatory system they are identified twice: by the asset manager and by the bank. In this regard, the bank is entitled to rely upon the efforts of the asset manager, although the bank is ultimately responsible and must, therefore, also receive all relevant documents.[495]

Although asset managers and investment advisors are covered by the scope and obligations of the Money Laundering Act, they are not subject to licensing requirements in Switzerland.[496] Their counterparts within the EU are subject to licensing in the EU.[497]

c Lawyers

Because the reporting of suspicious transactions is a sensitive issue for lawyers (it raises a difficult question regarding the special confidential relationship existing between lawyer and client when the lawyer provides legal advice or represents the client in legal proceedings), the MLA only imposes the duty to report on commercial lawyers.

Article 9, para. 2 MLA contains an exception to the duty to report for attorneys-at-law and notaries public, to the extent they are bound to observe professional secrecy pursuant to Art. 321 of the Criminal Code.[498] It remains to be determined when a client is one specifically for legal matters or when the commercial elements of the relationship are predominant. When the commercial elements are predominant, the provision of services is no longer seen as profession-specific, that is, as the provision of 'accessory' professional financial services.[499] As early as 1986, the Federal Supreme Court decided that 'the decision regarding which act is encompassed by professional secrecy is not mechanical, but rather, [can] only be made in consideration of the concrete circumstances of each individual case'.[500]

The carrying out of an administrative board mandate qualifies as an accessory activity for which the commercial element strongly predominates, as well as an activity that is normally carried out by banks and trustees. Incriminating factors in the context of these activities are covered by the duty to report.[501]

However, a lawyer or notary public does not act as a financial intermediary and is accordingly relieved of the duty to report, when, for example:

- assets are received during the liquidation of marital property (dissolution of marriage) (as long as no assistance is provided for asset administration);
- money is received from the client in the context of the purchase of real property;
- assets are received in trust in the context of the distribution of an estate (and the activity is limited to distribution);
- an official authority confers the job of acting as administrator of a decedent's estate. (Although the lawyer is subject to a duty to report when receiving the mandate on a private basis.)

A lawyer is not subject to a duty to report when purchasing a domiciliary company (*Sitzgesellschaft*), although the duty does attach when he manages the company for the client beyond the purchase. Similarly, a lawyer who has an administrative board mandate has no duty to report, except when he can influence the company's activities through his role as a member of the administrative board.[502]

Swiss banks set limits on asset management by attorneys and notaries public with the help of the CDB 1992 (Agreement on the Swiss Banks' Code of Conduct with Regard to the Exercise of Due Diligence). Due to pressure from the Swiss Federal Banking Commission, the so-called 'Form R' was introduced.[503] This form contained the written declaration of a lawyer that the bank or investment account for a client is being managed in connection with professional legal duties. The account may only be used for those professional-specific transactions. Only in such cases is it possible for the attorney to manage the account for the client without revealing the client's identity.

Pursuant to Art. 14, para. 3 MLA, attorneys and notaries public who are active as financial intermediaries must join a self-regulating organization (SRO); they cannot subordinate themselves directly to the Control Authority.

The new EU Directive also distinguishes between situations connected with the representation or defence of clients in legal proceedings and situations outside of legal proceedings. In the first case, lawyers enjoy full protection through rules of professional confidentiality and are not required to report. In the case of legal advice by lawyers outside of legal proceedings, lawyers are only required to report if they know (as distinguished from 'assume') that a client is using the legal advice for the purpose of money laundering. However, they do not report to the authorities, but only to their respective bar association or equivalent professional organization.[504]

d Domiciliary Companies

Numerous attorneys and trustees who are active in Switzerland are also subject to duties regarding domiciliary companies based upon a fundamental decision of the Control Authority.[505]

Pursuant to this decision, companies without operational activities in Switzerland should be registered through their Swiss entities. In principle, every person who takes over a function in a company that gives him dispositive powers over the assets of a foreign or domestic domiciliary company, is subject to the law. Those organs that act as an administrative board of such companies are particularly encompassed by the law.

This fundamental decision also affects the territorial scope of the Money Laundering Act. The law itself does not contain any provision regarding its territorial scope of application. Based upon its administrative law nature, however, pursuant to the applicable territoriality principle it can be assumed that the activity of the financial intermediary will be considered as taking place in Switzerland.[506] Based upon the Control Authority's interpretation it is possible that the legally prescribed duties of diligence – especially the duties to identify and report – will efficiently apply also to foreign domiciliary companies whose assets are administered by persons in Switzerland.

e Casinos

Casinos are already subject to special supervision[507] for various activities; however, casinos also have particular characteristics that make it desirable to conduct additional checks beyond the normal anti-money laundering controls. The Swiss scheme is based upon a concept that distinguishes among three risk areas. The first is where casino gambling is used as a front for otherwise dubious increases in assets or where casinos act as a currency exchange. The measure to this is the identification of the client. The second is where casinos offer actual financial services, which involves the risk of the creation of an additional non-banking network through which funds could be illegally quickly transferred. Therefore, casinos are forbidden from engaging in such financial activities. Finally, the third area involves abuse of the casino by an employee or manager in a key position. To prevent such abuse, the Federal Gaming Board conducts stringent checks on the fit and proper conduct of the owners, beneficial owners, managers, and operators of casinos as well as major business partners.

f Raw materials dealers, currency exchange and securities dealers

The goal of the provision in Art. 2, para. 3 MLA is to embrace persons and

companies who provide financial services without the requirement of being a bank or similar institution. The statutory language contains an additional exemplary list of financial intermediaries subject to the law's provisions, which also includes persons who 'on their own account or for third parties, trade in bank notes or coins, money market instruments, currency, precious metals, raw materials, or securities (paper or other rights) and their derivatives'.

Therefore, in each case it should be examined whether the business activity engaged in by the affected trader is that of a financial service and, thereby, is encompassed by the MLA. At first, the Control Authority had interpreted Art. 2, para. 2 subsec. c MLA literally, so that 'not only trading in raw materials for the account and with the money of third parties (*Kundenhandel*), *but also trading with one's own property and at one's own expense* (*Eigenhandel*) *is encompassed by the law*'.[508] The same rule also applies to trade with the other products named in the article, particularly for currency and securities dealers, insofar as the latter are not already subjected to the supervision of the Federal Banking Commission. However, in March 2003 the Control Authority changed its practice and decided that persons acting as agents on a professional basis and who deal with raw materials or derivatives thereof, would be regarded as financial intermediaries according to Art. 2 s.3 lit. c MLA. Persons who act on their own behalf and deal in raw materials or derivatives thereof, are not financial intermediaries according to Art. 2 s.3 lit. c MLA.[509]

g Art sector

Based upon the high value that individual cultural objects reach, the large degree of confidentiality and informality in art dealing, and the variable prices, art trading provides the opportunity for money laundering. Contrary to the scope of the new EU Directive, the art sector is not yet covered by the Money Laundering Act in Switzerland. This is so even though Switzerland, along with France, England, Germany, and the USA, belongs to the five most important art trading markets in the world.[510] Thus, in Switzerland in 2000, the total amount of art trading amounted to more than one billion Swiss francs.[511] In this regard, it is important to note that illegal trade of cultural objects has increased in the past several decades. Increasingly it has also been taken over by organized crime; 'Experts assume that illegal art trade is on par today with drug and weapons trading at the top of illegal trading business. The illegal transactions are associated with theft, the plundering of archaeological sites, the destruction of cultural objects, smuggling, and money laundering'.[512]

The Federal Cultural Office (*Bundesamt für Kultur*) is currently examining a duty to report in cases of suspicion of money laundering, similar to the MLA.[513] It is, however, not yet clear, how such a duty to report could be implemented in Switzerland. Several different possibilities are conceivable.

The suspicion could be reported to the Reporting Office for money laundering. This is beneficial on the one hand because the infrastructure already exists, but on the other hand, it is questionable whether the Reporting Office can acquire the required knowledge regarding the transfer of cultural property. Another possibility is where the report of suspicion could be made to the expert office in cultural property to be created by the new Federal Law on the International Transfer of Cultural Property. The problem here, though, could lie in the fact that the required infrastructure does not exist. One further possibility is for the art sector to create its own self-regulating organization similar to those in the MLA, which would be supervised by a federal office.

h Foreign subsidiaries: International inter-bank relationships

The world-wide monitoring of internationally active banks and financial groups is primarily left to the institutions themselves. Although banking secrecy also applies between parent and subsidiary companies within a group, it is, however, permissible for a subsidiary to pass on the information required for consolidated supervision.[514] The supervision should occur, furthermore, through co-operation between the supervisory authorities over the parent company and the supervisory authorities over the foreign branch office or subsidiary with the use of the exchange of information.[515]

Cross-border on-site inspections go one step further in this regard. When the rules established for administrative assistance are not adhered to, the supervisory authorities over the parent company can perform on-site inspections at the foreign branch office or subsidiary. The legal basis therefore in Switzerland was achieved with the amendment of the Banking and Stock Exchange laws on 22 April 1999. Apparently, this instrument will be increasingly accepted as a supervisory instrument equal to international administrative assistance.[516]

The cross-border provision of financial services was completely liberalized by the implementation of the amended Ordinance on Foreign Banks in Switzerland.[517] The Ordinance does not impose conditions on cross-border services by foreign banks, provided that the foreign bank does not employ anyone who is permanently and professionally active for the foreign bank in Switzerland or from Switzerland.[518] In any event, the foreign bank must be licensed and the Swiss Federal Banking Commission grants licences for the creation of a branch office under the following conditions:

- The foreign bank must be subject to appropriate supervision which includes the branch office.
- The foreign authorities must be in a position to provide mutual legal assistance to the Federal Banking Commission.[519]

If the branch office of the foreign bank forms part of a group that is active in the financial sector, the Federal Banking Commission may make the granting of a licence contingent on the provision that the branch office is subject to appropriate consolidated monitoring by the foreign supervisory authorities.[520]

Based upon this legislative situation, it seems clear that a considerable gap in the international fight against money laundering still exists today with respect to money flows among banks around the world. Whereas the principle of home country surveillance is justified under banking surveillance considerations, it is not appropriate as to the risks of money laundering activities by unreliable banks under weak home control.[521]

Moreover, the Swiss banking surveillance law explicitly states that deposits from domestic as well as from foreign banks or other enterprises under state supervision are not considered to be deposits from the public.[522]

Given this gap, it is significant that, in an act of international self-regulation, the Wolfsberg Group – a group of the leading international financial institutions – agreed on a set of global anti-money laundering guidelines for correspondent banking.[523] Although these guidelines are only a product of private initiative, they nevertheless set a standard – in view of the international activities of the members – that will be used world-wide.

3 Obligations of diligence based on the Money Laundering Act

The duties of diligence, which are today seen as a definitive element of the fight against money laundering and which were set forth in the Money Laundering Act of 1997, originated in Switzerland, on the one hand, at the private law level in the context of the Agreement of the Swiss Banking Association (thus the duties of identification and documentation regarding a contracting party and the duty to determine the beneficial party) and, on the other hand, through the actions of the Swiss Federal Banking Commission. The Banking Commission in a variety of decisions had developed the particular duty of clarification, whereby the economic background of unusual transactions must be clarified to the extent their legality is not apparent.

In this way, the legislature did not substantively change the established duties, nor did it create any new duties. Upon inclusion in the Money Laundering Act, the duties of diligence were given a statutory basis and the scope of application was broadened to the entire financial sector.

The following section outlines the contents of the duties of diligence, which were imposed on financial intermediaries in the Money Laundering Act. The Money Laundering Act is only framework legislation; detailed implementation and steps for execution should be developed by the financial intermediaries in self-regulatory work.

The diligence obligations required by the MLA must be perceived by the financial intermediaries as a routine part of their business activities. They have

the duty to ascertain the identity of customers and beneficial owners, to clarify certain transactions, and to create and maintain certain records. Moreover, in order to comply with FATF Recommendation 15, the MLA introduced a reporting obligation.

The draft by the Swiss Federal Council did not initially contain sanctions for violations of the duties of diligence or the duty to report. Competence for punishment for non-compliance was delegated to the self-regulating organizations, which could impose association or conventional penalties. Administrative bodies (special law supervisory authorities and the Control Authority for Money Laundering) were only given the authority over measures that could re-establish the legal situation in respect of preventing future violations. Originally non-compliance with this authority was to be punished under administrative law. This relinquishing of sanctions was based upon the existence of criminal law offences.[524] In the parliamentary debate that followed at least punishment of a violation of the duty to report was introduced. A violation of the duty to block assets pursuant to Art. 10 MLA remained unsanctioned. This is explainable in that a transfer of assets despite justifiable suspicion under Art. 9 MLA would anyway at least rise to a level of indirectly intentional money laundering under Art. 305bis.

a Duty to Identify: The contracting party and the beneficial owner

The need to properly identify the customer as well as the beneficial owner of an account (or the person on whose behalf a transaction is conducted) is a fundamental part of any anti-money laundering system, because information is obtained that is absolutely necessary to later make use of mutual legal assistance or to effectuate asset seizures in the context of national legal proceedings.

Along with the duty set forth in the Criminal Code (Art. 305ter para. 1) regarding identification, the principle should be adhered to and its formulation left to the affected professional groups. This hoped-for self-regulatory effect, based upon a criminal law standard, has not, however, been realized.[525] Therefore, the Criminal Code contains a more detailed description of the duty to identify. Arts. 3–6 stipulate at what point in time and for which businesses a financial intermediary must identify a contractual partner by means of a document or establish the identity of the material beneficiary by requiring the contractual partner to provide a written statement in this regard. The identification, pursuant to para. 1, must systematically occur at the beginning of the business relationship. With this requirement, the duty to identify is not at the outset limited to certain transactions and is also not limited to the opening of an account. This is because the MLA also encompasses financial services providers, which are usually based upon long-term business relationships

without accounts. In addition, para. 2 broadens the duty to identify to the area of transactions with clients who have not yet been identified through the opening of an account. To ensure that the duty to identify remains proportionate, it is only required when a 'considerable' value has been reached, whether in a one-off transaction or in many transactions that appear to be related. The law leaves the definition of the threshold amount in para. 5 to the supervisory authorities and also the self-regulating organizations. This has, in turn, resulted in inconsistent solutions. The threshold amount, however, is not absolute; if money laundering is suspected, the duty to identify applies even when small amounts are involved.

According to the revised Ordinance of the Money Laundering Control Authority on directly controlled financial intermediaries,[526] the financial intermediary has to identify the contracting party when one or more related transactions exceed SFr. 25 000, and in money changing transactions above SFr. 5000 and in all money and value transactions.

Nevertheless, the revision of the Ordinance envisages a relaxation of some of the formal requirements; for example, a Swiss citizen can prove his identity with any official document with his photo on it – a passport is no longer the only document that can be produced. Documents from the official company register databank will automatically be admissible, also where a legal entity is involved, an extract identifying the entity may be taken from a reliable, privately managed databank. These documents have to be produced in the original or be authenticated by a notary or other public official.[527]

The party to be identified is the contractual partner. In this regard, the legislature seeks the identification of both natural and legal persons. Moreover, not only must the contractual partner be established with due diligence, but also the beneficial owner. The beneficial owner does not have to be identified where the contracting partner is a legal entity under Swiss law that is subject to special supervision – what is meant here are bodies such as Swiss tax exempt pension fund or a foreign financial intermediary that is subject to an equivalent anti-money laundering supervision and regulatory regime.[528]

The beneficial owner is 'established' within the meaning of the statute, when the financial intermediary receives a written declaration from the contractual party (Form A) with the information. The accuracy of the information provided therein regarding beneficial ownership can only be verified to a certain degree. Additionally, Art. 4 MLA only refers to a written declaration and does not require that this be support by other proof. The MLA gives priority to the protection of confidentiality, whereby this is stronger under criminal law to the extent that the written declaration is a document within the meaning of Art. 110, fig. 5 Criminal Code. After all, a contracting partner commits a crime relating to false documentation (*Urkundendelikt*) when providing false information.[529]

The diligence required under the law is not fulfilled by a one time identification or establishment of the beneficial owner at the beginning of the business relationship. Pursuant to Art. 5, if doubt arises at a later point, the identification must be renewed.

During the discussions of the revision of the FATF Forty Recommendations consideration was given to the identification process in relation to corporate vehicles, and a prohibition on bearer shares was also mooted, because they were regarded as a hurdle to identifying ownership. The Recommendation was in fact watered down in the final revision, and states that, 'countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures'.[530]

b The duty of special clarification

The core of the Money Laundering Act is, next to the duty to report, the duty to continually clarify pursuant to Art. 6 MLA if the transaction or business relationship appears unusual, unless its legality is manifest or there are grounds for suspecting that the assets are the result of a crime or are under the control of a criminal organization pursuant to Art. 260ter first sentence Criminal Code.

This concept extends beyond simple customer identification. It requires knowing and understanding the customer, their business, and the type of business they engage in. The requirement was developed by the Swiss Banking Commission at the end of the 1970s based upon Art. 3 para. 2 subsec. c.[531] Pursuant to this standard, the approval for undertaking the business activities of a bank is tied to the condition, among others, that 'those persons entrusted with the administration and management must have a good reputation and offer the assurance of flawless business activities'. The Federal Supreme Court supported the practice of the Swiss Banking Commission and decided that 'for businesses . . . that are complicated, unusual, or meaningful, the economic background is [to be] clarified'.[532] As the FATF recognizes, this provides, among other benefits, a valuable tool for identifying unusual or suspicious transactions.[533]

The Control Authority deploys the risk-based approach. According to the revised Ordinance[534] the duty of special clarification should be differentiated according to risk categories. The financial intermediary has to classify his business into two categories, those that are associated with the usual money laundering risk and those that indicate a higher risk. The onus is on the financial intermediaries to develop his own individual criteria. In any event where politically exposed persons are involved the risk is automatically regarded as increased. The definitions used up until now by the Federal Banking Commission have been adopted in this description.[535]

Despite the increased duty of care in relation to 'PEPs' and despite the obligation and right to notify, it is still surprising that no notifications were made in relation to accounts held by President Charles Taylor (Liberia) in Switzerland. It was only after an application for legal assistance from the International Criminal Court that they were blocked.[536]

c Obligation to keep records

This obligation first attaches at the establishment of the business relationship.[537] It is divided into two responsibilities. The first is the obligation to keep the records in such a manner as to allow compliance within a reasonable time with any request or order freezing assets issued by criminal investigation authorities. Along with this duty of presentation, Art. 7, para. 3 creates a duty to maintain the records for at least ten years after the termination of the business relationship or the conclusion of the transaction.

d Duty to report connected with a duty to block assets and its relationship to the duty to report

The Swiss approach, as in most other FATF member countries, is based on the system of reporting suspicious transactions. However, the precise extent of the obligation varies. In Switzerland, the duty to report attaches when there is *knowledge or a justifiable suspicion* that the assets involved in a business relationship are connected to a punishable offence pursuant to Art. 305bis Criminal Code or that the assets are the proceeds of a crime or are under the control of a criminal organization (Art. 206ter para. 1 CC). The duty to report is combined with the automatic suspension of all transactions for a five-day period – this measure is unique within the FATF member countries.[538] The MLA introduced a prohibition against informing the customer during the period of freezing established by Art. 10 MLA.

However, since the duty to report only arises at the establishment of the business relationship, a concern remains within the FATF regarding the completeness of compliance with FATF-Rec. 15. The nature of the duty to report is believed to be incomplete because of the narrow interpretation applied by financial institutions.[539]

The right to report pursuant to Art. 305ter para. 2 CC discussed above should be considered in this context as well.[540] Basically, there is a continuum from a mere clue to certainty. The right applies to the area where indications exists, so, for example, when clarifications pursuant to Art. 6 do not provide a basis for suspicion but the existing doubt cannot be resolved. The duty first attaches when justifiable suspicion exists – and certainly when there is knowledge. When we orient ourselves toward criminal procedure law, it means that objective indications of a qualifying related prior offence are required. There

is no need for possibility bordering on certainty, but nevertheless for considerable objective indications, all the more so as here private citizens are used in conjunction with the clarification of a crime.

Seen from the perspective of the course of business, the *duty* to report first attaches after the relationship is in the contractual stage – not yet in the identification phase, which each time should be prior to this. Also not upon suspicion; for this pre-contractual area the *right* is explicitly set forth in the statute, since professional secrecy such as bank client confidentiality become mandatory at the beginning of the initial contact.

The distinction between the right and the duty to report should not be considered in a vacuum, since they are embedded in the previously discussed concept of the continual duty of clarification.[541]

The result is that with this system there is a long, internal, and, thereby, private observation stage compared with if the duty to report attached directly initially or upon indications.

The large differences regarding the number of reports in the different FATF member countries says less about actual money laundering incidents and much more regarding the divergent reporting systems. While other countries request notification when there are unusual circumstances, it fits within the Swiss system to leave the responsibility for managing the client relations in questions regarding a decision to report in the private sphere longer. Thus, many suspicions based on private investigations are already excluded. Internal compliance – though not expressly mentioned in the law – becomes significant with the important function as the first filter. This means that the Swiss system produces a 'black box' that first opens when a report based upon knowledge or justifiable suspicion is made to the authorities.

Transparency, if necessary, could be increased when, along with the reported cases, each case report to the front-line staff of the compliance department would be documented and maintained, even when the compliance department ultimately determines the case as not suspicious. Such files could then be checked by the regulator to determine whether the correct approach is being taken with regard to reporting.

On the other hand, this filtering could also increase the quality of the reports. The quality of the reports is measured from the point of view of criminal investigations on the basis of the number of reports forwarded to the criminal investigation authorities. In 2001, approximately 88.5 per cent of the 417 reports were forwarded by the Reporting Office to the responsible criminal investigation authorities.[542]

In any event the developments at the international level appear to swing. In 2002 in Switzerland the number of notifications that were passed to the prosecuting authorities (79 per cent) also declined, because of a lack of evidence that could be used in a prosecution.[543]

4 Money laundering reporting office or notification office

Incidents that are required to be reported are to be forwarded to the Swiss Reporting Office.[544] It was established by the Money Laundering Act coming into force and functions as a link between the preventative-administrative law pillar and the repressive criminal investigation pillar. The Money Laundering Reporting Office ('MLRO') is attached to the Central Investigation Service. Its task is to gather and analyse information received from financial intermediaries and to transmit relevant information to the prosecution authorities in cases of suspected money laundering.[545] The Reporting Office publishes a report four times a year, in which it presents current international trends, statistics, and characteristics of money laundering. Additionally, it maintains an Internet homepage.[546]

The establishment of such an office only makes sense when the goal of increasing the quality of the reported suspected cases can be reached, because the information received can be compared with other data. For this reason, the FIU (MLRO) must have access to a variety of data sources; it compares the persons and companies identified in a report with the information of the criminal registry (VOSTRA), the wanted persons search system (RIPOL), the files regarding international mutual legal assistance (AUPER), and the databank of organized criminality (JANUS). Also, public sources such as Reuters and Dun & Bradstreet would be used.

This central authority enables data to be collected on the number of notifications that are made and how many criminal investigations are undertaken. However, there is a gap; the state of knowledge regarding the whole picture in Switzerland and how many verdicts have been handed down, leaves much to be desired, although the criminal investigation authorities of the cantons are legally obliged to inform the Reporting Office of all investigations pending in connection with organized crime, money laundering or lack of due diligence regarding identification of customers (Art. 260ter s.1, 305bis, and 305ter of the Criminal Code), as well as to provide copies of judgements and investigation termination orders.[547]

As at July 2003 the Reporting Office has registered 31 verdicts (23 guilty verdicts and eight acquittals).[548]

All data received by the Reporting Office relating to reports made pursuant to Art. 9 and 29 and also based upon foreign information requests, are fed into its own databank (GEWA).

Further attention should be given to the lack or insufficiency of feedback given by the MLRO (FIUs) to reporting institutions. This is a deficiency that has been noted in more than half of the FATF mutual evaluation reports.[549]

However, given that they have serious manpower constraints (currently eight employees, which signifies a doubling of manpower since 1998), it raises the question whether this office can be little more than a clearing house

in view of the increasing number of notifications (in 2001 up 34 per cent and in 2002, up 56.4 per cent),[550] as well as the international and national efforts to extend the reach of money laundering provisions to other areas (for example, dealing in works of art and real estate) and in view of the increase in the exchange of information with foreign FIUs.

5 Statistics

Since the duty to report has taken effect, each year approximately 5 per cent more cases have been reported:

- 1999: 303 reports
- 2000: 311 reports
- 2001: 417 reports
- 2002: 652 reports

The significant increase in 2001 can be traced to the number of reports (95) that are related to the financing of terrorism. In 2003, there were only 15 notifications related to the financing of terrorism. The trend of increasing reports appeared to be continuing; already at the end of September 2002 over 400 reports had been made.[551] In fact, the notifications rose by 56 per cent in 2002.[552] In 2001 the majority of reports were made by banks (255), while 33 reports were made by asset managers, nine by attorneys, eight by casinos and five by investment consultants.[553] What is particularly noteworthy is the large increase in the number of notifications from financial intermediaries that conduct international payment business (so-called money transmitters).[554] The Reporting Office explained this increase as being a result of stricter reporting practices.[555] In 2000/2001 only 33/55 notifications (10.6 per cent; 13.2 per cent) came from this sector, (in contrast to 234/255 notifications (75.2 per cent; 61.2 per cent) from the banks), in 2002, 280 notifications from the payments system (42.9 per cent) in comparison to 271 notifications (41.6 per cent) by the banks.[556]

This may also explain the previously mentioned declining numbers of notifications being passed on to the prosecuting authorities, because money transmitters are involved in short term, real time transactions which do not lend themselves to clarification – neither of the client nor the background of the transaction. It follows therefore that the initial suspicions cannot be pursued further because the requisite elements of the right to notify as per Art. 305ter para. 2 CC that would have to be made cannot be met.

If the notifications by money transmitters are left out of the figures, the banking sector has increased its number of notifications by 6.2 per cent as against the previous year, while out of the rest of the non-banking sector, there are 5.6 per cent less.[557]

A further shift has also taken place within the banking sector. For the first time the private banks have submitted the most notifications (42 per cent from private banks domiciled in Geneva, 38 per cent in Zürich, 10 per cent in Ticino as well as a further 10 per cent in the city of Basel, and the cantons of St Gallen and Vaud), while there has been a decrease in reports by the large banks.[558] The reasons are not entirely clear; either the money launderers are switching to the private banks or the latter are taking there reporting responsibilities more seriously than hitherto.

In relation to the international dimensions of money laundering, the statistics suggest the following interpretation. The 38 per cent of notifications mentioned in section II.B.5 above that are passed onto the federal authorities indicate that many money laundering cases have a direct foreign connection. On the other hand on the basis of the growing number of beneficial owners who are resident or domiciled in Switzerland as well as the number of contracting partners who are Swiss passport holders, means that although Swiss companies are the contractual parties the assets involved actually belong to a foreigner. It may also be the case that a Swiss person acts as a stooge for a foreigner.[559]

B The System of Supervision

The MLA is implemented by four Swiss federal supervisory authorities: the Swiss Federal Banking Commission ('SFBC'), the Federal Office of Private Insurance ('FOPI'), the Swiss Federal Gaming Board ('SFGB') and the Money Laundering Control Authority ('MLCA'). The Control Authority was established by the MLA, which regulates its activities as well as those of the self-regulating organizations. The remaining three supervisory authorities not only monitor the implementation of the MLA, they also administer the specific supervisory laws governing their sector – so-called 'special laws'.

The supervisory duty is divided by sector:

1 Three tier supervision

a Regulated according to special law: role of supervisory agencies

The Swiss Federal Banking Commission ('SFBC') is the supervisory authority of banks, and since the Stock Exchange Act of 1997 took effect, also of the exchanges admitted to Switzerland, SWX Swiss Exchange and Eurex. Thus, it monitors banks, securities dealers, exchanges, investment funds, and mortgage bonds.[560]

This includes approximately 400 of the total 7000 financial intermediaries subject to the Money Laundering Act. Seen from an economic perspective,

these 400 (together with insurers) are the most significant sections; in 2001 they managed bank accounts with a value of about SFr. 3.3 bn, which is a large proportion of the total assets managed in Switzerland.[561]

The Federal Banking Commission has a remarkable independent role; the Federal Council selects its members,[562] but in fulfilment of its tasks, it is independent of both the Federal Council and the Swiss National Bank and is not subject to directives.[563]

The Swiss Banking Commission is especially important in its disciplinary role. Along with the introduction of the special duty of clarification (cf. 4.1.c.bb.), the SFBC also, on the basis of the cases involving Marcos, Mobutu or Benazir Bhutto, developed the requirement that it is the task of the bank business management (and not subordinate positions) to determine whether to enter into or continue business with a politically exposed person. The last cases of the special duty of clarification regarding economic backgrounds and the goal of business relationships in combination with the PEP customer characteristics were the cases of Abacha and Montesinos.[564]

The Money Laundering Guidelines of the Swiss Banking Commission applicable today were created in 1991 in implementation of the 'Forty Recommendations' of the FATF in the banking sector. They were revised in 1998 after the Money Laundering Act 1998 took effect and are planned to be further revised to take the form of a Regulation in 2003. Until now, the Guidelines were issued as a circular memorandum, not as a formal law. Nevertheless, the Swiss Banking Commission has been able to impose the duties of conduct prescribed therein on banks and securities dealers when necessary.

The Banking Commission has a variety of powers available to it for enforcing the requirements. It relies to a great extent on the reports of the external auditors when applying these powers. It can reprimand the bank, make rulings on the extent to which management and directors meet 'fit and proper' requirements, require closure of non-compliant foreign offices, or take stronger administrative actions when necessary. Management and directors may be suspended and individuals may be liable to criminal prosecution. As a last resort, the Banking Commission may revoke the bank's licence.[565] Recently, the EBK, in a new form of discipline, publicly reported on the results of their examinations and the measures ordered; the introduction of a form of 'naming and shaming'.[566]

The Federal Office of Private Insurance (FOPI) is part of the Federal Justice and Police Department. Regarding the fight against money laundering, the FOPI directly supervises three organizations; the Self Regulation Organization of the Swiss Insurance Association (SRO-SIA) supervises the others. Of the total premium volume of just over SFr. 50 bn (of which SFr. 30 bn relate to life insurance policies); some 20 billion Swiss francs are relevant for the supervisory purposes aiming at combating money laundering.

As the FOPI states, in enforcing the Money Laundering Act, inspections of insurance companies play a central part in supervisory activities.[567]

In this regard, changes are foreseen. An expert committee 'Zufferey' of the Swiss Department of Finance suggests integration of the supervisory bodies of the insurance and banking branches into one new integrated supervisory authority. According to the expert committee, regulation and supervision of independent asset managers as well as foreign exchange dealers and brokers can be justified within the framework of the current Federal Law on Stock Exchanges and Securities Trading.[568] The importance of creating a single supervisory authority with an institutional structure that will allow political independence and independence with regard to those supervised was highlighted.[569]

The Swiss Federal Gaming Board (SFGB) is an independent administrative authority of the Swiss Confederation, which is affiliated for administrative purposes to the Federal Department of Justice and Police. It began operating when the Gaming Act came into force on 1 April 2000.[570] At this time, Switzerland had no actual casino with table games such as roulette or blackjack. Only the new Act made it possible to issue licences to operate the 'Grand Jeu'. The first casino to obtain a licence started operating at the end of June 2002. A self regulation organization, organized by the Swiss Casino Association (SRO-SCA), has been in existence since 1999. The SFGB was able to give its approval to the SRO-SCA regulations in June 2002.[571] For the purpose of combating money laundering, the SFGB issued an Ordinance on 28 February 2000[572] on which the supervision must be based.

The Money Laundering Act gives the statutory specialized supervisory authorities the competence to define the duties of diligence under the MLA for the financial intermediaries under their supervision and to specify how these are to be fulfilled.[573] In addition to the measures they are empowered to use pursuant to special statute, the MLA gives the supervisory authorities the power to initiate measures pursuant to Art. 20 MLA.[574] Moreover, the supervisory authorities also have a duty to report.

b Unregulated activities: Self-regulating organizations (SROs) and Control Authority

a Self-regulating Organizations

With the MLA, the legislature gave private law organizations the competence to issue rules, by performing the quasi-legislative work of concretizing the statutory duties pursuant to Art. 3–9 MLA.[575] In addition, the private law organizations were also given the responsibility for imposing sanctions.[576] The self-regulating organizations are authorized to order conventional penalties as

well as other association law measures and, as the *ultima ratio* they can bar financial intermediaries.[577] It is important to note that it is not within the Control Authority's jurisdiction to intervene directly when a financial intermediary affiliated with an SRO violates the obligations stemming from the law. In such a case, the Control Authority passes any information it has to the relevant SRO, which then sets in motion the procedures based on the regulations. If these procedures result in the financial intermediary being barred, the latter comes under the direct supervision of the Control Authority, which may take any necessary measures, including liquidation of the financial intermediary's company.[578]

To also maintain contacts to the self-regulating organizations after the authorization procedure, the Control Authority has the stated goal of examining the way in which the SRO fulfils its legal obligations on the occasion of the annual audit of the SRO. Moreover, the Control Authority will organize an annual co-ordination conference to which all SROs will be invited. The goal of the conference is to improve the general knowledge of SRO managers.

Further, the SROs organize joint meetings several times a year, the SRO Forum, allowing them to discuss issues of general interest amongst themselves. The Control Authority and MROS representatives also attend these meetings.[579]

Whether the Swiss system of self-regulation in the non-banking sector is actually effective remains to be seen. Until now at least, most reports still originate with the banks.[580] In 2002, the SROs were revised for the first time.[581] At the end of 2002 the number of financial intermediaries that are supervised by an SRO was 6397.[582]

b Direct Supervision by Money Laundering Control Authority

Its supervisory function is divided according to the choice of the financial intermediary; direct or indirectly through a self-regulating organization. There were significant difficulties initially with the implementation of the statutorily required tasks. A parliamentary commission analysed the problems and the Control Authority was temporarily supported by an advisory council.[583] Since then the organizational structure was changed, whereby four sections were created according to subject matter, in order to support the development of specialized expert knowledge. Moreover, the staff was increased to 25 positions, which was approximately a doubling.

According to the Control Authority, there are approximately 6500–7000 financial intermediaries in Switzerland that are subject to the duties of the statute. A large portion of these belong to an SRO, while about 320 are directly subordinated to the Control Authority or have filed a request therefore.[584] Also according to the Control Authority, there are still a number of companies that

are engaged in activities that subject them to the duties of the statute, but have not joined an SRO, nor have they sought authorization from the Control Authority, although even by the time the MLA's grace period ended in April 2000 they had already enjoyed a relatively long grace period. These companies are illegally active. The Control Authority is now able – after organizational and personnel restructuring – to proceed against them. Accordingly, in June 2002 for the first time, three companies were liquidated and the responsible persons were fined. Dozens more liquidations and fines are expected.[585]

The Control Authority is not a criminal investigation authority. Criminal investigations based upon suspicion of money laundering are conducted by the Canton criminal investigation authorities and, since 1 January 2002, partly also by the federal prosecution office. Their task is primarily, along with the Reporting Office, to activate the non-banking sector in the fight against money laundering. However, the Money Laundering Control Authority does not provide complete prudential supervision and this absence creates a potential vulnerability.

While the audit of the SRO in every case will be undertaken by the Control Authority, financial intermediaries directly subordinated to the Control Authority make use of the statutory possibility of transferring control to external auditors. In principle, this means that financial intermediaries directly subordinated to the Control Authority will be examined by external auditors. Up until now 84 auditing companies have been accredited, which act as the 'long arm' of the Control Authority.[586]

2 Particular characteristics and critical points of the Swiss system of supervision

The system of supervision in Switzerland is characterized by a so-called bi-level system and through strong self-regulation. In Switzerland, the supervision of banks is not conducted directly by the supervisory authorities, but organized in a 'bi-level system', in which auditors have a significant role. The Federal Banking Commission has the ultimate supervisory responsibility; however, direct supervision is for the most part dealt with by audit offices that have been accredited by the Federal Banking Commission.[587] At the same time they must be appointed as external auditors by those being supervised.[588] They have a double-function: on the one hand they act based upon a private law mandate and on the other they have a quasi-official function. As described above, this supervision mode was broadened to apply to the para-banking sector by the Money Laundering Act. Hence, Swiss supervisory authorities traditionally do little on-site work and rely extensively on the work of licensed external auditors.[589] In the past there has been successful experience with this, although room remains to further develop the control of such auditors.

The second characteristic is the highly developed self-regulation. It was

accurately set forth in the FATF-Evaluation of Switzerland 1998 that self-regulation accompanied by state monitoring is the main facet of the Swiss concept for combating money laundering.[590] The Money Laundering Act of 1997 is based in large part upon the principle of self-control. Self-regulation in the Swiss financial market is traditionally highly developed and should be viewed in the context of the debate between the State's claims to regulate and control and confident private self-control.[591] The State (or its organs) retains its control claims, whereby others are encouraged to take on responsibility for the satisfaction of these claims. In this way a policy known as 'governance-at-a-distance' arises. For the effective exercise of control, private resources, non-state networks, become involved. This transference of function requires the empowerment of private parties, which thereby receive larger latitude for their actions as well as the right to be heard.

The empowerment of the private sphere, which goes hand in hand with self-regulation, need not automatically lead to a weakening of state leadership competence, since it at the same time makes extension of the state's control claims easier. An abundance of new possibilities for action are opened to the state and its representatives (here the supervisory authorities) with this understanding of the roles.[592] This tendency was strengthened with the introduction of the so-called 'risk based approach'.[593] From the government side, exact regulations no longer need to be worked out, the scope of control of which is inevitably reduced. Instead, one is content with the realization that loss in the context of particular risk categories will likely occur.[594] With the framework legislation, the State clearly sees its role in the first place in steering, in the guarantee of fulfilment of necessary measures, and less in the actual fulfilment. In this role the State can rely upon the existing strong self-regulation claims of commerce and industry, which are welcome, since otherwise the far-reaching control claims could not be implemented.[595]

The high degree of self-regulation within the framework of combating money laundering is problematic for many reasons:

- It would be prudent to examine the extent to which state-defined criminal politics changes in the hands of private parties. The interests of the criminal investigation authorities are not congruent with the interests of financial intermediaries. What happens with the money laundering that was originally defined as a criminal law problem when it is left to a privately organized lengthy process (in particular as regards the late-reporting system)? Certainly there is somewhere a common denominator between public and private interests regarding the necessity of resistance to money laundering. But in the hand of financiers, money laundering becomes primarily a 'compliance' problem, a question of risk management, one factor among several under the rubric 'reputation

damage'. This starting point is far removed from the concrete criminal investigation interests of state criminal politics, an additional goal of which – in short – is pursuit of the fight against each basic offence.

- When private law organizations receive greater jurisdiction for the imposition of penalties, this may run counter to an important claim; that of the highest degree of transparency.
- An adequate number of controllers must be employed to ensure the independence of the controllers in regard to each financial intermediary.
- While in practice the existing professional organizations will be used, the SROs typically have the necessary expert knowledge and organization, but in certain circumstances they are not familiar enough with money laundering issues to practise good supervision, training and guidance.[596]

On the whole, it must be recognized that the significantly fractured supervisory structure in the fight against money laundering requires a very high degree of co-operation between the private sphere and the various public authorities involved, but also among the public authorities themselves. This has been clearly shown in the fight against terrorism as a variety of different lists were circulated by different offices. Finally, it is apparent that the Money Laundering Act is overloaded with the supervisory burden. It would be advisable here to devote a separate statute to supervision in the financial market sphere, whereby the special law on combating money laundering would also be relieved.

C Switzerland under Examination: International Organizations and their Function

Further development and international equalization of the principles in combating money laundering take place primarily at the international level.[597] The work of international organizations, however, is limited not only to drawing up regulations. Of increasing importance are also country-specific examinations of national implementation and practical execution.

The international components of national supervisory authorities are an important element in combating money laundering. The Basel Committee on Banking Supervision, for example, is the international association of bank supervisors of the G-10 nations. At the end of 2001, the committee, together with the Association of Supervisory Authorities of Offshore Financial Centres, agreed upon a document for the fixing of international minimum standards for customer identification.[598] The International Association of Insurance Supervisors ('IAIS') has charged itself with developing supervision standards in the insurance branch and the securities supervisors have joined together into the International Organization of Securities Commissions ('IOSCO').

All three parties founded in 1996 a Joint Forum on Financial Conglomerates after an increasing number of global, cross-sector financial conglomerates arose.[599]

Particularly for combating money laundering, the Financial Action Task Force was founded in 1989 upon a proposal by the G-7 nations.[600] Switzerland is a founding member and significantly contributed Swiss regulatory principles to the development of the 'Forty Recommendations' for combating money laundering in 1990. The implementation of these recommendations was inspected by national authorities in a self-evaluation as well as by an FATF delegation. Switzerland last conducted a self-evaluation in 2002 and was inspected by an FATF delegation in 1993 and 1998.[601]

The International Monetary Fund also issued a paper on combating money laundering and undertook country evaluations in regards to transparency in monetary and finance politics, supervision of the banking sphere, securities trading, insurance matters, and the efficiency of payment systems. Switzerland is one of the 190 member states of the International Monetary Fund and was only recently assessed regarding its anti-money laundering system and practices for prevention and detection in the areas of banking, insurance, and securities. Overall, the staff found that the Swiss MLA scheme in the area of financial supervision is in line with international best practices.[602]

In a 1999 report by the Financial Stability Forum of the G-7 nations, in which 70 financial centres were divided into three offshore categories, Switzerland, as an 'offshore financial centre' – along with Luxembourg, Singapore and Hong Kong – was placed in the highest category. This means that the regulatory and supervisory framework of these countries – whereby combating money laundering was only one of the many elements assessed – were classified as 'high quality'.[603]

The aim of the work of international organizations is, in particular, the development of joint (minimum) standards. Of critical note is that the 'legislative' process does not have any democratic controls and the politics surrounding evaluations is not transparent.

NOTES

1. *Source*: World Trade Organization, cited in the UK part.
2. Swiss Banking Association, Compendium, 2001, p. 18.
3. *Source*: Swiss National Bank, Die Banken in der Schweiz 2000, p. 39.
4. Nobel, 2002, p. 13.
5. Nobel, 2002, p. 10
6. According to the opinion of Rossier Jacques, expressed at the 67th General Assembly of the Private Bankers Association. Media report: SDA, 14 June 2002.
7. Bergier, 1990, p. 294.
8. Mottet, 1987, p. 15; Bergier, 1990, p. 328.

9. Bergier, 1990, pp. 326, 327; Mottet, 1987, p. 42 *et seq*.
10. Bumbacher, 1993 p. 133.
11. Mottet, 1987, p. 19.
12. Bumbacher, 1993, p. 140.
13. König, 1998, pp. 265–290 (273).
14. Bergier, 1990, p. 326 *et seq*.
15. Following the repeal of the Edict of Nantes (1685) the immigration of Huguenots became increasingly important. The population of Geneva was for a time doubled by their influx.
16. König, 1998, p. 273.
17. König, 1998, p. 273.
18. König, 1998, p. 283 *et seq*.
19. Jung, 2000, p. 44 *et seq*.
20. König, 1998, p. 284.
21. Guex, 1993, p. 22.
22. König, 1998, p. 285.
23. The balance sheet totals of the eight large banks shrank between 1930 and 1935 by more than half to SFr. 4.2 bn. Five of the large banks had to be reorganized. Some 60 banks between 1930 and 1939 were either taken over or wound up. Media report: Vogler, NZZ 18 March 2000, p. 29; Bumbacher, 1993 p. 183 *et seq*; also local and regional banks suffered major losses and merged with cantonal and large banks. Between 1906 and 1915, 85 banking institutes were deleted from the commercial register.
24. König, 1998, p. 284 *et seq*.
25. König, 1998, p. 286.
26. Nobel, 2002, p. 11.
27. Tanner, 1991, pp. 168–170; Iklé, 1993, pp. 415–18.
28. See section C.5. hereinafter.
29. Bernasconi, 1988, p. 25 *et seq*; Bernasconi, 1990, pp. 199–229.
30. To name but a few: the Federal Court had to decide legal assistance cases relating to the following persons: Marcos/Philippines, Mobutu/Congo, Benazir Bhutto/Pakistan, Milosevic/former Yugoslavia, Lasarenko/Ukraine, Abacha/Nigeria.
31. The parliamentary Initiative (02.432) was proposed by the parliamentary party of the Swiss People's Party on 17 June 2002 in the National Assembly, and thereafter accepted by the National Assembly's Standing Commission for the Economy and Taxation (WAK). According to the majority of the Commission the position of the Federal Council is thereby strengthened in its bilateral negotiations with the EU. Press release: Parliamentary service 18 November 2002.
32. SR 952.0. Swiss Federal Act of 8 November 1934 on Banks and Savings Banks.
33. FCD 108 Ib 231; Meier-Schatz et al., 2001, p. 232, 250 *et seq*.
34. SR 311.0. Swiss Criminal Code of 21 December 1937.
35. SR 955.0. Swiss Federal Act of 10 October 1997 on Money Laundering.
36. Only Austria, France and Luxembourg also have a criminal sanction. To compare the position with the EU states, see Meier-Schatz et al. 2001, p. 19 *et seq*.
37. Meier-Schatz et al., 2001, p. 46, 52, 230.
38. Rappo, 2002, pp. 65 *et seq*.
39. Kleiner/Schwob, 2001, on Art. 47 N.2.
40. Berger, 2000, p. 183 *et seq*.; Klauser, 1977.
41. SR 220.0. Swiss Federal Act concerning the Amendment of the Swiss Civil Code: Fifth part: Code of Obligations of 30 March 1911.
42. Kleiner/Schwob, 2001, on Art. 47 N.2.
43. Mueller, 1998, p. 18; Kleiner/Schwob, 2001, on Art. 47 N.112.
44. Kleiner/Schwob, 2001, on Art. 47 N.7.
45. SR 952.0. Swiss Federal Act of 8 November 1934 on Banks and Savings Banks.
46. Vogler, 2000a.
47. Bänziger, 1986, p. 114 *et seq*; Vernay, 1968, p. 209.
48. Berger, 2000, p. 186.
49. Hirszowicz, 1996/2001.

50. Kleiner/Schwob, 2001, on Art. 47 N.7. Art. 47 s.1 of the banking law covers the attempt to incite as a separate offence in contrast to Art. 24 para. 2 Criminal Code.
51. Schürmann, 1994, p. 369 *et seq.*; Aubert, 1997, p. 2; Blackmann, 1989, p. 48.
52. Guex, 1996, p. 13.
53. Hirszowicz, 1996/2001; Aubert, 1997, p. 4; Aubert/Kernen/Schönle, 1995.
54. Tomasone, 1997; even at the cost of principles relating to the rule of law according to Schwob, 1997, pp. 169–176.
55. Pieper, 1995, p. 43.
56. SR 642.11.
57. Aubert, 1997, p. 10.
58. OECD, Improving Access to Bank Information for Tax Purposes, Paris 2000.
59. De Wattville, 2000, pp. 32–35.
60. Vogler, 2000b, p. 29.
61. Lademann, 1988, p. 4.
62. Media report: Tages-Anzeiger, 4 August 1997, p. 23.
63. König, 1998, p. 287.
64. Jung, 2000, p. 362 *et seq.*
65. Jung, 2000, p. 366.
66. Ordo-Liberalism theory was developed in the 1930s in Germany as an alternative to socialist controlled economies and to laissez faire capitalism. In contrast to Liberalism, which only concerns free competition and regards this as primarily threatened by the State and not by the private sector, Ordo-Liberalism envisages a strong, active state, that is neutral in that it is independent of economic power groups.
67. Previous version of the Federal Constitution Art. 31, actual version of the Federal Constitution Art. 27 und 94. Details on the economic freedom in the new Constitution: Rhinow, 2000, ch. 7, para. 23.
68. Müller, 1999, p. 633 *et seq.* According to Müller, no other Constitution contains a guarantee of comparable scope. In his opinion it is a particular trait of the federal Constitution. That Switzerland is more liberal than the ordo-liberal line, becomes apparent through the fact that there are only few trade unions and they are very weak, none or only rudimentary participation by workers in their companies, no worker participation in the management, weak job protection laws, a long working week, etc.
69. The Weisscredit Bank in Lugano with branches in Zürich and Chiasso held money mostly from Italy and concealed it by using a Liechtenstein letter-box company to conduct high risk business. On 1 March 1977, the Federal Banking Commission removed its licence to conduct business. The second collapse occurred on 5 May 1977 when the Geneva Bank Leclerc & Cie (which had been operating since 1885 as a collective company for private banks) after one of the participants in dubious business, including dealings with a Luxembourg arms trading company which had made a section of the clientele mistrustful. Maurer, 1981; Jung, 2000, p. 253.
70. Jung, 2000, p. 246.
71. Jung, 2000, p. 261.
72. Jung, 2000, p. 253.
73. Cf. Official Bulletin National Assembly and cantonal Assembly, June Session 1977.
74. Jung, 2000, p. 290 *et seq.*
75. Note that the abbreviation CDB used throughout corresponds to the French version of the title of the Agreement 'Convention relative à l'obligation de diligence des banques'.
76. In addition it sets out that banks are obliged to obtain this information also in relation to numbered accounts. Over and above this, briefly put, active assistance in relation to capital flight was forbidden henceforth; money that appears dubious or stemming from crime may no longer be accepted; also active assistance in tax evasion, for example, by producing confusing bank statements or certificates, is equally forbidden.
77. The bank initiative was launched at the party congress of the Swiss Social Democrats on 20 May 1978, with 124 291 signatures it was submitted on 8 October 1979. Jung, 2000, p. 293 *et seq.*
78. König, 1998, p. 288.

79. Bauer, 1990, p. 183.
80. FCD 116 IV 56; Report of the Parliamentary Investigation Commission of 22 November 1989, 89.006, incurred by the Federal Department of Justice and Police FDJP.
81. Report of the Parliamentary Investigation Commission of 22 November 1989, 89.006, incurred by the FDJP. Media report: SDA 1989, 1990. Some of the protagonists in the Pizza- and Lebanon- Connection were many years later once again before the courts, in part in different roles: in 1998, the 'Pizza Connection' clerk Paul Waridel, again for heroin smuggling as a member of a band, was sentenced to 13 years prison in 1985 (media report: SDA, 4 May 1998); the lawyer of both Paul Waridel and also of the Magharian brothers was arrested in 2001 and prosecuted for fraudulent business practices as vice president of the board of directors of the Cantonal Bank of Ticino and was accused of having engaged in highly speculative stockmarket transactions (media report: SDA, 3 October 2001); Franco della Torre, similarly convicted in connection with the Pizza Connection, living in Switzerland was prosecuted by the Italian authorities in Bari in March 2002 for cigarette smuggling, money laundering and belonging to the Mafia (media report: SDA, 5 March 2002). Della Torre place in the hierarchy is above that of the cigarette smuggler Gerardo Cuomo, the former living Switzerland and convicted for active bribery of Franco Verda. Franco Verda for his part was President of the Criminal Court in Lugano and the judge responsible for the cases in connection with the Pizza and Lebanon Connection. He was sentenced on 27 June 2001 to an 18 month prison sentence which was suspended. He was found guilty of passive bribery and for breaches of official secrets (media report: SDA, 9 August 1989, 27 June 2002).
82. Form B1 applies to Swiss lawyers and notaries, Form B2 for fiduciaries and asset managers.
83. Media report: SDA, 7 May 1991.
84. See Chapter 5.
85. The 'Money Laundering Guidelines' 1991, since 1998 the Guidelines contain special provisions with respect to handling money from politically exposed persons. Cf. Mazumder 2002. The Guidelines have been revised and put into an ordinance in 2003, see Chapter 5.
86. Swiss Federal Banking Commission, 'Abacha- Gelder bei Schweizer Banken', 2000, p. 6.
87. Swiss Federal Banking Commission, 'Abacha- Gelder bei Schweizer Banken', 2000.
88. Parliamentary motion by Christian Grobet (PdA (Workers Party) Geneva).
89. Press release of Swiss Federal Department of Finance, 5 July 2000.
90. French National Assembly, Rapport d'information sur les obstacles au contrôle et à la répression de la déliquance financière et du blanchiment des capiteaux en Europe, Paris 2001.
91. Report of the Business Audit Commission of the National Assembly 29 June 2001.
92. Media report: SDA, 21 February 2002.
93. Press release of Swiss Federal Department of Finance, 15 May 2002.
94. Federal Police, Report on the Internal Security of Switzerland, Berne 2001, p. 71; telephone call with press speaker on 12 March 2004.
95. See the diagram in Bernasconi, 2002, p. 428.
96. Official Brochure 'Combating Money Laundering in Switzerland', Berne 2002, p. 8.
97. On the right to notify see pp. 144–5 and more generally see section IV.
98. 'Switzerland as an international financial centre, which is able to exert an enormous pull for foreign capital, risks belonging to that group of countries that is preferred by money launderers. Therefore the fight against money laundering also serves the purpose of maintaining our good name, because this will have a preventive effect against the bringing in of unwanted capital'. Point f. of the criminal policy considerations in: Preliminary Draft Bernasconi, 1986, p. 21.
99. Preliminary Draft, Bernasconi, 1986
100. At that time the assumption was 'of several hundred millions', in: Preliminary Draft Bernasconi, 1986, p.20.
101. Memorandum, 1989, p. 6 *et seq*.
102. Bernasconi, 1988, p. 38.
103. Preliminary Draft, Bernasconi, 1986, p. 20.

104. Preliminary Draft, Bernasconi, 1986, p. 20.
105. Bernasconi, 1988, p. 38.
106. Recommendation relative aux mesures contre le transfer et la mise à l'abri des capiteaux d'origine criminelle R 80 (10) adopted 27 June 1980, published in Council of Europe, Committee of Ministers, Recommendations and resolutions 1980, Strasbourg 1981.
107. Consultations are a formal part of the law making process in which the cantons, political parties, organizations and groups can express their opinions.
108. FDJP, 1988, p. 2.
109. Federal Law on Narcotics and Psychotropic Substances of 3 October 1951, revised according to para. 1 of the Federal Law of 20 March 1975, in force since 1 August 1975, SR 812.121.
110. In addition, there was also the International Convention from 21 February 1971, concerning psychotropic substances and the additional protocol of 24 March, 1972 of the Convention on narcotics from 30 March, 1961. See Preliminary Draft, Bernasconi, 1986, p. 23.
111. Art. 36 of the Convention from 1961 concerning narcotics, SR 0.812.121.0.
112. Memorandum, 1989, p. 16.
113. As the State Prosecutor (notably in the Pizza Connection case) Bernasconi had gained first hand experience of prosecuting a money laundering case. In addition he had, independently from the consultative procedure in relation to the criminal law on property, drawn attention to the problem of a lack of an appropriate offence on money laundering at the 'Juristentag' in 1985. See: Report 1989, p. 16.
114. FDJP, 1988, p. 2.
115. Preliminary Draft, Bernasconi, 1986, p. 24. Cf. Stratenwerth, 2000, §55 N. 21, Schild Trappe, 1999, p. 212 *et seq*.
116. FDJP, 1988, p. 2 *et seq*.; Report 1989, p. 17. Although Italy at this time already had criminal laws on money laundering in relation to the proceeds of drug dealing and other legal instruments. Preliminary Draft, Bernasconi, 1986, p. 25; Report 1989, pp. 14, 35 FN 61: Reference to Art. 648bis of the Criminal Code (introduced on 21 March 1978) to combat money laundering in relation to theft, blackmail and hostage taking. In addition the 'decreto-legge' No. 625 from 15 December 1979, contained an obligation to register all financial transactions for the administration, banks and the post in relation to sums over 20 million Lira.
117. Bernasconi, 1988, p. 39.
118. For details of this affair see section I.
119. Memorandum, 1989, p. 18.
120. Memorandum, 1989, p. 18 *et seq*.
121. Memorandum, 1989, p. 18.
122. Memorandum, 1989, p. 19.
123. See among others, Stratenwerth, 2000, p. 189.
124. Subsidiary criminal law refers to the provisions in the criminal law that mainly regulate other material administrative policies that are contained in other Federal laws. Because of their low profile, these criminal provisions are often not accorded the importance that they should.
125. FDJP, 1988, p. 24.
126. FDJP, Annex IV, printed in Bernasconi, 1988, p. 48.
127. The start of the ratification process of the 1988 Convention against illicit drug trafficking was postponed until the conclusion of the revision of the narcotics law which was then running. Switzerland however, already fulfilled all its international obligations according to the terms of this Convention, such as the control of precursors and combating money laundering . See Statement of the Federal Department of Foreign Affairs: http://www.eda.admin.ch regarding its policy on illicit drugs. Accessed 5 December 2002. See Pieth, Part I above.
128. Recommendation relative aux mesures contre le transfer et la mise à l'abri des capiteaux d'origine criminelle. R 80 (10) adoptée le 27 June 1980, published in Council of Europe, Comité des Minisres, Recommendations et résolutions 1980, Strassbourg 1981.

129. Memorandum, 1989, p. 13.
130. Cf. Pieth above.
131. SR 0311.53.
132. OJ L 166/77.
133. On the background to this agreement following the Chiasso Affair, see the historical introduction, section I. The Agreement was signed on the one hand by the Swiss National Bank and on the other by the Swiss Banking Association and by all the Swiss banks. A first revision was made with the version published on 1 July 1982, the second revision came into force on 1 October 1987 and the Swiss National Bank withdrew as a signatory and the name was changed to 'Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence (CDB)'. As to the importance of this Agreement as a legal instrument against money laundering, see Bernasconi, 1988, p. 39 *et seq*.
134. Memorandum, 1989, pp. 12, 34 FN 34.
135. Crime and Secrecy: The Use of Offshore Banks and Companies, Permanent Subcommittee on investigations of the Committee of Governmental Affairs, US Senate, Washington, February 1983, p. 135, cited in Bernasconi, 1988, p. 44 FN 7 and FN 14.
136. Memorandum, 1989, p. 13.
137. Memorandum, 1998, p. 27.
138. Memorandum, 1989, pp. 14–16.
139. FCD 108 Ib 186; 111 Ib 126; see section IV.
140. *Anti-Money Laundering Guidelines* No. 91/3.
141. Schwob, 2000, No. 20–24. She is particularly critical of, what in her opinion, constitutes the unclear legal basis upon which the guidelines are based, and that they in part go beyond what was foreseen legally.
142. Memorandum, 1993, p. 324.
143. Memorandum, 1993, p. 322.
144. Memorandum, 1996, p. 1102.
145. De Capitani, 2002, p. 567.
146. Federal Law of 22 December 1999, regarding the creation of a new procedural competence by the federal authorities in the areas of organized crime and economic crimes, in force since 1 January 2002 (AS 2001 3071 3076; BBl 1998 1529).
147. Beyond this the reform of the Swiss police has long been the subject of discussion. A federal commission has been working on this topic since 1999. Project USIS ('Ueberprüfung des Systems der Inneren Sicherheit der Switzerland'), http://www.admin.ch/usis.
148. This change of competence requires a personnel increase of the Attorney General's Office, the Federal Police and Federal Investigating Magistrates by 2004. The Attorney General's office consisted originally of 20 employees, and has increased to 100 people, the Federal Police has increased from 100 to around 425 and Federal Investigating Magistrates from two to around 25. These federal authorities have to prosecute transborder cases relating to organized crime, money laundering and corruption. The transfer of the cases from the cantons to the federal level involves certain problems however because both the material and the procedural laws contain unclear legal concepts. Thus the distribution of the cases requires some interpretation, the development of common interpretive criteria and the analysis of controversial cases. According to the Attorney General Roschacher Valentin: New developments in the fight against organized crime, speech 26 February 2002, given at the Europa Institut, Zürich University. Allocating competence is not only a problem that affects the cantonal and federal authorities. There also appears to be a lack of clarity regarding the allocation of competence between the Attorney General's Office and the Federal Investigating Magisrates. So in the Bellasi case – which involved a former secret service accountant who was accused, among other things, of money laundering – it was unclear which of the two authorities could decide about the application for bail. FCD 8G.87/2002, 8 August 2002 in NZZ, 22 August 2002, No. 193, p. 14. The decision is not going to be published.
149. Annual Report of 2002 of the Reporting Office, Berne 2003, 4.
150. Annual Report of 2002 of the Reporting Office, Berne 2003, 32.

151. Art. 4 s.2 of the Council of Europe Convention No. 141 (SR 0.311.53) which has been ratified by Switzerland. Memorandum, 19 August 1992 in BBl 1992 VI 9.
152. Figure 6 of the recommendations of the KKJPD commission on economic crime to the cantonal prosecuting authorities relating to the blocking of accounts and confidentiality obligations of the banks from 7 April 1997 and explanations of 25 March 1997.
153. FDJP, 2001, pp. 27, 235.
154. Press release from the Federal Department of Finance, 15 May 2002.
155. Federal Judge Wieprächtiger Hans, in NZZ, 13 March 2002.
156. An appropriate restriction to the value of property that can be linked to organized crime, was at least discussed in parliament, but then was rejected. Motion by Salvioni, rejected by 86 to 89 votes, AB NR 1989 1843, 1845; see also the case law: FCD 119 IV 62, 122 IV 222 *et seq*.; 120 IV 327 *et seq*.
157. The accused was tolerant of the consumption of drugs and allowed friends to hide the proceeds of drug trafficking on his balcony (initially SFr. 70 000, then SFr. 120 000). Later he removed some of the money and hid it in his kitchen, another part he spent.
158. Pieth, Estermann, 2002, p. 385.
159. Memorandum, 1989, p. 7 on the state of knowledge of the Swiss prosecuting authorities.
160. Since 1986, see section II.2.
161. A similar approach is taken by other FATF member countries, for example Austria (more than three years) and New Zealand (more than five years). This method has proved to be a practical one because where countries have itemized the offences they then have to pass amending legislation that adds new predicate offences for money laundering. These lists are often very long anyway, for example the USA covers more than 130 predicate offences. FATF, 2001, p. 8 N. 24.
162. Art. 146 CC, Art. 172ter CC.
163. According to Art. 14 VStr.
164. Art. 161 CC.
165. Art. 161bis CC.
166. Art. 186 DBG.
167. FATF, 2001, p. 8 N. 26.
168. Art. 251 CC ; Trechsel, 1997, 305bis N. 10 with reference to 251 N. 20.
169. See III.A.2.c.b. regarding Switzerland's interpretation of smuggling.
170. Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, 8 November 1990.
171. FATF, 2001, p. 3 N. 7, 8.
172. Directive 91/308/EWG from 10 June 1991, OJ L344 s. 76.
173. See section III.
174. Bernasconi, 2002, p. 450. These issues are currently the subject of negotiations between Switzerland and the EU and concern a co-operation agreement to combat fraud and other crimes that affect the financial interests of the EU and Switzerland.
175. For example cheques, exchange, credit cards, securities and creditors' rights. Schmid 1998, Art. 59 with a detailed list in N17 *et seq*.
176. Preliminary Draft, Bernasconi, 1986, pp. 27, 30 *et seq*.
177. Preliminary Draft, Bernasconi, 1986, p. 28.
178. Bernasconi, 1988, p. 48 *et seq*.; Pieth, 2002 N. 61.
179. Ackermann, 1998 N. 156.
180. AA.$260^{quinquies}$ CC, in force since 1 October 2003.
181. Ackermann, 1998 N. 211 *et seq*.
182. Pieth, 2001d N. 65 *et seq*.
183. Although the obstruction of the investigation as to the provenance and the discovery are explicitly and separately mentioned, in practice activities that obstruct the investigation of the provenance or the discovery, will very often also affect the confiscation. Pieth, 2003 N.73. The elements 'establishment of the provenance' and 'discovery' are included in law in conformity with the Vienna Convention 1988, Official Bulletin SR 1990 195.
184. Memorandum BBl, 1989, p. 1083.
185. Wohlers, 2002, p. 197 *et seq*.

186. FCD 119 IV 62 *et seq*.
187. FCD 122 IV 218.
188. FCD 127 IV 26.
189. Pieth, N. 85 for further references.
190. FCD 119 IV 124.
191. Ackermann, 1998 N. 317, Pieth, 2002 N. 85.
192. Unpublished decision from 24 January 2000, cited in FCD 127 IV 26; Ackermann, 1998 N. 261 *et seq*. and 268 *et seq*.; Cassani, 1996 N. 32; Trechsel, 1997 N. 17; Pieth, 2002 N. 79; FCD 124 IV 278 *et seq*.
193. Pieth, 2003 N. 87.
194. Cf. Ackermann, 1998 N. 300.
195. FCD 120 IV 324, 122 IV 223, 124 IV 274 *et seq*. E.3 with references to many academic critiques.
196. FATF 2001, p. 8 N. 28.
197. FDC 119 IV 247 *et seq*.; 122 IV 217, Ackermann, 1998 N. 407 *et seq*.; Stratenwerth, 2000 §55 N. 32.
198. For example France and Norway, FATF 2001, p. 10 N. 35.
199. Ackermann, 1998 N. 566.
200. Hence, foreign predicate offences are not a problem for almost all FATF members, with the exception of the USA, which has a very limited list of such predicate crimes'. FATF, 2001, p. 9 N. 33.
201. Pieth, Estermann, 2002, p. 385.
202. Stratenwerth, 2000 §55 N. 33.
203. On international reception, see section II.2.
204. See previous chapter.
205. Schmid, 2002, p. 20; For the origins of the CDB and context 1977, see ch. 1.
206. See p. 134.
207. See hereinafter section IV.
208. As an administrative law which has been created to substantiate criminal provisions therefore this law is binding when Art. 305[ter] para. 1 applies. See Schmid, 2002, p. 31.
209. Schmid, 2002, p. 46 *et seq*.
210. Pieth, 2003 N.129.
211. SR 955.022, in force since 1 July 2003 replacing the guidelines 98/1. Press release of 17 January 2003 of the Federal Banking Commission.
212. Up until now the precise status of the CDB 03 is a matter of dispute: While the Supreme Court regards the application of the CDB only as unbinding interpretive assistance (FCD 125 IV 139 *et seq*.) in relation to the criminal law, according to Schmid it has a substantiating function (2002, p. 29 *et seq*.). See Wiegand, Wichtermann, 2000, pp. 28–36.
213. Schmid, 2002, p. 68, 74 *et seq*.
214. Schmid, 2002, p. 48.
215. With respect to the identification of just the beneficial owner, see Cassani, 1996 N. 17; Egger Tanner, 1999, p. 276 *et seq*.; Trechsel, 1997 Art. 305[ter] N. 6; on the inclusion of the immediate contracting partner: Memorandum, 1989, p. 1089; Ackermann, 1992, p. 112, 126, Graber, 2000, p. 199, De Capitani, 2002, p. 734 *et seq*.
216. Pieth, 2003, N. 123.
217. Schmid, 2002, p. 71; in more detail see the section on customer due diligence in Chapter 5.
218. Pieth, 2003, N. 125. The crucial point is judging whether the financial intermediary, on the basis of the information in Form A, must have had doubts about the declarations set out in the Form and that the person mentioned therein is not the beneficial owner of the money to be deposited. These potential various interpretations of facts led in a 1991 case, to a decision by the Supervisory Board of the Private Banker's Association, that the due diligence duty on identification of the beneficial owner had not been breached, on the other side though to a conviction for an offence under Art. 305[ter] para. 1 CC by the Supreme Court (FCD 125 IV 139 *et seq*.); Work Report 1998–2001 of the Supervisory Board, 2002, pp. 3, 4.

219. Art. 18, para. 1 CC.
220. FCD, 8 June 1999, unpublished but quoted in Schmid, 2002, p. 81.
221. Tanner Egger, 1999, p. 301 *et seq*.
222. Kuster, 2000, p. 797.
223. Trechsel, 1997, 305ter N. 19
224. Schmid, 2002, p. 119; Schwob, 2000, N. 27.
225. See section IV.
226. Schwob, 2000, No. 27.
227. Kuster, 2000, p. 797.
228. Schmid, 2002, p. 121.
229. Memorandum, 1996, p. 1131.
230. Kuster, 2000, p. 798.
231. Schmid, 2002, p. 120.
232. Memorandum, 1998, 1979 *et seq*. [23333] on Art. 102 Draft-CC.
233. Adopted by the General Assembly of the United Nations on 9 December 1999.
234. BBl 2002, p. 5455 *et seq*.
235. Unofficial translation, because no official translation is available.
236. Memorandum, 98.038, 21 September 1998, 217.421.
237. Memorandum, 98.038, 21 September 1998, p. 355.
238. Memorandum, 98.038, 21 September 1998, 217.421.
239. Pieth, 2001c, p. 11 *et seq*; Huber, 1995; Stratenwerth, 1992, p. 303 *et seq*.
240. Memorandum 02.052, 26 June 2002, published in: BBl 13 August 2002, p. 5390 *et seq*., p. 5437.
241. Memorandum, 98.038, 21 September, 1998, 217.422.
242. Trechsel, 1997, Art. 58 N. 4 1997.
243. The administrative law is applied where there is an illegal act by a federal administrative authority (Art. 1) (SR 313.0).
244. A multilateral agreement whereby banks that operate in Switzerland have agreed to be subject to the Swiss Bankers Association. See section I.
245. This is supposed because according to the media report 4 March 2002, several million francs in fines was collected. This money was donated to the International Committee of the Red Cross.
246. Art. 25 para., 3 para., c MLA. See section IV.
247. Art. 260bis para. 1 and para. 2. Imprisonment of up to five years is foreseen.
248. Introduced through s. I of the Federal Law, 18 March, in force since 1 August 1994 (BBl 1993 III 277).
249. Art. 6 s.3 of the legal assistance treaty between the Swiss Federation and the USA, signed in Bern, 25 May 1973, SR 0.351.933
250. Stratenwerth, 2000, p. 198 N. 18.
251. Quite clearly, in practice the group targeted by Art. 260ter CC are not caught. According to the Report 2000 of the Federal Police, between 1 August 1994 and 31 December 2000 in the cases dealt with 80 per cent were stopped or were acquittals and guilty verdicts in around 20 per cent (that is, 12).
252. Supreme Court Judge Wieprächtiger Hans in NZZ 13 March 2002, for example a cigarette smuggler wanted in Italy cannot be extradited because the tax offence is not criminal in Switzerland, but only on the basis of Art. 260ter CC, if membership of a criminal organization can be shown.
253. FATF, 2001, p. 8 N. 25.
254. Art. 305bis s.2, para. a Criminal Code.
255. Art. 59 s.3. CC.
256. Memorandum 99.026 §212.24.
257. Capus 2002, pp. 633–669.
258. For further information on ‘corruption money laundering’, see Pieth, 2001d (Festschrift), pp. 437–56.
259. Schmid, 1998, p. 4.

260. Target 23 in the Outline of Future Activities in Drug Abuse Control of the United States, New York.
261. See the FATF, 2001, pp. 11 *et seq.*, N. 37–48.
262. The confiscation corresponds in procedural terms the seizure, which enables the prosecuting authorities to obtain control over property before a final judgement has been given, which may assist in the collection of evidence or the covering of the costs of the procedure as well as relate to any final decision on confiscation. Trechsel, 1997, Art. 58 N. 1.
263. SR 812.121.
264. SR 313.0.
265. Schmid, 1998, p. 84.
266. Schmid, 1998, Art. 58 N. 12.
267. The separation of security confiscation from the so-called comprehensive deprivation (Art. 59, s. 1) followed in the context of the 1994 reform.
268. Schmid, 1998, Art. 58 N. 22–24.
269. Art. 58 para. 1 CC '[. . .] if these objects endanger the security of people, morals or public order'.
270. Schmid, 1998 Art. 58 N. 31, 32; Trechsel, 1997, Art. 58 N. 10.
271. Schmid, 1998 Art. 59 N. 17, 18.
272. FCD 119 IV 10.
273. FCD 105 IV 171; 106 IV 11
274. Schmid, 1998 Art. 59 N. 10.
275. FATF, 2001, p. 8 N. 25.
276. Schwob, 2000, No. 29.
277. Pieth, Estermann, 2002, p. 375.
278. On confiscation and transfer of property in the context of legal assistance, on sharing and also on confiscation and seizure based on the foreign policy competence of the Federal Council: see section III. On administrative law possibilities to block assets see section IV.
279. Schwob, 2000, N. 28.
280. Hauser, Schweri, 1999, p. 294 *et seq.*
281. Trechsel, 1997 Art. 59 N. 1, 4–6.
282. Ackermann, 1998, p. 672 *et seq.*
283. Ackermann, 1998, p. 673 *et seq.*
284. This data base is not national, but in relation to the offence of money laundering this canton (Zürich) because of its significance as a financial centre can be used as a reliable example for the situation in Switzerland. Pieth, Estermann, 2002, p. 380.
285. Statistics on Judgements, Federal Office for Statistics.
286. Pieth, Estermann, 2002, p. 385.
287. Federal Police, Report on the internal security of Switzerland, Berne, 2001, p. 71; Telephone call with Ms Bersier who is the person responsible 9 September 2002.
288. Statistics on Judgements, Federal Office for Statistics.
289. Bernasconi, 2002, p. 154.
290. Bernasconi, 2002, p. 154; Nobel, 2002, p. 896; see Popp, 2001, p. 13 *et seq.*; Glaser Tomasone, 1997, p. 10 *et seq.* and p. 20 *et seq.*
291. Art. 3 and 4 of the Concordat; Pieth, 2001a, p. 60 *et seq.*
292. Distinction pursuant to Mutual Legal Assistance Act, Art. 1, para. 1; Mueller, 1998, p. 3.
293. Art. 63 *et seq.* IMAC.
294. Bernasconi, 2002, p. 153.
295. See below regarding the relationship between foreign and Swiss criminal proceedings; Pieth/Estermann, 2002, p. 376, with reference to practices in Geneva, whose legal political basis is set out in 'Appel de Genève'. 'Appel de Genève' is the call by the association 'Magistrats européens pour la Démocratie et les Libertés' for the development of an efficient system of European criminal investigations. The text can be found (in French) at: http://www.genève.ch/tribunaux or http://www.cidadevirtual.pt/asjp/medel/appel.html.
296. Swiss Financial Centre, A documentation, 2002, Ch. VIII, 1.
297. IMAC, 20 March, 1981, SR 351.1.
298. IRSV.

299. The Law on Data Protection (DSG) is not explicitly applicable to proceedings in international mutual legal assistance: Art. 2, para. 2c DSG. The legislature had already sufficiently developed mutual legal assistance procedurally and in the area of data protection. This is not true with administrative assistance.
300. Pieth, 2001a, p. 59.
301. SR 0.353.1 (in force in Switzerland since 20 March 1967).
302. SR 0.351.1 (in force in Switzerland since 20 March 1967).
303. SR 0.101 (ECHR).
304. Pieth, 2001, p. 58 and p. 67; Huber, 1995.
305. Various exchanges of letters and a Memorandum of Understanding dated 10 November, 1987 (BBl 1988 II.394) supplement this treaty.
306. Swiss Federal Act with regard to the American-Swiss Treaty on Mutual Legal Assistance in Criminal Matters dated 3 October 1975, SR 351.93; Swiss Federal Council, Memorandum with regard to the American-Swiss Treaty on Mutual Legal Assistance in Criminal Matters dated 28 August 1974, BBl 1974 II 582, 632.
307. These goals were set out in 'RICO,' the Racketeer Influenced and Corrupt Organizations Act from 1970.
308. Pursuant to the principle of the priority of *jus gentium* over national law. Zimmermann, 2004, N. 105 and FN. 729.
309. Cf. FCD 122 II 140 (*Bofors*), 120 Ib 179 (*mani pulite*), 116 Ib 452 and 115 Ib 496 (*Marcos*), 115 Ib 517 (*PEMEX*).
310. BBl. 1995 III p. 1 *et seq*.
311. Art. 18, para. 2 IMAC.
312. Mueller, 1998, p. 35, FN 287.
313. English translation according to Nobel, 2002, p. 899.
314. For further Decisions of the Swiss Federal Court, see Nobel, 2002, p. 900.
315. Federal Banking Commission, Annual Report 1986, p. 25 and 26. In addition, the Marcos case had the consequence that the Banking Commission created a new concept of 'increased diligence', which makes it the direct responsibility of a bank's top management to decide whether or not business relationships with politically exposed persons (so-called 'PEPs') may be initiated or continued. See section IV.
316. Art. 102 para. 8 FC.
317. Art. 67a IMAC.
318. Decision of the Federal Supreme Court on this issue quoted in Ziegler, 1999.
319. Formerly the Federal Office of Police Affairs, Guideline 1998, p. 27 *et seq*.
320. Art. 17, para. 4 IMAC.
321. See section II; AS 2001 3071. Bernasconi, 2002, p. 171 *et seq*.
322. Inserted by II 2 of the Federal Law, 22 December 1999 (Creating new federal procedural competencies in the areas of organized crime and economic criminality), effective since 1 January 2002 (AS 2001 3071 3076; BBl 1998 1529).
323. Art. 10 *et seq*. of the Swiss Federal Act with regard to the American-Swiss Treaty on Mutual Legal Assistance in Criminal Matters, 3 October 1975, SR 351.93.
324. Art. 36a of the Swiss Federal Act with regard to the American-Swiss Treaty on Mutual Legal Assistance in Criminal Matters, 3 October 1975, SR 351.93.
325. Art. 64 IMAC, section d. below.
326. Art. 67 IMAC. Foreign authorities must accept the obligation that information they receive from Switzerland will only be used for the goal for which it was transmitted. This means in particular, that in the context of mutual legal assistance proceedings, information received may not be transmitted to other authorities (for example tax authorities).
327. Art. 66 IMAC states the principle of *ne bis in idem*, which allows mutual legal assistance to be denied when the accused is in Switzerland and a criminal proceeding is pending or has been finally completed regarding the acts upon which the request is based.
328. Art. 7 IMAC.
329. Pieth, 2001a, p. 58; Switzerland's first extradition treaties stem from the years 1850 and 1853 and were concluded with the USA and the Netherlands. A total of 14 more were concluded by 1890. These extradition treaties regulated extraditions based upon a catalogue of crimes

and contained the first provision on 'other' mutual legal assistance, meaning it involved the surrender of objects. With increasing mobility and improved communications they took on greater independent meaning. Even the exchange of evidence took place, although primarily for proving that the conditions for extradition are met and not for purposes of the foreign proceedings.

330. Art. 2 IMAC.
331. Art. 4, 5, and 1a IMAC.
332. Art. 3, para. 3 second sentence IMAC.
333. Art. 3, para. 3 first sentence IMAC.
334. Switzerland's refusal to provide mutual legal assistance in cases of tax evasion is officially explained (Swiss Financial Centre, A documentation, 2002, Ch. VII. 1.2.) as a peculiarity of the Swiss legal system and the principle of non-discrimination of foreigners in comparison with Swiss citizens. As a counterweight to bank confidentiality – and thereby to possible tax evasion – Switzerland levies a very high withholding tax (35 per cent), which means that it is reimbursed to an investor when he pays income tax in accordance with the regulations. Nevertheless, tax evasion is possible because foreign investment instruments with no withholding taxes are available, for example, trust investments or foreign bonds. These exceptions are, however, based on the fact that Switzerland's tax legislation cannot be applied extraterritorially, but rather only interest amounts and dividends from national debtors or Swiss companies are captured at their source.
335. Bundesgesetz 14 December 1990 regarding the direct federal tax (DBG), SR 642.11.
336. Bundesgesetz on the harmonization of direct taxation by the cantons and local municipalities (SR 642.14).
337. Art. 14, para. 2 VStrR, SR 313.O.
338. Cf. the legislative formulation in, for example Art. 175, para. 1 DBG; Art. 56, para. 1 StHG; Art. 85 MWSTG.
339. Art. 186, para. 1 DBG; Art. 59, para. 1 StHG; Meier-Schatz et al., 2001, FN 1077, p. 249.
340. Meier-Schatz et al., 2001, p. 249. According to Meier-Schatz et al., however, in many cases prosecution because of tax fraud does not occur, which is legally problematic, and for tax officials who do not file a criminal complaint, the problem of preferential treatment pursuant to Art. 305 Criminal Code is raised.
341. Meier-Schatz et al., 2001, FN 1081, p. 249.
342. Art. 14, para. 2 VStrR.
343. FCD 115 Ib 68 *et seq*.
344. FCD 111 Ib 249.
345. Pieth 2001a, p. 73, quoting FCD 111 Ib 249 *et seq*.
346. Press release of the Federal Finance Adminstration, 20 June 2003.
347. See for the case of cigarette smuggling see section III.B.4.
348. Bernasconi, 2002, p. 433.
349. Art. 6, para. 4 ETS No.141.
350. So-called 'Al Capone Exception': even decades ago the US fight against criminality was based upon the use of tax offences primarily, but also other offences of supplementary criminal provisions, in combating serious offences and organized crime. In this context, the example of Al Capone's arrest in the 1930s is often cited: Al Capone could not be found guilty of murder, but only tax evasion. Bernasconi, 1988, p. 31.
351. FCD 116 Ib 103, 115 Ib 77 *et seq*.
352. FCD 117 Ib 64.
353. Agreement 10 September 1998, Art. II, para. 3; BBl 1999 II 1485 *et seq*., 1585. Quoted in Nobel, 2002, p. 898.
354. Meier-Schatz et al., 2001, p. 262.
355. FCD 110 IV 28, Pieth, 2001a, p. 73, with additional references in FN 93.
356. Meier-Schatz et al., 2001, FN 1130, p. 260.
357. FCD 111 Ib 249 *et seq*.
358. FCD 111 Ib 248, Meier-Schatz et al., 2001, FN 1130, p. 260.
359. Nobel, 2002, p. 898.
360. FCD 113 Ib 272.

361. FCD 114 Ib 59 *et seq*.
362. Meier-Schatz et al., 2001, p. 262.
363. Meier-Schatz et al., 2001, p. 262.
364. Pieth 2001a, p. 72. The rules on subsidy fraud under Swiss law are, however, rather complex: Article 146 CC (general fraud), Article 14 Federal Administrative Criminal Law (VStR), or cantonal substantive subsidy fraud provisions may be applicable.
365. Information of the Federal Department of Justice and Police, http://www.FDJP.admin.ch, visited in September 2002.
366. Mueller, 1998, p. 12.
367. Bernasconi, 2002, p. 183; Popp, 2001, §8.
368. See FCD 109 Ib 164; 107 Ib 254 E. 2b, aa.; 112 Ib 585 E. 3.
369. The principle of dual criminal liability was traditionally generally recognized, but not considered binding under international law. Popp, 2001, p. 134. Zimmermann, 2004, N. 87 FN 619. Within international legal and administrative assistance, dual criminal liability is one of a number of principles, such as for example, protection of human rights, principle of obtainability, adverse right, principle of proportionality, principal of speciality, and *ne bis in idem*.
370. Art. 64, para. 1 IMAC.
371. FCD 109 Ib 53; 111 Ib 137.
372. Bernasconi, 2002, p. 186.
373. Popp, 2001, p. 141.
374. Bernasconi, 2002, p. 187.
375. See Bernasconi, 2002, p. 187
376. See also Popp, 2001, p. 143 *et seq*.
377. Popp, 2001, p. 145.
378. Zimmermann, 2004, N. 377.
379. Contrary to the view of the Federal Supreme Court, which declared the condition of dual criminal liability as mandatory, even when it was not explicitly foreseen in an international agreement. FCD 105 Ib 286 E. 2a, p. 294, quoted in Bernasconi, 2002, p. 187.
380. Cf. to complete discussion, Popp, 2001, §10.
381. See part II; this condition is in accordance with the declaration delivered by Switzerland on the occasion of the deposit of the ratification of ETS No. 141 in regards to the Art. 6 para. 1 (see *Bundesbeschluss* (Federal Resolution) dated 2 March 1993, AS 1993, p. 2384.)
382. Bernasconi, 2002, p. 438.
383. Bernasconi, 2002, p. 438.
384. If the investigation authorities discover a suspicious account, for example the account of an accused person or an account into which the criminal proceeds at least in part have flowed, surrender of the documentation regarding all transactions in the account will be requested. In a second phase, the surrender of the documentation of financial transactions of all accounts that are demonstrated to be connected to the first identified bank account will be surrendered, etc.
385. Schmid, 2004, N. 686 FN 3.
386. For a thorough discussion, see Bernasconi, 2002, p. 261 *et seq*.
387. International law sources include: ETS No. 141, Art. 5 of the Vienna Treaty 1988; Art. 12 *et seq*.; the United Nations Treaty against Transnational Organized Crime; Art. 8 of the United Nations Treaty on Combating the Financing of Terrorism; Art. II of both the Treaty between Switzerland and Germany and Switzerland and Austria on the Expansion of the European Union Treaty regarding Mutual Legal Assistance in Criminal Matters dated 20 April 1959 and Assisting with its Application.
388. Art. 74 IMAC.
389. Art. 74a IMAC.
390. Mueller, 1998, p. 16.
391. FCD 115 Ib 517 *et seq*.
392. FCD 116 Ib 452 *et seq*.
393. Pursuant to Art. 58 *et seq*. CC.
394. Art. 59, 74a IMAC.

395. Art. 74a, para. 3 IMAC.
396. Art. 59, para. 1 IMAC. Pursuant to Art. 59, para. 7 and Art. 22 IRSV the extradition of objects is independent of the consummation of the extradition of the person.
397. Art. 59, para. 7 IMAC; FCD 126 II 595 E. c.
398. Bernasconi, 2002, p. 241, quoting FCD 123 II 595 E. c.
399. Mueller, 1998, p. 18. Critical of this legislative compromise: Popp, 2001, p. 282 *et seq*.
400. Art. 13, No. 1 of the Council of Europe Convention No. 141 or Art. 5 No. 4 of the Vienna Treaty, 1988; Bernasconi, 2002, p. 359.
401. Art. 59 para. 5 IMAC, Bernasconi, 2002, p. 244.
402. Primarily seizure for the purpose of confiscation pursuant to Art. 58 und 59 CC as well as pursuant to Art. 24 Narcotic Law. See part II; Bernasconi, 2002, p. 241.
403. Art. 40 IMAC. Bernasconi, 2002, p. 243, quoting FCD 113 Ib 188 E. 5.
404. Bernasconi, 2002, p. 357 *et seq*. , quoting FCD 115 Ib 53, 123 II 273, 276.
405. Art. 59 CC and Art. 24 Narcotic Law.
406. SR 0.311.53. Cf. in particular on this point the Memorandum of the Federal Council 19 August 1992 (BBl 1992 VI 9).
407. On 24 October 2001, the Federal Council approved a Memorandum on the Federal Law Regarding the Division of Collected Assets, SR 01.064, BB1 2001, p. 441 *et seq*.
408. However, internationally ten FATF-members cannot share and six cannot receive shared assets, FATF 2001, p. 33 N. 122.
409. Art. 11, para. 2 TEVG.
410. See Ackermann, 1992, p. 315 *et seq*.
411. §43a, para. 1 of the German Criminal Code allows the court, in cases where the statute references this provision, the possibility of imposing in addition to a prison sentence of more than two years the payment of a fine in an amount limited to the value of the offender's assets.
412. Memorandum on TEVG, No. 2.1.2.2, p. 461 *et seq*.
413. Pieth/Estermann, 2002, p. 378.
414. The survey results of the Swiss Financial Administration showed that the Cantons confiscated SFr. 21 million in 1998 and 30 million in 1999. The Federal Prosecution Office between 1994 and 1998 confiscated 15.5 million and seized 5.6 million Swiss Francs and 3 million dollars. Contrary to this, the newspaper CASH (No. 46, 13 November 1998) reported that the Federal Government and the Cantons confiscated drug money in the amount of SFr. 572 million since 1990. Memorandum on TEVG, No. 1.1.2, p. 445.
415. Meier-Schatz et al., 2001, N. 648.
416. Cf. Bernasconi, 2002, p. 337; as to administrative assistance by bank supervisors, cf. Bodmer/Kleiner/Lutz, 2001, on Art. 23^{sexies} N. 27.
417. Bernasconi, 2002, p. 344.
418. Basically, the DSG is only secondarily applicable in light of the special rules for the provision of administrative assistance. Bernasconi, 2002, p. 345.
419. A person is 'ascertainable' when, although they cannot be definitively identified by the data alone, the context of the information enables the identification. A person is not 'ascertainable' when the effort to identify the person would be so significant that, based on general life experience, one must not reckon with someone taking on such a task. Art. 3 lit. a and Art. 2, para. 1 DSG.
420. Memorandum DSG, p. 444 *et seq*.
421. Bernasconi, 2002, p. 345 quoting FCD 126 II 126 *et seq*., 131 E. 5a/aa.
422. FCD 125 II 74 *et seq*. E. 7. A legislative basis is demanded in the literature, when third party interests are affected: Glaser Tomasone, 1997, p. 68; Althaus, 2001, p. 151.
423. Bernasconi, 2002, p. 349.
424. Annual report, 2002, p. 52, published in April 2003.
425. See section IV.
426. For the international law sources of administrative assistance regarding financial market supervision, see Sansonetti, 1998, pp. 203–355.
427. United Nations Treaty against Transnational Organized Crime 15 November 2000.
428. Rec. 5 FATF.

429. Art. 30 MLA refers to the special law supervisory authorities foreseen in the MLA for administrative assistance (Art. 12 MLA) and to those for the applicable federal law special statues. By this, for the Swiss Banking Commission Article 23^{sexies} Bank Act, Art.63 AFG, Art.38 BEHG, for the Federal Office for Private Insurance Art. 17 LeVG, and for the Swiss Casino Commission Art. 98 CDBG are meant.
430. Bernasconi, 2002, p. 484.
431. SR 955.0
432. The federal law, 7 October 1994 regarding criminal police central offices of the federal government (Zent), took effect on 15 March 1995, and regulates the forwarding of personal data in Art. 13.
433. SR 955.23. Federal Ordinance on the MRO.
434. SR 952.0
435. SESTA.
436. AFG.
437. BBl 1993 I 1392 *et seq*.; FCD 125 II 73. Meier-Schatz et al., 2001, p. 243.
438. SR 954.1.
439. This is why the FBC has recommended to the Federal Council and Parliament that legislative amendments happen quickly. FBC Press release 23 January 2002.
440. Meier-Schatz et al., 2001, p. 237 *et seq*.
441. Introduced to Switzerland with the amendment to the Bank and Stock Exchange Act of 22 April 1999.
442. See below; Meier-Schatz et al., 2001, pp. 23, 239.
443. Art. 351$^{bis\text{-}octies}$ CC.
444. Art. 75a IMAC.
445. SR 360.
446. SR 360.2.
447. SR 360.2. JANUS is the information system of the federal criminal police, which contains data relating to the fight against criminal organizations.
448. Mueller, 1998, p. 4.
449. Bernasconi, 2002, p. 411.
450. Bernasconi, 2002, p. 417.
451. Federal Police, Report on Internal Security in Switzerland, Bern, 2001, p. 53.
452. Treaty in the form of a letter exchange between the European Community and the Swiss Confederation on Reciprocal Administrative Assistance in the Area of Customs regarding a Supplementary Protocol to the Treaty 22 July 1972 between the Swiss Confederation and the European Economic Community. SR 0.632.401.02.
453. Memorandum on administrative assistance in the Area of Customs regarding a Supplementary Protocol to the Free Trade Treaty between the Swiss Confederation and the European Economic Community 19 January 1998, BBl 1998, 939.
454. Pieth, 2001a, p. 74.
455. Bernasconi, 2002, p. 421, quoting Swiss Federal Department of Finance, May 2001.
456. Swiss Financial Centre, A documentation, 2002, Ch. VIII, 2.4.
457. Art. 3, para. 3 IMAC.
458. Bernasconi, 2002, p. 422.
459. Bernasconi, 2002, p. 423. Moreover, smuggling was introduced by the FATF-Rec. 1 as a predicate offence in June 2003, and it's open if all partners will accept Switzerland's interpretation of 'smuggling', see III.A.2.c.b and regarding cigarette smuggling, see III.B.4.
460. Swiss Financial Centre, A documentation, 2002, Ch. VIII, 2.4
461. Press release of the Federal Department of Finance, 15 March 2002.
462. OECD, Committee on fiscal affairs (eds), Model Tax Convention on income and on capital, Paris. Art. 26 contains a model clause on administrative assistance, which has a so-called 'major' administrative assistance clause providing, among others things: that exchanges of information should be guaranteed of appropriate application of the convention and for the enforcement of national law regarding taxes that are within the scope of the convention. The efforts of the OECD are toward expanding the exchange of information to

all (and not only those within the scope of the convention) taxes and the introduction of mutual enforcement assistance.

463. Meier-Schatz et al., 2001, p. 253, N. 706.
464. This practice was confirmed in FCD 96 I 737 and FCD 101 Ib 160.
465. IMAC discusses fiscal fraud without using the term itself. The legislative materials reference Art. 14 VStR (Federal Law on Administrative Proceedings 22 March 1974). Cf. Pieper, Rechts und Amtshilfe in Steuerangelegenheiten durch die Schweiz insbesondere im Hinblick auf das schweizerische Bankgeheimnis, Frankfurt a. Main 1995, on the meaning: pp. 69 *et seq*.
466. BBl 1999 II 1460 *et seq*.
467. This definition corresponds with the Memorandum on the Double-Taxation Treaty (BBl 1997 II p. 1099) of the previous decision of the Federal Supreme Court in mutual legal assistance cases.
468. Meier-Schatz et al., 2001, p. 266.
469. See section I.
470. FCD 113 Ib 167, 118 Ib 444, 123 II 153. In some treaties this has even been explicitly stipulated.
471. Bernasconi, 1988, pp. 114–142. Procedural sanctions against unwilling and uncooperative witnesses vary from Canton to Canton, but typically fines and imprisonment may be imposed. See the general provision in Art. 292 CC.
472. FBC Press release 26 April 2000.
473. Since 1997 the Swiss Federal Banking Commission issued 118 formal decrees of which 73 were appealed to the Federal Supreme Court, which partially or fully granted the appeals in 34 cases. Statistics by Zuberbühler, 2002.
474. According to the Director of the Secretariat of the Swiss Federal Banking Commission, this is considered a unique Swiss feature. Zuberbühler, 2002.
475. Meier-Schatz et al., 2001, N. 670.
476. FBC Press release, 26 April 2000
477. See FCD 126 II 126 *et seq*. (*ABB/Elsag Bailey*) and FBC Press release of 23 January 2002.
478. This means, in particular, the conditions for dual criminality and the exclusion of tax offences (except tax fraud). On that issue, the Commission must decide in accordance with the Federal Office of Justice.
479. Schwob, 1997, pp. 169–176.
480. Meier-Schatz et al., 2001, N. 677 and N. 682
481. Zuberbühler, 2002 p. 13 *et seq*.
482. Zuberbühler, 2002.
483. SR 955.0.
484. Proposal for a European Parliament and Council Directive amending Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, COM (1999) 362 final; Official Journal C 177 E of 27 June 2000, pp. 14–20, which resulted in Directive 2001/97 EC amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering, see Official Journal L 344 of 28 December 2001, pp. 76–82.
485. Nobel, 2002, p. 860.
486. FATF, The Forty Recommendations, June 2003, Glossary, p. 14.
487. Art. 2, para. 2, para. a–e MLA.
488. Art. 2, para. 3 MLA.
489. Art. 2, para. 3 para. a–g MLA.
490. Berti/Graber, 1999, Art. 2 N. 11.
491. Report of the Business Audit Commission of the National Council, 29 June 2001.
492. Ordinance of 20 August 2002 of the Money Laundering Control Authority concerning Financial Intermediation in the Non-Banking Sector as a Commercial Undertaking; SR 955.20.
493. http://www.gwg.admin.ch/d/faq/index.htm.
494. SR 955.20.
495. Official brochure ‘Combating Money Laundering in Switzerland’, Berne, 2002, p. 3 *et seq*.

496. The Federal Council was required to examine such a possibility by the parliamentary motion (Felix Walker), see Press release of the Federal Department of Finance, 7 December 2001.
497. Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field. Nobel 2002, p. 860 *et seq*.
498. De Capitani, 2002, pp. 2002, 691, 773; Friedli, 1998, p. 294.
499. Control Authority for Combating Money Laundering, Zu Fragen der Unterstellung von Angehörigen des Anwalts und Notarenstandes unter das Geldwäschereigesetz (MLA) sowie der Aufsichtstätigkeit der Kontrollstelle für die Bekämpfung der Geldwäscherei, Anwalts Revue 4/1999, p. 19; Graber, 2000, p. 24.
500. FCD 112 Ib 608 E.c).
501. De Capitani, 2002, pp. 691, 773.
502. Control Authority for Combating Money Laundering, Zu Fragen der Unterstellung von Angehörigen des Anwalts und Notarenstandes unter das Geldwäschereigesetz (MLA) sowie der Aufsichtstätigkeit der Kontrollstelle für die Bekämpfung der Geldwäscherei, Anwalts Revue 4/1999, p. 19 *et seq*.
503. Compare section I.
504. Official Journal L 344 28 December 2001, Art. 6 (3); Nobel 2002, p. 860 FN. 19.
505. Practice of the Control Authority Regarding Dealers in Raw Materials and Domiciliary Companies, 18 January 2002, http://www.gwg.admin.ch/d/publika/ausleg.htm.
506. Berti/Graber, 1999, Art. 2, N. 25.
507. Art. 2, para. 2, para. E, MLA; Federal Gaming Legislation of 18 December 1998 on Casinos and Gambling, SR 935.52.
508. Practice of the Control Authority Regarding Dealers in Raw Materials and Domiciliary Companies, 18 January 2002: http://www.gwg.admin.ch/d/publika/ausleg.htm.
509. Press release of the Control Authority 26 March 2003.
510. Media report: NZZ, 27 August 2002, p. 11.
511. Claudia Buess, Positionspapier der Erklärung von Berne zum illegalen Kulturgüterhandel und dem neuen Kulturgütertransfergesetz (KGTG).
512. Swiss Department of the Interior, Press and Information Service, UNESCO-Convention 1970 and the Law on the Transfer of Cultural Property (*Kulturgütertransfergesetz*), November 2001.
513. Media report: NZZ, August 2002, p. 11.
514. Art. $4^{quinquies}$ Bank Act.
515. Meier-Schatz et al., 2001, N. 661. This concerns the area of 'administrative assistance' and is regulated by the corresponding supervisory statutes. See section III on international administrative co-operation.
516. Meier-Schatz et al., 2001, N. 667.
517. FBO.
518. *Argumentum e contrario* from Art. 2, para. 1 FBO.
519. Art. 4, para. 1 subsecs. b and e FBO.
520. Art. 4, para. 2 FBO.
521. Nobel, 2002, p. 855.
522. Art. 3a, para. 4, para. a, BankO.
523. The Wolfsberg Group is comprised of 12 banks, including two large Swiss banks. In 2000, it issued anti-money laundering principles for private banking (revised in May 2002). See: http://www.wolfsberg-principles.com.
524. Memorandum accompanying Federal Law on Combating Money Laundering in the Finance Sector 17 June 1996, BBI 1996 III, pp. 1114, 1155 *et seq*.
525. To lead the legislative target group to a particular form of self-regulation places certain demands on the legal text. The theory has until now only initially been worked on. Compare Bender, 1978, pp. 31–47.
526. SR 955.16, in force since 1 January 2004.
527. Press release Control Authority 26 May 2003
528. Press release Control Authority 26 May 2003
529. De Capitani, 2002, pp. 763–809.

530. Rec. 33 FATF 2003.
531. See below regarding the role of the FBC.
532. FCD 108 Ib 186; 111 Ib 126.
533. FATF, 2001, p. 18 N. 66.
534. SR 955.16, in force since 1 January 2004.
535. Press release Control Authority 26 May 2003.
536. NZZ, 27 June 2003; 25 and 24 June 2003.
537. De Capitani, 2002, pp. 921–55.
538. FATF, 2001, p. 20 N. 72.
539. www.fatf-gafi./org./Ctry-orgpages/ctry-ch_en.
540. Memorandum, 1993, p. 323.
541. See IV.3.b.
542. Federal Police, Report on Swiss Internal Security, Berne, 2001, p. 71.
543. NZZ, 27 June 2003, 25.
544. In the international context this agency is called 'financial intelligence unit' (FIU). The definition of an FIU as agreed by the Egmont Group is now widely accepted: 'A central, national agency responsible for receiving (and, as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information (1) concerning suspected proceeds of crime, or (2) required by national legislation or regulation, in order to counter money laundering'. FATF, 2001, p. 29 N. 105, FN 24.
545. Art. 29, para. 3 MLA. On the duty to report, see above IV.3.d.
546. htpp://www.bap.admin.ch
547. Art. 29, para. 2 MLA.
548. NZZ, 27 June, 2003, 25.
549. FATF, 2001, p. 19, N. 70.
550. Annual Report of 2002 of the Reporting Office, Berne 2003, 4.
551. Official brochure 'Combating Money Laundering in Switzerland', Berne, 2002, p. 61; Annual Report 2001 of the MROS, May 2002.
552. Annual Report of 2002 of the Reporting Office, Berne, 2003, 5.
553. Annual Report 2001 of the MROS, May 2002, p. 13 *et seq*. This observation also applies to the years 1999 and 2000.
554. Art. 2, para. 3 lit. b MLA for the definition of a financial intermediary.
555. Annual Report of 2002 of the Reporting Office, Berne 2003, 5.
556. Annual Report of 2002 of the Reporting Office, Berne 2003, 9.
557. Annual Report of 2002 of the Reporting Office, Berne 2003, 5.
558. Annual Report of 2002 of the Reporting Office, Berne 2003, 18.
559. Annual Report of 2002 of the Reporting Office, Berne 2003, 24–30.
560. Art. 23, para. 1 Bank Act, BEHG, AFG.
561. Official brochure 'Combating Money Laundering in Switzerland', Berne, 2002, p. 37. Total number of staff in FBC's Secretariat (as of 1 September 2002): 123, with approximately 46 members of staff involved in Anti-Money Laundering monitoring (same brochure, p. 55).
562. Art. 23 Bank Act.
563. Art.5 FBC Rules: 'Die Kommission und das Sekretariat sind in der Ausübung ihrer Funktion von den Verwaltungsbehörden des Bundes unabhängig' ('The Commission and the Secretariat are independent of the federal administrative authorities in the exercise of their functions'.)
564. Report of the KYC Working Group, June 2002, pp. 11, 12.
565. Art. 23bis–$23^{septies}$ and Art. 24 Bank Act.
566. FBC Report 'Abacha-Gelder bei Schweizer Banken' and Media report dated 13 November 2001 in the case of Montesinos.
567. Official brochure 'Combating Money Laundering in Switzerland' Berne, 2002, p. 43 and 67; Ordinance 30 August 1999 on Combating Money Laundering of the Federal Office of Private Insurance, SR 955.032.
568. Swiss Financial Centre, A documentation, 2002, p. 40
569. Recommendation 39 of the Commission Zufferey. The first round of proposals of the

Zimmerli Expert Commission were published on 14 July 2003. The question whether the supervision of independent asset managers as well as foreign exchange dealers and introducing brokers is still open and will be addressed in a second report. At the same time the question regarding the integration of the Control Authority into the new supervisory authority will be considered. Press release 14 July 2003.

570. SR 935.52.
571. Official brochure 'Combating Money Laundering in Switzerland', Berne, 2002, pp. 49–53.
572. SR 955.021.
573. Art. 2, para. 2, Art. 12 and Art. 16 MLA.
574. See p. 192.
575. Art. 25, para. 1 and 2 MLA.
576. Art. 25, para. 3, para. c MLA.
577. BBl 1996 III 1149.
578. Official brochure 'Combating Money Laundering in Switzerland', Berne, 2002, p. 30.
579. Ibid., p. 33.
580. Federal Police, Report on Swiss Internal Security, Berne, 2001, p. 71.
581. Media report: SDA, 20 August 2002.
582. 8 April 2003, correction to the MROS Annual Report 2002.
583. Report of the Business Audit Commission of the National Council, 29 June 2001.
584. Official brochure 'Combating Money Laundering in Switzerland', Berne, 2002, p. 27 *et seq*; Media reports: SDA 20 August 2002; NZZ 24 July 2002.
585. Media report: SDA, 1 July 2002.
586. Official brochure on 'Combating Money Laundering in Switzerland', Berne, 2002, p. 63.
587. Meier-Schatz et al., 2001, N. 514.
588. Art. 18 Bank Act.
589. International Monetary Fund, 2001, p. 16 N. 44; Meier-Schatz et al., 2001, N. 514.
590. http://www1.oecd.org/fatf/ctry-orgpages
591. See section I.
592. The theoretical model of governmentality demonstrates particularly well the background and logic of this new understanding of governance. As to the term 'government,' see Foucault, 1987, p. 255. Rose and Miller, 1995, and Dean, 1999. For the development regarding crime control: Capus, 2002a.
593. See Chapter 5.
594. FBC, Preliminary Draft of the Ordinance on Combating Money Laundering, 2002.
595. Capus, 2002b.
596. BBl 1996 III 1146, cited in Berti/Graber, 1999, Art. 24, N. 7.
597. See Pieth earlier.
598. Basel Committee on Banking Supervision, Customer Due Diligence for Banks, October 2001.
599. http://www.iaisweb.org.
600. http:/www.iosco.org.
601. http://www1.oecd.org/fatf/ctry-orgpages.
602. See International Monetary Fund, 2001, p. 42.
603. http://www.fatf-gafi.org.

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5. Country Report: Customer due diligence in Switzerland

Mathias Pini

I INTRODUCTION

In addition to *criminal law* instruments, the *administrative law* area is also significant and self-regulation is particularly important in this area, as mentioned in the previous chapter, 'Combating money laundering'. Customer due diligence forms an essential part of self-regulation and hence earns a chapter of its own.

Customer Due Diligence (CDD) may be described as the concept that aims to reduce damage. It was developed by the banks to address their concerns about the particular risks that face their industry and above all, the risk of concentration in relation to their clients and the risk of reputation. However, this concept was not applied consistently by all banks, so it was only after several banking scandals that appeared particularly threatening to the industry that produced the level of pressure required for action to be taken. With assistance from the Swiss National bank, the concept CDD was developed by the Swiss Banking Association in 1977 which for the first time bound all banks by way of a code of conduct. CDD comprised the so-called five obligations, namely the identification of the contracting partner, and the beneficial owner (Know Your Customer Principle), the possibility of having to repeat identification, the special duty to clarify in the case of unusual transactions and business relations, the obligation to document, as well as the duty to implement organizational measures to ensure that adequate internal systems function to detect money laundering. This corresponds to the arrangement of CDD in the Money Laundering Act (MLA) (Arts. 3–8).

In implementing and following the CDD obligations, financial intermediaries fulfilled their duty in rather a formalistic way and in so doing were applying the rule-based approach; clients were identified on the basis of documentation that was presented, the beneficial owner was referred to, depending on the circumstances and the information collected according to the rules. Compliance officers were trained, checklists were developed which followed a 'tick the box' system and offices to deal with questions on money

laundering were established. Financial intermediaries followed the letter of the CDB and their own internal regulations, but the spirit of the obligations, which at the end of the day were aimed at reducing risks were not implemented as they should have been.

Between 1990 and 2000 the system did not change substantially. It is only in the recent past that the paradigm has been changed and the risk-based approach developed. Both the regulators as well as the industry itself agree that the implementation of the CDD obligations, their aims and sense have to be weighted so that the risks related to a client or a transaction are brought into the foreground. The result being that the fixation on the formal fulfilment of the five obligations from 1990 has shifted, and responsibility for effective implementation lies with the financial intermediary. They have to classify their business relationships according to prescribed risk indicators and to develop the risk categories accordingly. The criteria to be used are for example, the place of origin of the client, the place where the transaction is to be carried out, the nationality of the client as well as the beneficial owner, the business and transactions related risks. Measures have to be taken such as developing internal updated lists of so-called higher risk countries or the involvement of a member of the management where higher risks are involved. Above and beyond these measures, it may be necessary to obtain analyses and complementary information in order to be able to assess the transaction or the client properly. All in all, employees dealing with clients have to be conscious of the risks associated with the work in which they are involved.

Apart from the goal of reducing risk, the advantage of a risk-based approach is that it entails a simplified procedure and is relatively economic in applying CDD where it applies to retail banking. Retail business involves a standardized and formal application of CDD, which does not involve increased diligence. The aim is not to use a comprehensive and costly CDD tool in an area that is not necessarily misused for money laundering purposes. On the other hand, for private banking, increased diligence is envisaged which necessarily involves higher costs and more time to implement.

In order to describe the CDD obligations in Switzerland, a short overview regarding the interplay between the various legal bases that are involved will be briefly outlined. The Criminal Code contains the norms relating to money laundering and the lack of care in financial transactions.[1] The anti-money laundering law, implementing the offences of the Criminal Code, sets out the most important principles of CDD and distinguishes between three categories of financial intermediary. The first comprises intermediaries that are under a special supervisory body; and includes banks, securities dealers, insurance brokers and others. The second category is financial intermediaries that are part of a self-regulatory organization, for example trust administrators. Where financial intermediaries[2] are neither under a body designated by law nor a

self-regulating organization (SRO),[3] they fall into the third category, where they are directly under the control of the money laundering control authority. The various authorities have the competence to make their own regulations relating to CDD that are relevant to the branch for which they are responsible. Banks fall under the first category and are supervised by the Swiss Federal Banking Commission (SFBC). The most important tool so far in relation to the supervision of the banks with respect to AML was the SFBC Circular 98/1. The Circular was replaced by the latest legislation, the ML Ordinance as of 1 July 2003. The CDB[4] is the classical self-regulatory tool for banks and forms an integral part of and is explicitly referred to in the ML Ordinance[5] and above all contains the KYC regulations. Other financial intermediaries of the first category, such as, for example the private insurance sector have also developed appropriate orders.[6]

The following section covers the CDD obligations of the banks, fund managers and securities dealers under Art. 2, para. 2 subsecs. a, b and d of the MLA.[7] In April 2001, the SFBC as the supervising authority, set up a working group (*WG KYC*) with the mandate to revise the SFBC-Circ. 98/1. In July 2002, the *WG KYC* published for consultation its *Draft Ordinance* on Due Diligence Obligations for Banks and Securities Dealers in relation to Money Laundering, Terrorist Financing and Business Relations with Politically Exposed Persons. This Ordinance has replaced the existing guidelines and brought changes to the concept of fighting money laundering and the financing of terrorism.[8] On 17 January 2003 the SFBC published the definitive version of the new Anti-money Laundering Ordinance (ML Ordinance), effective as of 1 July 2003 and transition provisions for certain sections have to be effective by 30 June 2004.[9] In the light of the recent and important changes as well as the clear trend towards implementing a risk-based approach the new developments in relation to CDD in Switzerland will be dealt with under the appropriate sections below.

II ORDINARY PROCEDURES

The KYC principle in the first CDB of 1977 implies that the financial intermediary should know his customer and his business practices. The KYC principle sets out the most important part of the CDD and as already mentioned originally served as a means to reduce internal risks within the bank rather than combat money laundering. KYC still serves this purpose but in the meantime it is also a key component in combating money laundering. Only by knowing precisely who the customer is, can a financial intermediary possibly know if that client could be a ‘potentate’, whether he carries out transactions that are incompatible with his business and therefore could be suspicious, or

whether there is some other indication that might link him to criminal behaviour.

The formal aspects of the KYC principles are covered by the steps that are to be taken under the ordinary procedures and essentially they always have to be done when entering into a new client relationship. These steps have to be differentiated from the simplified procedures (see section III) and the cases where enhanced due diligence has to be carried out (see section IV).

The risk-based approach that has applied since 1 July 2003 does not affect the basic KYC rules in the CDB because they have to be applied to every client relationship (irrespective of whether a lower or higher risk is involved).

A Formal Identification

According to Art. 2 CDB 03, the obligation to identify the contracting partner applies to the following businesses:

> The banks undertake to verify the identity of the contracting partner when establishing business relations with the said partner. This regulation applies to:
>
> - opening of accounts or passbooks
> - opening of securities accounts
> - entering into of fiduciary transactions
> - renting of safe-deposit boxes
> - entering into management agreements for assets deposited with third parties
> - the execution of transactions with securities, currencies as well as precious metals and other commodities exceeding the amount of CHF 25 000
> - cash transactions exceeding the amount of CHF 25 000.

1 Contracting partner

a Regular clients

Where the contracting partner is a natural person, identification has to be carried out by a *personal interview* on the basis of the document establishing identity, for example an identity card, passport, driving licence or something similar.[10] The family name, first name, date of birth, nationality and address of the contracting partner have to be noted and the document has to be photocopied and stored.[11] The CDB 03 additionally requires a photograph on the document establishing identity.[12] This applies to both domestic and international contracting partners, however, the date of birth and address of domicile may be omitted, if the contracting partner is domiciled in a country where such data is not customarily registered.[13]

Where the contracting partner is a legal entity domiciled in *Switzerland*, its identity has to be established against an entry in the Swiss Commercial

Gazette or other source book such as Teledata, or ZEFIX, an extract from the commercial register or similar.[14] The identification is not only aimed at verifying the existence of an entity but also to verify that the natural person representing the legal entity is entitled so to act. For associations, foundations and partnerships not entered in a commercial register, the verification is to be made on the basis of statutes or any other equivalent documentation and must also include the natural persons opening the account.[15]

If the legal entity is domiciled *abroad*, the CDB requires that an extract from the commercial register or an equivalent document from which it is possible to infer the existence of the legal entity.[16] The documents may not be older than 12 months.[17] The latter applies to both domestic and foreign domiciliary companies.[18]

If the contracting partner is represented by a person with power of attorney, this person is not identified in the same way as the contracting partner itself. The financial intermediary must however be satisfied that the person really is authorized to act on behalf of the contracting partner by examining, for example the power of attorney documentation as well as looking at any other relevant documentation. The financial intermediary must in addition, within a reasonable time, be in a position to give the prosecuting authorities information about the power of attorney and the contracting partner behind the authorized person or beneficial owner.[19]

The obligation to identify exists regardless of whether the contractual relationship is in the name of the contracting partner or a number, and therefore also applies to numbered accounts – contrary to the general, world-wide norm. On the other hand, whether it is more difficult to establish identity where a numbered account is involved in the context of a request for legal assistance is another question.[20] In the case of bearer savings accounts the person opening the account has to be identified as well as any person who makes a deposit or withdrawal of over SFr. 25 000.[21]

b Special cases

a Walk in Clients

The identity of the customer has to be verified in spot transactions,[22] namely for cash transactions at the counter such as currency exchange, the buying and selling of precious metals, cash purchase of travellers cheques and so on, as well as for dealing with stocks and shares, currency and precious metals and other commodities, if the total amount involved in the transaction exceeds the SFr. 25 000 threshold.[23] This threshold can be understood in terms of stemming from the principle of proportionality and serves the purpose of ensuring that bank business is not unnecessarily hindered by the obligation to identify

the client. Spot transactions are only relevant to money laundering once a particular amount is reached. However, where large sums are clearly being split into smaller amounts in order to avoid exceeding the threshold, ('smurfing'), the exception does not apply.[24]

If there is a suspicion of money laundering then there is an obligation to identify the contracting partner in any case, if the bank has not actually refused the business.[25] The decision to make a report possibly at a later stage under Art. 9 MLA will not be thereby prejudiced.[26] Although KYC essentially starts out from a rule based approach,[27] the financial intermediary is expected to be alert – at the earliest stage of a contractual relationship or in a one-off transaction – to the possible risks a customer may present. But to speak of a risk-based approach at this stage would be premature.

b Non Face-to-Face Clients

International standards regard the commencement of a contractual relationship through non-face-to-face contact as being risky because the lack of direct contact makes verification of the identity of the client more difficult.[28] The international trends in particular as expressed in the BCBS text, are reflected now in the CDB 03: where a business relationship comes about via a correspondent relationship – be it through correspondence or via the Internet – the question then arises how should the identity of the contracting partner be verified. The identity of a domestic or foreign contracting partner is to be verified by obtaining a certified copy of an official identification document.[29] The authentication can be provided by a branch, representative office or group company of the bank, a correspondent bank or some other financial intermediary specifically appointed by the account opening bank, a public notary or another public office that customarily issues such authentication.[30] Provided that personal delivery to the recipient is warranted it is also deemed as sufficient proof of identity to identify the customer on the basis of an official document at delivery or receipt of mail.[31] The copy of the document however must be sent to the bank. The certification of the copy by a third party replaces the official certification or the certification that the signature is genuine. This offers a significant degree of comfort when obtaining the necessary attestations which then relieves the bank of the costly business of having to verify with authorized documentation and so on.

The ML Ordinance weights the importance of personal contact with the client and regards the failure to establish this contact as a possible ground to increase the risk category according to Art. 7 ML Ordinance. The question arises whether an increased weighting of personal contact really is appropriate in this day and age and if it really would lead to better identification of the customer. What advantage is to be gained when the customer in a personal

interview presents a perfectly forged identity document? Surely trusting a third party with a good reputation would be more efficient.

c E-Banking

E-Banking presents a special form of non face-to-face customer relationship. According to the FATF[32] the risks are particularly acute because of the 'ease of access to the network, regardless of location, equipment or time of day, in the dematerialization and the rapidity of electronic transactions. These factors combined with automation of financial operations can make the due diligence more difficult to perform'.

Under Swiss law as it currently stands, there are no explicit rules relating to electronic banking. The client relationship that exists electronically is essentially treated as a sub-set of the non face-to-face relationship.[33] The minimum standards developed by the SFBC for banks that operate purely on the Internet[34] were abolished on 1 July 2003[35] and the obligation is now on the financial intermediary to assess the risk associated with the business transaction itself – which corresponds to the principle of the risk-based approach.

c Exceptions to identification

There are exceptions to the rules relating to identification, which are to be seen as a form of facilitation of the formal regulations for the financial intermediary. This topic will be revisited under sections II, III.

2 Beneficial owner

a Basic principles

In the Swiss legal system, the beneficial owner has to be identified, when this is a different person to the party entering into the contractual relationship, or if there is a doubt as to the real identity of the beneficial owner.[36,37] The principle is based on the presumption of identity of the contractual partner and the beneficial owner.[38]

The apparent discrepancy appears on the one hand in the case when the contracting partner states that a third party is the beneficial owner, or that this is clear from the circumstances. This situation will not present any difficulties for the financial intermediary. On the other hand a more problematic area will be when there are grounds for doubt. The CDB 03 sets out in (25) para. 2 the rules relating to the MLA and considers that doubts must be raised when:

- a power of attorney is conferred on someone who evidently does not have sufficiently close links to the contracting partner; this provision does not

include a power of attorney for the management of asset given to a financial intermediary;
- when the financial standing of someone wishing to carry out one of the transactions described in Art. 3 is known to the bank, and the assets submitted or about to be submitted are disproportionate to said person's financial standing;
- when, in the course of its relations with the customer, the bank is led to make other unusual observations.

The formal registration of the beneficial owner is done using the so-called Form A in which the client makes a written declaration. The details to be recorded in the case of natural persons are the full name, address and domicile and due to the CDB 03 also the date of birth and nationality, while for legal persons, the firm and the company's domicile address are required.[39] An exception to the identification of the beneficial owner is contained in the CDB's Form R, which permits Swiss lawyers and notaries to act as the contracting partner whereby the obligation to identify the beneficial owner is no longer required. This topic will be further considered under section III.

In determining the beneficial owner, the CDB requires that all due diligence which can be reasonably expected under the circumstances be applied. But what exactly is to be understood under reasonably expected, when should the financial intermediary doubt the identity of the contracting partner and the beneficial owner? According to the Botschaft 1996[40] the AML requirements are identical with those of Art. 305ter CC. 'However whilst Art. 305ter CC creates an obligation to identify the beneficial owner, the financial intermediary only has to obtain a written explanation stating who the beneficial owner is, according to Art. 4 MLA. Similarly, the CDB consequently appears in Art. 4 MLA to take as the starting point a concept of *formal diligence*, while a *material diligence* concept underlies Art. 305ter subsec. 1 CC'.[41] The consequence to be drawn from these differences is that a financial intermediary cannot be content with simply completing the formalities of Form A and assume that the diligence requirements of Art. 305ter CC have been met. Similarly, in the routine identification of the beneficial owner (using Form A) for all business relationships, even when no doubts have been raised, the financial intermediary runs the risk of being accused of showing lack of due diligence.[42] The AML does not explicitly require identification in every case and puts the burden on the financial intermediary to pay attention. In addition it should be noted that there is no duty to verify the information.[43] The financial intermediary is not an extension of the prosecution authorities and must – at least according to the rationale behind the construction – not be forced to check the details of the contracting partner – insofar as they appear to be plausible.

It is however, an aim of the revision of the CDB, that the Form A should

not be used in a generalized way.[44] For the bank employees this will entail an increased workload, which can be justified by the argument that it will mean a more efficient application of the KYC principles. The question remains open however, whether the beneficial owner is really ascertained and the aim of preventing money laundering is met. The financial intermediary has to rely on the information from the contracting partner and must make further enquiries when this information appears implausible. But how should certainty about the beneficial owner be obtained? W. De Capitani describes the ascertainment as an *attempt* to clarify and assigns it a less important significance.[45] According to this author, the main emphasis must be put on the clarification of the economic background to the transaction in the context of which the beneficial owner may also be confirmed. While accepting this critique as well as appreciating the importance of clarifying the economic background, the systematic ascertainment of the beneficial owner at the outset of the contractual relationship must be accorded greater weight. Knowledge about the person who is behind the client relationship must be obtained as early as possible taking for example into consideration the risks resulting from corporate vehicles.[46]

A consequence of the lack of care could be a violation of Art. 305[ter] CC the CDB,[47] an internal bank rule or employment contract obligations which could lead to a civil claim.

In embracing the risk-based approach, the ML Ordinance has affected the identification of the beneficial owner for client relationships or transactions that present a higher risk in abstract terms. If a client relationship or transaction falls into a risk category according to Art. 7/8ML Ordinance, the consequence is an increased duty of care. Additional clarifications have to be made, for example to ascertain whether the contracting partner is the beneficial owner of the assets in question.[48] This may mean investigations that include obtaining information in written or oral form from the contracting partner or the beneficial owner, visits to their place of business, etc.[49] The most important aspect though is the fact that the risk perception of the financial intermediary has been heightened by the ML Ordinance, so that it bears the ultimate responsibility. In addition, in business relationships with an increased risk, the involvement of a member of senior management is required.[50]

If it is not possible to identify the beneficial owner, or if serious doubts remain despite further clarification, the financial intermediary is obliged to refuse to enter into a business relationship.[51]

b Ascertaining the beneficial owner in every case

a Current Regulations

In addition to the cases where the beneficial owner diverges from the contracting

partner and the cases where doubts exist there are cases where the beneficial owner has to be identified in any case.[52] So where spot or commercial transactions exceed the threshold of SFr. 25 000 – just as this already applies to the contracting partner, similarly identification invariably has to be provided by individuals entering into a business relation with a bank through correspondence.[53]

In the case of joint accounts or joint securities accounts held by financial intermediaries, the bank basically has to be supplied with a full description of beneficial owners and be informed of any changes.[54] In the case of collective investment with more than 20 beneficial owners as investors, the data regarding identification must be recorded only for the beneficial owners who hold severally or in joint agreement a minimum of 5 per cent of the assets.[55] The basic principle as such is of less interest than the exceptions to it, see under section III.B.2, below.

Domiciliary companies have to be given special attention, and according to the CDB these include companies[56] that do not have any offices or personnel other than administrative staff. Domiciliary companies can be completely legitimate, for example for tax planning purposes. However, experience has shown that the lack of a physical presence as well as the possibility of not having to declare the beneficial owner in many jurisdictions may lead to a misuse of these companies for money laundering or other criminal activities.[57]

The Swiss legal system envisages that following the identification of the corporate vehicle itself as the contracting partner, so must the beneficial owner also be identified. The beneficial owner in relation to a corporate vehicle can only be a natural or legal person involved in trade, manufacture, financial services or some other form of business. A corporate vehicle itself can never be the beneficial owner because according to the principle of identification the corporate veil must be pierced and goes to the person behind the structure and is merely an additional layer to be removed. Where there is a change of person entitled to sign, then the identification of the beneficial owner has to be repeated, unless a written confirmation is available or it is absolutely clear that the beneficial owner has not changed.

One of the special features of an Anglo-Saxon trust is that there is no beneficial owner as such, just beneficiaries. In relation to the virtually irrevocable trust instrument, the financial intermediary has to have the facts relating to the set up of the trust confirmed rather than an identification of the beneficial owner. In order to be able to do this, he has to have information about the true settlor – as oppose to the economic settlor – of the trust as well as potential beneficiaries.[58] In the case of revocable trusts the CDB takes the position that the settlor is the beneficial owner (but this also has to be contained in the documentation).[59] If there is a change in relation to the person entitled to sign, then the identification of the beneficial owner has to be repeated.[60]

Referring to the critique in section II.A.2a, corporate vehicles such as trusts and domiciliary companies reveal just how dependent the financial intermediary is upon information from the contracting partner and just how limited the efficiency of checking the plausibility is. Even under the new paradigm of the risk-based approach it seems questionable whether this problem can be dealt with in an effective manner.

b International Standards

Ever since the FATF started its NCCT initiative, corporate vehicles and trusts have been under fire on the international level. They have been described as 'ubiquitous in money laundering schemes'. And, 'The FATF has consistently found that the lack of transparency concerning the ownership and control of corporate vehicles is a problem for money laundering investigations'.[61] 'In April 2000, the Financial Stability Forum (FSF) Working Group on Offshore Financial Centres concluded that the misuse of corporate vehicles could threaten financial stability from a market integrity perspective. Over the past decade, the FATF has noted the role of corporate vehicles in money laundering schemes. Similarly, the OECD working Group on Bribery in International Business Transactions has found that the misuse of corporate vehicles in Offshore Financial Centres (OFCs) can hinder what might otherwise be successful anti-corruption investigations'.[62]

The BCBS as well as the Wolfsberg Group require that a financial intermediary *understands* the structure, the real relationships behind it and who has control over the assets.[63] The latest version of the FATF (Rec. 5.b. FATF 40/2003) requires the financial intermediaries to understand the ownership and control structure of the legal persons and arrangements.

c Exceptions to ascertaining the beneficial owner

The CDB contains some notable exceptions or simplifications to the obligation to identity the beneficial owner (and the contracting partner). Given the increased risks in relation to money laundering this topic will be dealt with separately under section III.

B Substantive Identification: Establishing a Customer Profile

The data relating to the client and the beneficial owner enable the financial intermediary to establish a customer profile. The current CDD regulations do not explicitly require a customer profile but it follows from the principles of KYC on the one hand and anti-money laundering concepts on the other. The CDB for example mentions unusual indications in relation to the amount of

assets involved.[64] The financial intermediary is expected to know more about the client's financial situation which in turn means knowing more than just his name and that of the beneficial owner and to have noted it in writing. The anti-money laundering concept is based on the precept that unusual transactions or business relationships have to be specially clarified, so for example this would cover unusually large transactions in comparison to the purported business.[65] But establishing what is unusual can only be done by knowing what constitutes the opposite. And this of course varies whether the client is a multinational or a private person. Knowledge about what may be regarded as normal business practice, the financial relationships, the source of the assets, the reasons why a particular legal structure is chosen for a business entity, the (business) partners with whom the client conducts business, is required. In order to do this effectively the financial intermediary needs to establish a customer profile that will enable him to recognize unusual transactions.

Above and beyond this, the new ML Ordinance requires that clients are allocated to a risk category. This in turn means that the financial intermediary from the outset of the business relationship has to establish the client's background in order to be able to allocate effectively. If the client is assigned to a high risk category, the financial intermediary is obliged to undertake additional clarification and controls in order to redefine the customer profile.[66] The customer profile is above all to be created for the latter group of clients; but also in respect of 'normal' clients although on a reduced scale. The introduction of computer systems are envisaged as aids to assist in the process of overseeing transactions, and will help the financial intermediary to spot the unusual transactions.[67] In order for these computer systems to be able to function, data has to be fed into the computer that corresponds to 'normal transactions'. Only then will 'red flags' signal that the boundaries have been transgressed which will require the financial intermediary to make further enquiries in relation to the transactions in question.

For private banking, the establishment of a client profile is very important. Foreign clients may have extensive assets at their disposal which may be subdivided between complex structures requiring classification so that both the origins and the use to which they are to be put, has to be established. Aside from the need to be able to offer the client the best advice, anti-money laundering rules require the financial intermediary to know the client and his economic background. The Wolfsberg AML Principles require its members to ascribe the private client to a risk category. The client files have to be checked and serve the purpose amongst other things of establishing whether activities 'are not consistent with the due diligence file'.[68] The private banker has to ask the client's permission to obtain information from third parties to back up the information already known and so develop knowledge about the client's situation.

In retail banking, there are less onerous requirements in relation to the customer profile. Thus the knowledge that a branch has about the client will suffice to determine whether a transaction is unusual and whether further enquiries are necessary. However, even here a customer profile is of course of central importance because retail banking is as vulnerable to money laundering as private banking.

C Client Acceptance

The identification of the client and the beneficial owner are the basic precepts for entering into a client relationship. If the client or the beneficial owner cannot be identified, or if there are serious doubts relating to the written declarations of the beneficial owner, the financial intermediary may not enter into the relationship in the first place, or withdraw in the course of a client relationship or refuse to execute a transaction.[69] If in the course of dealing with a client the financial intermediary develops doubts as to the accuracy of the information about the contracting partner or the beneficial owner which cannot be resolved then the relationship must be terminated, unless the requirements for notification according to Art. 9 MLA are given.[70]

D Renewed Identification or Ascertaining the Beneficial Owner

The obligation to identify the contracting partner and the beneficial owner primarily occurs at the start of the business relationship. If however, during the course of that business relationship, doubts arise as to the identity of the contracting partner or the beneficial owner, then the identification procedures according to Art. 5 MLA and Art. 6 CDB 03 have to be repeated. Thus KYC is not a one-off obligation but is to be regarded as an ongoing duty if it is to be an effective tool in the fight against money laundering.

This obligation is of fundamental importance confirming that the fight against money laundering is a continuing process which is not over once the initial identification has been made. Thus checking the client relationship and transactions is to be regarded as an ongoing commitment.[71]

The ML Ordinance expands the regulation set out in Art. 5 MLA, in that certain categories of clients or transactions are deemed per se as being associated with higher risk, which means that further clarification is required. This additional clarification has to be undertaken as soon as the increased risk in relation to a business relationship has become apparent,[72] which similarly is an ongoing obligation.

III SIMPLIFIED PROCEDURES

A General Remarks

There are certain situations that enable a simplified identification procedure to be undertaken or even allow it to be left out altogether. Although this is not explicitly stated in the anti-money laundering law, the SROs may – depending on the specific situation – allow a deviation from the general rule set out in Arts. 3–7 MLA.[73] The CDB has made full use of this possibility and developed some important exceptions and waivers to the obligation to identify.

B Exceptions to CDD

1 Exceptions for immediate clients

First, spot and securities transactions that do not exceed the threshold relevant for money laundering of SFr. 25 000 need to be mentioned.[74] In addition, the CDB lists three exceptions that apply to customers.[75] It is not necessary to identify formally the identity of a contracting partner domiciled in Switzerland when opening:

1. an account, deposit account or passbook in the name of a minor, provided that the assets deposited with the bank at the outset do not exceed an amount of SFr. 25 000. The adult opening the account however must be identified[76];
2. a rent guaranty account for rented property located in Switzerland[77];
3. an account with a view to paying up capital stock in connection with the formation of a corporation or a limited liability company or an increase of its capital.[78] The *WG KYC* suggested to reconsider this regulation.[79] This seems to be an unnecessary sharpening of the obligation to identify when the company in a formative stage cannot be properly identified because of its lack of legal personality. As long as the company is neither established nor identifiable the assets remain blocked and in the event that the company is not formed, the founders of the entity will be repaid. The CDB 03 did, however, not implement the critique.

Legal entities, that are publicly known do not have to be identified.[80] This applies in particular to public companies or companies that are directly or indirectly associated with such companies.

Identification can also be dispensed with if the contracting partner's identity has been verified previously in an equivalent manner within the bank's group.[81] The financial intermediary must hold copies of the original identification files.

The former exemption if identification for natural persons who enter into business relations with the financial intermediary and who are personally known to it has been repealed.

2 Exceptions in the case of the beneficial owner

The duty to ascertain comes about when doubts are raised regarding the supposed identity of the contracting partner and the beneficial owner. However, even in the case of the beneficial owner the SRO rules can – as with the direct contracting partner – envisage exceptions under certain circumstances to identification.

In contrast to the business instances that are listed in Art. 2 CDB, the safety-deposit box holders are not listed with relation to the identification of the beneficial owner. The conclusion to be drawn from this is that the obligation to identify falls away. The reason for this is not entirely clear, because for example someone with power of attorney who is not in a close contractual relationship with the contracting partner according to (25) para. 2 of the CDB 03 presents a doubtful case which would require the financial intermediary to ascertain who the beneficial owner is. This could also be the case for safety-deposit box holders.[82]

In the aftermath of the terrorist attacks of 11 September 2001 and the special recommendations of the FATF on Terrorist Financing, the revised CDB 03 abolished the general exception for charitable institutions and other such organizations domiciled in Switzerland to give a statement relating to the beneficial owner.

If the bank knows who the beneficial owner of a domiciliary company is, then instead of filling out Form A, it can make an appropriate note on the file. This possibility does not enable the bank to get round its obligations to identify but is an easier way for them to fulfil their obligations and is mentioned here to complete the picture.

C Outsourcing and Reliance on Third Parties

The realities of business today are such that in many cases a financial intermediary may not be involved in conducting KYC, they may leave this to a third party. The term generally used for this award of service performance is delegation or outsourcing. Another question arises whether the financial intermediary may rely on the KYC that has been carried out by a third party. In daily business, the reality is that the client invariably will not go to the bank in person but will execute transactions via a correspondent method. In many cases, clients are introduced by a third party such as an asset manager, banker or lawyer (single or professional intermediaries or agents) or even within a financial group they may be passed from one section to another, the question

here is whether the bank clerk can rely on information given by the intermediary on the identity of the contracting partner. Or does the duty rest with the financial intermediary in any case to repeat the identification?

1 Delegation

a Delegation of identification according to the CDB 03

Art. 305ter CC was unclear about whether the delegation of identification[83] met the criteria relating to the duty to identify. The CDB 03 makes a positive statement in relation to this issue and permits the delegation of identification of the contracting partner and the beneficial owner under certain circumstances.[84] The bank may appoint an individual or a company by written agreement. The third party to whom the identification has been delegated has to be selected and instructed by the bank. According to the CDB 03 the delegating bank must be able to control the identification procedure by the mandatory. The mandatory has to forward all identification documents to the bank and certify that any photocopies are identical with the originals. A further delegation is not permitted. The delegation of identification is most often used in the case of foreign clients by the foreign subsidiary but where the business is will mostly occur in the headquarters in Switzerland. The banks give this process preference over taking on relationships via correspondence. Delegation is also possible in the case of domiciled clients but should according to some commentators remain the exception.[85]

b International standards

The FATF[86] on the basis of the diversity of the financial sector permits identification and verification by agents or other third parties but requires that these entities are subject to the same or similar rules relating to AML and CDD as the financial intermediary itself. The rules relating to introduced business would then apply.

The BCBS discusses the problem of outsourcing (without using the term) in the case of non-face-to-face customers (and also electronic banking) through independent verification by a reputable third party. The BCBS also comments on the risks related to introduced business.[87]

c Delegation under the Ordinance

The ML Ordinance makes mention of delegation in the case of additional investigations and not in relation to delegation of KYC itself.[88] Additional investigation that can be delegated according to Art. 19 of the ML Ordinance

means investigations in relation to business dealings or transactions that pose a higher risk for the financial intermediary. These investigations should either be carried out within the finance group itself or delegated to an external asset manager. Such a delegation according to the ML Ordinance should only be possible where a written agreement with the third party is signed and where the third party is subject to a comparable supervisory and legal regime (*cura in eligendo*). Instructions must also be in writing (*cura in instruendo*) and the documentation be given to the financial intermediary. The financial intermediary is responsible at all times for the accuracy of the clarification. And finally the financial intermediary must be in a position to verify that such investigations are carried out with due diligence (*cura in custodiendo*).[89]

The delegation of additional investigations is regulated by a statutory order and is therefore in a somewhat antagonistic position in relation to an existing circular, namely the Outsourcing of Services Circular SFBC-RS 99/2. This circular regulates the long-term expenditure of 'important services' for the conduct of business which means services that relate to the control of risk in its broadest senses such as market; credit; liquidity; transactions; image, as well as operational and legal risk.[90] The fact that delegation is specifically mentioned in the ML Ordinance clearly indicates that an independent solution for additional clarification will be made.[91]

2 Introduced business and professional intermediaries

The nature of introduced business is such that the KYC procedures in relation to a client have already been carried out by another bank or another financial intermediary and so the question here is whether the financial intermediary can rely on the information that has been gathered on the client. In order to put the current Swiss situation and the changes to it there follows a brief overview of the international regulations in this area.

a International standards

a Introduced Business

BCBS, FATF and the Wolfsberg Group employ the terms 'introduced business', 'intermediaries' or 'eligible introducers'[92] for the constellation in which a client is introduced by a third party and the financial intermediary has left the identification to the introducer. The client of the financial intermediary is however the direct client and not the introducer. The standards are strongly influenced by the risk-based approach: the financial intermediary has to have direct knowledge of the introducer and may not rely on an introducer that is subject to less strict CDD regulations than it itself is. The data relating to the client and the beneficial owner have to be given to the financial intermediary

directly and the ultimate responsibility is always with the financial intermediary.[93]

b Professional Intermediaries

A further group are professional intermediaries.[94] A professional intermediary is the contracting partner of the financial intermediary who holds assets on behalf of a number of beneficial owners. If the professional intermediary holds pooled accounts that are co-mingled the bank does not need to know who the beneficial owners are, as long as the 'intermediary is subject to the same due diligence standards in respect of its client base as the bank'.[95] Only in this instance can the bank be relieved of its duty to identify the beneficial owner. Where professional intermediaries hold pooled accounts not co-mingled and comprise sub-accounts, then all the beneficial owners have to be known to the bank.[96]

For the private banking sector the Wolfsberg Group makes a difference between three different forms of intermediaries (introducing, managing and agent intermediary) and imposes different levels of due diligence to be applied to the intermediary.[97] The Wolfsberg principles appear to state in the case of a managing intermediary,[98] which means a professional asset manager managing pooled accounts, the beneficial owner does not have to be identified by the financial intermediary.[99]

The international standards therefore set out strict rules relating to a financial intermediary's reliance on a third party. In only a few instances may the financial intermediary leave out the identification of the beneficial owner. Despite this, the ultimate responsibility for knowing the identity of the client and the beneficial owner remains with the financial intermediary.[100] Referring to Switzerland, the question is whether the responsibility is compatible with the Swiss legal system and whether the financial intermediary would be liable or not if it has carried out its due diligence obligations with the requisite degree of care, and in particular in relation to an intermediary that has to conform to the same standards as the financial intermediary itself.

b The Regulation in Switzerland

The CDB states that ascertaining the beneficial owner can be omitted in business relationships with domiciled and foreign banks as well as with other domestic financial intermediaries.[101] The rules start from the premise that Swiss banks and financial intermediaries are subject to adequate supervision. With respect to correspondent banking the CDB 03 however foresees that the 'beneficial ownership has to be declared for sub-accounts held on behalf of undisclosed clients by banks which are not subject to appropriate supervision

and regulation in terms of anti-money laundering provisions'.[102] The same applies for foreign financial intermediaries if they are not supervised and regulated accordingly.[103]

The current Swiss regulations lack clarity in the terms set out in the CDB that do not offer much help to the intermediary when determining – with respect to the foreign financial intermediary – what constitutes *appropriate supervision and regulation* in terms of anti-money laundering provisions.[104] The inference to be drawn from the SFBC-MLReport[105] is that the CDB regards only those countries that are members of FATF as reaching these standards.

c The special case of professional secrecy

a Current Situation

If a lawyer holds an account for his client he is basically bound by his professional secrecy and may not disclose the identity of his client. The financial intermediary for its part is obliged to know who the beneficial owner is when different from the contracting partner. So the question now arises whether the lawyer is also under the regulation relating to professional intermediaries and therefore not obliged to identify the client to the bank.

Asset management by lawyers was for a long time permitted but was drastically curtailed by the SFBC in its regulation CDB 92 and the introduction of Form R.[106]

Lawyers and notaries should only hold accounts and deposits for their clients and not be obliged to identify them when the account is set up in relation to professional legal business according to Art 5. subsecs. a and b of the CDB. In these instances lawyers are bound by their professional confidentiality rules[107] and may not deviate from them. Therefore the financial intermediary can waive identification of the beneficial owner:

1 if the lawyer or notary declares and signs in writing (Form R) and
2 states that the said account or securities are held exclusively for reasons that conform to Art. 5 subsecs. a and b CDB[108] and are registered as such. These provisions relate to accounts and deposits that are to be used in connection with professional activities where professional secrecy is relevant.

What constitutes a specific lawyers' mandate and what does not, is difficult to determine and has to be decided according to the particular circumstances.[109] The work that is the monopolistic preserve of the lawyer is regarded as falling into this area. If the business element however outweighs the legal, for example the investing of money in a family foundation in Liechtenstein, then this is

no longer covered by professional confidentiality and has to be classified as belonging to financial intermediation. If in the course of a business relationship it turns out that the Form R was wrongly filled out, then the mistake has to be rectified by getting the beneficial owner to fill out Form A. If this is not forthcoming then the client relationship has to be terminated.[110] In all other cases which do not fall within the professional lawyers' sphere, the lawyer is not bound by professional secrecy and has to identify the beneficial owner.

b International Standards

The Swiss special rules do not correspond to the BCBS. This states that banks should not enter into professional business relationships with intermediaries that are bound by professional secrecy.[111] Switzerland will have to abandon Form R in order to conform to the BCBS requirements.

The FATF does not yet go so far in its requirements. The option that the FATF envisages in its latest Forty Recommendations 2003 depends on the spheres of activity, which would be compatible with the Swiss system.[112] Because of the risks of lawyers being misused for the purposes of money laundering the FATF enumerates high risk activities for lawyers whereupon the scope of activities subject to the due diligence requirements is rather broad.[113]

The EC Directive 2001/97/EC lists the various functions that lawyers carry out and which are explicitly covered by the Directive and therefore require identification of the beneficial owner.[114] Functions that are not covered by the Directive may be dealt with at the national level, however the room for manoeuvre for the exceptions is extremely narrow, for example in the opening of a bank account or the formation of a company or trust to be subsumed under the Directive.[115]

What is somewhat surprising is the fact that the SFBC has not addressed the problems of Form R in its report. They talk about the need for knowing the beneficial owner in every case but would only like to lift the principle in relation to the supposed identity of the contracting partner and the beneficial owner.[116] In its revision of this topic the CDB 03 does not contain any changes.

IV INCREASED DILIGENCE IN SPECIAL CASES

A Special Obligation to Clarify According to the MLA

The financial intermediary can assess the risks it is undertaking by knowing the contracting partner and the beneficial owner of the business relationship. This knowledge, however, only covers a part of the business relationship and

does not cover the circumstances when a financial intermediary has doubts despite the knowledge about identity. The ways and means that transactions are carried out or which forms they take, who the payee in the transaction is, or the background of the client are all relevant to assessing money laundering risk. There are circumstances, in which an increased degree of diligence is appropriate and further clarification regarding the aim and background of a proposed transaction from a contracting partner to the economic relationships as well as the purpose have to be made. In knowing the entire circumstances, the financial intermediary is in a better position to recognize the indications for money laundering and to make an appropriate decision on how to proceed.

Art. 6 MLA requires the financial intermediary to carry out special clarification if a transaction or a business relationship appears unusual or there are indications that the assets stem from a crime or the instructions are coming from a criminal organization.[117]

Of central importance is the differentiation between unusual and suspicious transactions, and business relationships. An unusual business would require the financial intermediary to employ particular diligence and obliges him to carry out special clarification. If the clarification means that the business is unusual but does not indicate money laundering then the financial intermediary can continue the relationship. If on the other hand the clarification means that there is a chance that money laundering is involved the financial intermediary has other obligations to follow (breaking off the business relationship, notification, establishing a paper trail etc.).

The obligation of the financial intermediary to conduct special clarification under the MLA has been made more concrete since the ML Ordinance entered into force,[118] this will be examined in the following section.

B The New Concept in Switzerland

1 Introductory remarks

The ML Ordinance which came into force on 1 July 2003 makes a basic differentiation between the general duty of care and the increased duty. In the context of the general duty of care (*identification of the contracting partner and the beneficial owner*), the *CDB* 03 regulations apply to all financial intermediaries that are subject to the anti-money laundering supervision of the SFBC.[119] This is described in more detail in sections 2, 3. In the context of the increased duty of care on the other hand, the ML Ordinance contains various rules that need further examination.

The Ordinance is based on the current MLA[120] and is related to the financial intermediaries according to Art. 2, para. 2 subsecs. a, b and d MLA. Being an ordinance it corresponds to the other AML instruments that have been developed by the anti-money laundering supervisory authorities,[121] and

replaces the SFBC circ. 98/1. The content of the new provision consists mainly of the systematic categorization of business relationships and transactions with an increased risk (placing into risk categories) and relates to the deepening and comprehensive clarification of these business relationships as well as the introduction of a computer support system that will oversee transactions. The Ordinance will equally deal with the assets of 'politically exposed persons' (PEPs) and also be used in the fight against the financing of terrorism. In contrast to the previous legal position, the ML Ordinance is quite clearly embracing the risk-based approach and takes into account the risk categories enumerated in the BCBS and relevant to the banking sector, namely the reputational, operational, legal and concentration risks.[122]

The ML Ordinance primarily sets out the framework that the regulated financial intermediaries are obliged to observe, whereas the specific implementation of the new rules according to the risk-based approach obliges the financial intermediary itself to take action.

2 Overview of the details of the ML Ordinance

a Segregation into higher risk business relationships

The financial intermediary should no longer be satisfied with information received from the contracting partners or his representative, instead it has to use certain indicators to allocate the client into a risk category.[123] The aim above all is to take account of the legal and reputational risks. The criteria for developing the categories are for example the amount of assets that are involved in the business relationship, the domicile or residence of the contracting partner or beneficial owner, the nationality of the contracting partner or the beneficial owner, the absence of personal contact with the contracting partner or the beneficial owner,[124] the location and type of business being carried out, or the destination where regular payments are made.[125] PEPs are always regarded as clients associated with increased risks. If a client meets one of these criteria then he must automatically be assigned to an increased diligence category and labelled for internal use. The development of the criteria – and thus the responsibility – is up to the individual financial intermediary.

b Segregation into higher risk transactions

The financial intermediary has to develop criteria which help the detection of transactions which involve increased legal or reputational risk.[126] Again, the responsibility to define the criteria lies with the financial intermediary depending on the type of operations conducted. Criteria of particular relevance can be the importance of incoming and outgoing assets, any significant divergence

from the type, volume or frequency of transactions that would be normal in the context of the business relationship or in comparable business relationships.[127]

There are however some transactions, that are always deemed to involve higher risks, such as the physical deposit of assets exceeding the threshold of SFr. 100 000 or transactions for which indicators of money laundering according to the annex of the ML Ordinance[128] apply.[129]

c Enhanced due diligence in the case of higher risks

In the case of detecting a customer relationship or transaction with a higher risk enhanced due diligence obligations have to be adopted.[130] Enhanced due diligence comprises research into precise details relating to the client, the origin and the use to which the assets that are to hand are to be put, the rationale of large transactions, the profession, whether there is a relation to a PEP or who in the case of legal persons is qualified to participate.[131] The clarification should not be broad and superficial but should correspond to the individual case and the risk involved. Publicly available sources that are also open to the financial intermediary should be consulted. These may include databanks, information from third parties or a contracting partner, visits to the place of business, enquiries to other financial intermediaries, or persons in a position of trust.[132] The timing of the clarification should be when the first client contact is made or during the business relationship as soon as the risk has become apparent.[133] The outcome must be recorded in writing and top management is to be involved in the decision to accept the client.[134]

d The systematic monitoring of transactions

According to Art. 12 ML Ordinance, computer systems shall be available to assist in identifying transactions involving increased risk. So for example large cash transactions or through-account operations, but also other unusual transactions that deviate from what would be expected in respect of the client's normal business can then be recognized in a standardized form. However, computer systems should be deemed solely as a tool to assist and are not meant to alleviate the financial intermediary of its responsibility to make other checks. At the same time computer systems, which may be extremely costly, should not become compulsory for financial institutions with only a few clients or transactions. The parameters of the automated systems must however correspond to the individual risk that the financial intermediary has to bear in relation to his particular business.

The introduction of automated systems to support monitoring programs has most notably been pressed for by the Wolfsberg Group[135] and seems to have been included here.

e Global management of legal and reputational risks

Legal and reputational risks know no country borders, which motivated the SFBC to take a consolidated approach to the prevention of money laundering. International finance groups that have their headquarters in Switzerland have to cover their legal and reputational risks on a global basis, ensure that they are contained and controlled.[136] The basic principles of the ML Ordinance have to be applied to branches and subsidiaries abroad, and this has to be controlled by the group's internal control bodies as well as the external auditors.[137]

The SFBC must be informed if there is a serious impediment to accessing information on contracting partners or beneficial owners.[138] The SFBC will have to find a solution together with the financial intermediary and the foreign regulator, whereby the set up of branches and subsidiaries in certain countries could be prohibited as *ultimo ratio* solution.

f PEPs

a General Remarks

The problems related to accepting money from PEPs and their entourages has been exacerbated through a series of crises provoked by business dealings with corrupt heads of state. The enormous risks to reputation of individual financial intermediaries involved but also to the financial centre itself requires that particular care is taken when dealing with PEPs. The classification of a person as a PEP does not mean that they are to be regarded as either corrupt or otherwise criminally suspect, but quite simply they may present an increased risk in that an abuse of power may occur and monies so derived may be transferred into a financial system. In Switzerland, since 1 May 2000, the acceptance of money that has been obtained through corruption (domestic and transnational) is now a predicate offence to money laundering.[139] The heart of the problem though, lies in recognizing a PEP and his entourage, as well as prudent and efficient monitoring of the client and his business activities during the course of the business relationship.

The Supervisors PEP Working Paper of November 2001[140] (PEP-Paper) sets out guidelines for monitoring business relationships and transactions with PEPs. The Paper defines PEPs and lists the risks factors that should be considered when an account is opened.[141] These include for example, unexplained source of wealth, lack of verifiable sources of income, concerns over the country where the account holder has a political position etc. In addition the PEP Paper gives indications how business relations would be conducted with a PEP and regularly monitored, senior management involvement is also required.

b International Standards

The international standards emphasize the serious legal and reputational risks that a financial intermediary could face with respect to a business relationship with a PEP.[142] The reputation of an entire financial centre can be negatively affected by publicity surrounding the criminal origins of a PEP's assets.[143] An essential obligation for a bank therefore is to collect enough information from the client and compare this with what is available publicly in order to be able to identify the client as a PEP. The relationship with the client must be monitored closely and a senior manager has to be involved in this process.[144] The BCBS CDD 2001 is notable for its far reaching statement that calls on banks to avoid entirely contractual relations with PEPs that are corrupt – notwithstanding the position with respect to national laws regarding the criminality of bribing a foreign public official.[145] In this way international standards can have an enormous 'external influence' even in countries that are experiencing difficulties in implementing laws – or are slow to introduce them at all, in this area.

c ML Ordinance

The potential problems with PEPs have been recognized and tackled by the ML Ordinance, which refers to them now in Art. 1 with a definition.[146] Over and above this, a business relationship with a PEP would always be allocated to a high risk category. This does not mean that these sort of relationships are not wanted, but according to Arts 17 *et seq.* of the ML Ordinance there are consequences in relation to enhanced due diligence. One of the central provisions of the ML Ordinance is the requirement to double check information received – be it from the client himself, his representatives or other bank clients, against publicly available sources, and to obtain permission from a member of management before entering into the business relationship. Thus the ML Ordinance follows the BCBS CDD 2001 requirements quite closely.[147]

g Correspondent banking

a General Remarks

Correspondent banking may be defined as 'the provision of banking services by one bank (the 'correspondent bank') to another bank (the 'respondent bank').[148] In the UBS Dictionary of Banking[149] a correspondent bank is defined as a 'credit institution acting as agent for a bank in a banking centre where the latter is not represented'. Correspondent banking comes under the

topic of 'introduced business and professional intermediaries'[150] but includes more services than only holding an account. Services provided by respondent banks such as cash management, electronic payments systems, cheque clearing, through accounts etc. enable a bank that is not physically present in the land where the respondent bank is, to offer the services of the latter to its own clients. These services are essential preconditions for international payments systems and are based on factors such as speed, precision and geographical reach. The Correspondent bank on the one hand meets the needs of the global economy, but on the other hand is not without its risks. The speed and quantity of transactions makes it very difficult to identify transactions as suspicious and to stop them, if they have not already been identified as a problem.

The CDB does not contain any particular details regarding diligence in relation to correspondent banking. It simply states that banks domiciled in Switzerland or abroad as well as other financial intermediaries domiciled in Switzerland or – if domiciled abroad they must be subject to adequate supervision – do not have to give information on the beneficial owner.[151] Only financial intermediaries domiciled abroad and which are not subject to any reasonable supervision and where there are no adequate laws relating to money laundering, have to give information about the beneficial owner.[152]

b International Standards

On the international level, correspondent banking is dealt with by the risk-based approach. 'The FATF considers, that correspondent banking is an area where the higher risks of money laundering and terrorist financing mean that it needs to be treated differently from other business relationships involving two or more financial institutions'.[153] The risks of correspondent banking lie in 'failure to ask respondent banks about the extent to which those respondents allowed other banks to use their accounts with the correspondent bank. In this way, the correspondent bank might find itself indirectly conducting business for a number of offshore or shell banks with which it would not even consider establishing a direct account relationship'.[154] The BCBS requires that 'banks should gather sufficient information about their respondent banks to understand fully the nature of the respondent's business'.[155] The financial intermediary must for example be extremely careful when dealing with through-accounts where third parties as sub account holders are able to access the account. The same degree of due diligence needs to be employed on respondent banks as by introduced business.[156] Dealings with shell banks are generally not allowed.[157] Special attention also needs to be given to respondent banks that are domiciled in an NCCT country.

The Wolfsberg Group published its Principles for Correspondent Banking

in November 2002[158] aiming to govern the establishment and maintenance of correspondent banking relationships. The Principles are very much governed by the risk-based approach to evaluating correspondent banking clients. In evaluating prospective risks, the Principles requires its member banks to consider the domicile of the client, its ownership and management structures, its business portfolio and its customer base.[159]

c ML Ordinance

Art. 6 ML-Ordinance foresees that the provisions of the Ordinance apply to correspondent banking relationships. It herewith implicates the risks the financial intermediary accepts to take when entering such a relationship. It is especially forbidden to maintain any business relationship with so-called shell banks[160] unless they are part of a financial group subject to effective consolidated supervision.

In addition to the above provisions of the ML Ordinance the CDB requires that 'beneficial ownership has to be declared for sub-accounts held on behalf of undisclosed clients by banks which are not subject to appropriate supervision and regulation in terms of anti money laundering provisions'.[161] As to what constitutes an appropriate degree of supervision and regulation, reference has to be made to the work of the FATF. To be noted in particular are the obligations to document the anti-money laundering cases and discussions on the allocation of AML roles between the two institutions, the collection of sufficiently comprehensive information in the requesting bank, restrictive measures in relation to through accounts and on requesting banks that are based in NCCT jurisdictions.[162] In addition, there should be periodic reviews of correspondent relationships based on information from financial intermediaries as to whether the respondent bank still fulfils the stipulated criteria.

V DOCUMENTATION

Art. 7 MLA imposes a duty on all financial intermediaries to draw up and retain documents. An appropriate record is to be kept of the contracting partner's and the beneficial owner's data.[163] The rules represent the implementation of the obligation to document according to Art. 7 MLA. The ML Ordinance specifies this obligation to document and states that the financial intermediary has to apply this when ascertaining who the contracting partner or beneficial owner is, or when cash transactions necessitating identification of the person concerned have been carried out or when a permanent power of attorney – unless recorded in a public register – has been issued.[164]

The duty to maintain documentary records serves on the one hand external

and internal controls including conformity with laws, regulations and the CDB.[165] On the other hand, maintaining records enable a financial intermediary to assist the investigatory and prosecuting authorities within a reasonable period of time, and may include information on the contracting partner and beneficial owner, powers of attorney and spot transactions that require identification.[166]

Art. 8 MLA requires financial intermediaries to take all steps necessary to prevent money laundering including adequate training of their staff and checks. To be fully compliant with AML internally financial intermediaries are obliged to set up internal structures and inflows to alert their employees to the risks of money laundering. This means that an internal office dealing with money laundering has to be set up and which is capable of advising the employees. This office has multiple functions in that it develops internal rules, educates and trains employees, and is responsible for controlling and implementing the compliance tools.

The ML Ordinance prescribes in its Art. 10 in detail the content of internal directives and requires them to be sanctioned by the highest levels of management. The directives cover for example rules on which business relationships are to be regarded as higher risk, the training of employees, details on reporting to the money laundering office and other internal transfers of CDD obligations within a company that are necessary and helpful indications. Particular emphasis is put on continuous education of client advisors,[167] which conforms to international standards[168] and constitutes an essential element in the proactive fight against money laundering.

VI TERRORISM AND THE AML SYSTEM

The subject of the financing of terrorism also partly relates to CDD in Switzerland thereby becoming part of the fight against money laundering. Given its growing importance as a subject in itself as well as in the context of the implementation of the ML Ordinance, the topic will be briefly considered here.

A International Efforts

Neither combating terrorism nor its financing are new topics.[169] The tragic events of 11 September 2001 did result in a speeding up of the implementation of standards, recommendations and national laws against the financing of terrorism. In October 2001 FATF published its Special Recommendations on Terrorist Financing. The Wolfsberg Group made its Statement on Suppression of the Financing of Terrorism. In January 2002 and in April 2002, the BCBS came out with a paper on the sharing of financial records between jurisdictions

in connection with the fight against terrorist financing. The 2003 version of the Forty Recommendations expressly states that the Recommendations do not only apply to money laundering but also to terrorist financing and are to be combined with the Special Recommendations on Terrorist Financing.[170] What all these standards have in common is the acknowledgement that KYC rules have to be implemented consistently by financial intermediaries, lists of client names have to be compared to lists of suspected terrorists and that the exchange of information has to occur on a global basis.[171]

B The Swiss Perspective

1 MLA

Art. 9 MLA sets out the duty on the financial intermediary to report when it knows or has grounds to suspect that assets are controlled by a criminal organization according to Art. 260ter subsec. 1 of the Criminal Code. Even though not expressly mentioned, this article encompasses terrorist organizations and the offence is complete before an act of terrorism has been committed. Belonging to and the financing of a terrorist organization is covered by Art. 260ter of the Criminal Code because it would either constitute participation in the crime in itself or complicity.[172] If the financial intermediary is uncertain about whether a connection to a terrorist organization exists, then it may report its suspicions under Art. 305ter of the Criminal Code.

2 ML Ordinance

The ML Ordinance defines a terrorist organization as per Art. 260ter CC[173] and herewith reflects the current state of the law.[174] The prohibition against business relationships with criminal or terrorist organizations in Art. 5 ML Ordinance may be regarded as the practical implementation to guarantee impeccable business practices.[175] The CDB similarly contains rules in its preamble that extend the fight against the financing of terrorism.[176]

One of the reforms, however, imposes an obligation on the financial intermediary to report to the money laundering office if it supposes that a *link* to terrorism or a terrorist organization exists. This applies even if the basis for filing a report is not based on a founded suspicion,[177] but only a mere indication.[178] Thus the ML Ordinance lowers the threshold in relation to when a notification has to be made (from a grounded suspicion), to that of just *revealing of a link to a terrorist organization*. From a formal legal perspective the question here is whether the obligation to report can be lowered to that contained in the statute by virtue of an Ordinance, which is based on that same statute. What is specifically open to question is at what point does an indication of terrorism and the failure to report contravene Art. 37 MLA (carrying as it does the risk of a fine of up to SFr. 200 000).

A further important development is contained in Art. 15 ML Ordinance. In order to comply with Recommendation VII of the FATF Special Recommendation on Terrorist Financing[179] the financial intermediary is obliged in the case of cross-border wire-transfers to record the name and the account number and domicile of the person making payment.[180] The financial intermediary can be freed from this requirement if the reasons for the transfer are clarified and recorded in writing[181] or in the case of domestic wire-transfers.[182]

3 Revision of the Criminal Code

Switzerland has ratified international conventions to Suppress the Financing of Terrorism and terrorist bombings. It is in this context that revisions to the Criminal Code are envisaged. Although the current version of Art. 260ter CC covers all terrorist organizations according to the *Botschaft*, 26 June 2002, there are still gaps.[183] Financial dealings that are carried out for the benefit of more loosely organized groups or for terrorists acting alone are not covered by Art. 260ter according to the *Botschaft*. In addition it is not always easy to establish the requisite proof that there is a causal link between the financing and the terrorist act, similarly proving that the constituent elements of a criminal organization exist is not a simple matter.

The UN Convention requires that a free-standing norm that criminalizes the financing of terrorism be enacted and which is not confined to being an accessory to a terrorist act. To close these gaps in the criminal law the government is considering bringing in a new general provision relating to terrorism as well as a free standing criminal provision relating to the financing of terrorism and in addition appropriate corresponding revision to other laws.

These amendments are to be welcomed, indicating as they do, that Switzerland seeks to conform to its international obligations and is taking an unequivocal stance against all forms of terrorism.

While conforming with the international standards in this area is a positive move, there are however from the perspective of fundamental criminal law principles some disquieting aspects to the extrapolation of criminality to the financing of terrorism. A person will be criminally liable if he intentionally finances a crime as set out in Art. 260^{quinquies} Draft CC (terrorism), collects or makes available assets. These acts are on the face of it neutral activities that in themselves do not pose a threat, it is only when the mental element is added that they become an offence. Because it is not possible to be an accessory to the crime, the element of criminality has been transferred to an extremely early stage, which is not part of a criminal offence. There is a risk that the principle of certainty in criminal law may be undermined. The standards relating to the subjective elements – knowledge and intention to finance a terrorist act – also have to be proved. This matter will be left to the courts to be interpreted, which is not how the principle of certainty is supposed to function.

Efforts to prevent the financing of terrorism by way of regulatory law and penal law are essentially to be welcomed. However, the fact that these developments will mean that it will continue to be difficult for financial intermediaries to detect terrorist financing should not be downplayed.

VII CROSS BORDER EFFECT OF CDD

The efficacy of domestic CDD regulations can only have a limited effect if standards in other countries are lower and significantly different. The consequences are competitive disadvantages for the financial centre that has stricter rules and there is a risk of regulatory arbitrage that may endanger the banking system itself. For these reasons the international standards pose a world-wide harmonization of CDD obligations. The BCBS is addressed to supervisors around the world and requires banking groups to employ a consolidated application of 'policies and procedures to their overseas branches and subsidiaries including non-banking entities such as trust companies'.[184] Here mention should also be made of the 1997 Basel Committee Core Principles for Effective Banking Supervision[185] which require a global consolidated supervision over internationally active banking organizations. The main burden for the operational aspect of monitoring is in practice in the hands of the auditors.

The Wolfsberg Principles achieve the goal of world-wide harmonization of CDD obligations but not via the supervisory bodies but quite simply by the fact that the members of the largest international players in private banking have agreed to the Principles they develop in consultation with each other. The Principles are regarded by the Group as global guidance for sound business conduct in international private banking.

FATF is supported by a large number of countries that subscribe to efforts to combat money laundering on a global basis. The Recommendations of the FATF are addressed to the member states with the aim of getting them transposed into national laws.

The national AML regulations should however not be underestimated because they apply to all parts of a group of companies and thereby transcend national borders. The ML Ordinance obliges financial intermediaries to ensure that their branch offices or subsidiaries operating outside Switzerland comply with the basic principles. This is to apply even in affiliated companies and subsidiaries that are located in non-FATF member countries which are not subject therefore to the international norms that set high standards. The aim is that these rules be applied via internal directives to ensure their application.

The bank statutory order requires in certain cases that a group-wide audit be carried out.[186] This thought can be found again in the provisions of a global management of legal and reputational risks according to Art. 9 ML Ordinance.

Herewith Switzerland implements the recommendations in the BCBS CDD 2001 which request that supervisors apply the national standards to all conglomerate companies that are obliged to consolidate their reporting.[187] As one of the most important financial centres, Switzerland leads the way to global implementation of sound AML Systems stemming directly from the national legislation.

NOTES

1. Cf. Chapter 4, section 'Lack of due diligence: Criminal aspects relating to the obligation to exercise due diligence (Art. 305ter para. 1 Criminal Code, in force since 1 August 1990)'.
2. Financial intermediaries as per MLA.
3. The financial intermediaries must come within the definition in Art. 2 MLA.
4. The last revised version of the CDB is the CDB 03. It is effective, as of 1 July 2003.
5. Art. 14 MLO.
6. Cf. the Verordnung des Bundesamtes für Privatversicherungen über die Bekämpfung der Geldwäscherei (30 August 1999).
7. Where there are important deviations in respect of financial intermediaries that are also subject to the MLA they will be mentioned in the appropriate section. This relates for example to the Due Diligence Ordinance of the MRO as of 1 January 2004.
8. To understand the interplay of the various institutions the following should be noted: The *WG KYC* set up by the SFBC has on the one hand developed a Draft Ordinance. The SFBC has published its commentary to the Draft Ordinance as prepared by the WG KYC. On the other hand, the WG KYC has also developed a proposal for the Revision of the CDB. The latter is neither in their competence sphere or that of the SFBC and is directed at the Swiss Bankers Association, which published its revised version of the CDB on 17 January 2003.
9. During the transition period the provisions in the Ordinance for which there is no transition period will apply RS 98/1 vor. (see SFBC communication No. 25, 17 January 2003, s. 2).
10. Art. 3, para. 1 MLA; CDB 03, (9).
11. CDB 03, (22).
12. CDB 03, (9).
13. CDB 03, (22).
14. CDB 03, (12). The Due Diligence Regulation (as of 1998, currently under revision) Art. 13, para. 4 subsec. a, states that the original document or an authenticated copy be produced. Comparable documents are, for example an authenticated copy of a certificate of incorporation or contract or a confirmation by the auditors. Due Diligence Regulation Art. 13, para. 3.
15. CDB 03, (13), (16).
16. CDB 03 (14).
17. A document older than 12 months may be used in conjunction with an audit report of a 'certificate of good standing', dated no older than 12 months (cf. CDB 03 [15]).
18. Art. 4, para. 2 CDB 03. Domiciliary companies are of a bigger interest with respect to the beneficial owner, see further under section II.A.2.b.
19. Art. 23 subsec. c, ML Ordinance, see Documentation.
20. See Chapter 4, II, Country Reports, The AML System in Switzerland section Art. 305bis CC.
21. CDB 03 (5).
22. According to the *Botschaft* 1996, (1122) 'Business that is not carried out using an existing account with a financial intermediary and which does not have any further link to the relationship of the client with the financial intermediary'.
23. Art. 2, para. 2 CDB 03; this amount corresponds to the amount of Euros 15 000 in the Directive 2001/97/EC (amending Council Directive 91/308/EC). In Switzerland though

this amount deviates from the threshold of SFr. 25 000 for spot transactions, and SFr.5000 for exchange set by the Control Authority of for those entities that are directly controlled (Art. 12 para. 2 Due Diligence Regulation). The *WG KYC* proposed in its report from June 2002, Annex II, that this difference should be specially checked in the Revision of the CDB and dealt with there.

24. CDB 03 (8) para. 1.
25. Art. 3, para. 4 MLA; CDB 03 (8) para. 2; see the position of the banks in cases.
26. Stephen Berti/Christoph Graber, Das Schweizerische Geldwäschereigesetz, Gesetzesausgabe mit Englischer Übersetzung und Anmerkungen, Zürich 1999, Art. 3 (10).
27. Cf. the distinction between the CDB and the ML Ordinance, section III.
28. BCBS CDD 2001 (45) *et seq*.; FATF Cons. Paper 2002 (58) *et seq*.; cf. Interpretative Note to Rec. 5 FATF 40/2003; WB §1.2.5.
29. CDB 03 (10 *et seq*.).
30. CDB 03 (11) para. 1.
31. CDB 03 (11) para. 2.
32. FATF Cons. Paper 2002 (63).
33. SFBC-Money Laundering-Report (2003), p.27.
34. Mindeststandards für reine Internet-Banken und -Effektenhändler zur Kontoeröffnung auf dem Korrespondenzweg und zur Kontoüberwachung (‘*Minimal standards*’), cf. http://www.ebk.admin.ch/d/archiv/2001/neu5-01.pdf
35. SFBC Communication No. 25 (2003) 17 January 2003.
36. Art. 4 MLA, corresponding with FATF 40/1996, Rec. 11. However FATF 40/2003, Rec. 5. (b) requires the identification of the beneficial owner in more general terms obliging the financial intermediary to be satisfied that it knows who the beneficial owner is.
37. Art. 305ter CC only mentions the identity of the beneficial owner, but assumes that the direct contracting partner is known.
38. The critique of the WG KYC (Annex II, 10) to formulate this principle in a positive way, that is to only assume the identity of contracting partner and beneficial owner if there are no doubts, apparently has not been implemented in the CDB 03.
39. See CDB 03 (27).
40. Bundesblatt, 1996 III 1126.
41. Berti/Graber (see Note 26), Art. 4 (2).
42. Form A has the advantages like simplification and standardizing of the identification procedure on the one hand, but on the other hand comprises the risk of neglecting the diligence required.
43. W. De Capitani (2002), ‘Kommentierung einzelner Bestimmungen des GwG‘, in Schmid (ed.), *Kommentar Einziehung, Organisiertes Verbrechen und Geldwäscherei*, Bd. II, Zürich 2002, MLA 4, 113. (Quoted in W. De Capitani, MLA [*Art.*] [*Note*]).
44. Cf. *WG KYC* Annex II (10).
45. W. De Capitani (see Note 43), MLA 4, 131 *et seq*.
46. Cf. FATF Cons Paper 2002, 177 *et seq*; Cf. also the Interpretative Note to Rec. 5 40/2003.
47. According to Art. 11 CDB 03 the SBA can fine the fallible bank with a penalty of a sum up to CHF 10 Mio (SFr. 10 million).
48. Art. 17, para. 2, lit. a ML Ordinance.
49. Art. 18, para. 1, ML Ordinance.
50. Art. 21/22 ML Ordinance.
51. CDB 03 (29).
52. The WG KYC would basically have liked to move away from the notion that the contracting partner is identical with the beneficial owner. The beneficial owner should have been identified in every case, not only in case of doubt or where there are clear differences. In the case of corporate vehicles the rule was suggested to be that the contracting partner and the beneficial owner were not the same person, although it would be questionable whether this supposition is even necessary if ascertaining the beneficial owner as well as the basic principle are laid down. The wording of the definite version of the CDB 03 did, however, not take the suggestion into account and still presumes that the contracting partner and the beneficial owner are identical.

53. CDB 03 (26).
54. Art. 4, para. 2 MLA; CDB 03 (32).
55. CDB 03 (33).
56. Companies, institutes, foundations, trusts etc. (Art. 4 CDB 03).
57. 'Despite the important roles that corporate vehicles play in the global economic system, these entities may, under certain conditions, be misused for illicit purposes, including money laundering, bribery/corruption, improper insider dealings, illicit tax practices, and other forms of illicit behaviour. A recent report commissioned by the EC concluded that the ability of legal entities to effectively conceal the identity of their beneficial owners stimulates their use for criminal activities. Even in jurisdictions with bank secrecy laws, perpetrators of illicit activities prefer to deposit their ill-gotten gains in an account opened under the name of a corporate vehicle because bank secrecy protections may be lifted in certain situations'. *Behind the Corporate Veil, Using Corporate Entities for Illicit Purposes*, OECD, Paris, 2001.
58. At first glance, it seems to be illogical that with an irrevocable construction the settlor is to be regarded as the beneficial owner because he just resigned from his beneficial ownership. But from a more practical and realistic point of view the resignation from the beneficial ownership is rather a formal than a material aspect. This argues for the identification of the settlor but also for the identification of the persons authorized to give instructions.
59. CDB 03 (44).
60. CDB 03 (45).
61. FATF Cons. Paper 2002 (176).
62. *Behind the Corporate Veil, Using Corporate Entities for Illicit Purposes*, OECD, Paris, 2001.
63. BCBS CDD 2001, 32 *et seq*.; WB, 1.2.2.
64. CDB 03 (25).
65. Art. 8, para. 2, lit. b. ML Ordinance; an unusual transaction can – after clarification – become a suspicious transaction which then is to be notified.
66. The WG KYC (in its Report, ad 17) has renounced explicitly mentioning the customer's profile in the text of the Draft Ordinance in order to avoid any confusion with other clarification necessary for an optimized client service.
67. Art. 12 ML Ordinance.
68. WB 4.1.
69. CDB 03 (24) (29).
70. Art. 6, ss.3 and 4 CDB 03.
71. W. De Capitani (see Note 43), MLA 3 (4), 4 (5), 5 (20) *et seq*.
72. Art. 20 ML Ordinance.
73. *Botschaft*, 1996, 1148.
74. Art. 2 CDB 03.
75. CDB 03 (18).
76. CDB 03, (18) lit a.
77. CDB 03, (18) lit b.
78. CDB 03, (18) lit c.
79. *WG KYC*, Annex II (4).
80. CDB 03 (17).
81. CDB 03 (19).
82. Cf. also W. de Capitani (see Note 43), MLA 4 (25).
83. Urs Zulauf (1994), 'Gläubigerschutz und Vertrauensschutz – zur Sorgfaltspflicht der Bank im öffentlichen Recht der Schweiz', *Schweizerischer Juristenverein*, **4**, 490.
84. CDB 03 (21) for the contracting partner and (35) for establishment of the beneficial ownership.
85. W. de Capitani (see Note 43), MLA 4 (14).
86. FATF Cons. Paper 2002 (105); FATF 40/2003 (9).
87. BCBS CDD 2001 (45) and (48, bullet point 6).
88. Pro memoria: KYC is left to the CDB as the self-regulating body.
89. Art. 19 sec. 1 lit. c.

90. See SFBC Circ. 99/2 Outsourcing (2).
91. Even though the solution is very similar to the SFBC Circ. 99/2 Outsourcing. It seems to be illogical that the WG KYC offers a special solution for the delegation of additional clarification on the level of a formal regulation on the one hand, but on the other hand states in its report (ad Art. 20) that the SFBC Circ. 99/2 Outsourcing will be applicable.
92. FATF Cons. Paper 2002 (96) *et seq*.; FATF 40/2003 (9); BCBS CDD 2001, 2.2.3 *et seq*., WB 1.2.3.
93. The BCBS requires, that 'banks that use introducers should carefully assess whether the introducers are "fit and proper" and are exercising the necessary due diligence in accordance with the standards set out in this paper. The ultimate responsibility for knowing customers always lies with the bank. Banks should use the following criteria to determine whether an introducer can be relied upon:

    - It must comply with the minimum customer due diligence practice identified in this paper;
    - The customer due diligence procedures of the introducer should be as rigorous as those which the bank would have conducted itself for the customer;
    - The bank must satisfy itself as to the reliability of the systems put in place by the introducer to verify the identity of the customer;
    - The bank must reach agreement with the introducer that it will be permitted to verify the due diligence undertaken by the introducer at any stage; and
    - All relevant identification data and other documentation pertaining to the customer's identity should be immediately submitted by the introducer to the bank, who must carefully review the documentation provided. Such information must be available for review by the supervisor and the financial intelligence unit or equivalent enforcement agency, where appropriate legal authority has been obtained.
    - In addition, banks should conduct periodic review to ensure that an introducer which it relies on continues to conform to the criteria set out above'. BCBS CDD 2001 (36).
94. For example, banks, lawyers, stockbrokers etc.
95. BCBS CDD 2001 (39).
96. BCBS CDD 2001 (38).
97. The Wolfsberg AML Principles – Questions and Answers (WB-Q&A), Madrid 9 February 2002, Questions and Answers 1–8.
98. 'The role of the managing intermediary is to act on behalf of one or more clients. The intermediary may be the accountholder or have power of attorney over the account for the purposes of managing the assets in the account'. WB-Q&A, Answer 7.
99. This is in fact not explicitly mentioned in the text but must be concluded with respect to other standards, such as, for example the BCBS CDD 2001. The *managing intermediary* himself is the account holder. This is not the case with the *introducing* or the *agent intermediary* whereupon the contracting partner and the beneficial owner always must be identified.
100. This is the case with the introducer but also with professional intermediaries (cf. the cross reference in BCBS CDD 2001 [39] to [36]).
101. Fund managements, life-insurance companies, brokers and tax-exempt institutions of the professional pension funds. For the definition of foreign financial intermediaries the special laws of the country of domicile are applicable (CDB 03 (34) para. 3).
102. CDB 03 (34) para. 1.
103. CDB 03 (34) para. 2.
104. CDB 03 (34).
105. SFBC-ML Report 2003, p. 29. See also the report of *WG KYC* June 2002, Annex II, (17) and Note 9.
106. Form R replaced the controversial Form B1 for Swiss lawyers and notaries and Form B2 for fiduciaries and asset managers. According to the SFBC these forms had established a so-called 'super banking secrecy'. The account holding lawyers or fiduciaries only had to declare that they knew the beneficial owner and no objectionable business in the sense of the CDB (87) was intended to be conducted. If so the banks were relieved from their duty

to identify the beneficial owner. The introduction of Form R has limited the asset management business conducted by persons under a professional secrecy and is now only allowed within the scope of Art. 5 CDB 03.

107. Art. 321 Criminal Code.
108. Short-term investments of advance payments for court fees, bails etc. deposit and investment of assets resulting from a settlement of an estate or a pending separation of goods in a divorce, deposit of a security for an escrow or blocked accounts for a purchase of shares.
109. Decision of the Supreme Court 112 Ib 608, Considerations c.
110. Art. 6, sec. 2 CDB 03.
111. BCBS CDD 2001 (40).
112. Switzerland is characterized a 'FATF jurisdiction where action has been taken to include lawyers within the scope of their AML regime. All financial intermediaries are covered, and lawyers that provide the requisite financial services are regarded as financial intermediaries, though not with respect to the core business of a lawyer i.e. business covered by legal privilege'. (FATF Cons. Paper 2002, §276).
113. FATF 40/2003, Rec. 12 and 16.
114. Directive 2001/97/EC, Art. 2a, 5.
115. Ibid.
116. *WG KYC*, Annex II (10).
117. Art. 6 MLA
118. See also the reproof in CDB 03 (3).
119. Art. 14 ML Ordinance.
120. Art. 16 and 41 MLA.
121. Cf. other regulations, for example die Verordnung der Kontrollstelle für die Bekämpfung der Geldwäscherei über die Sorgfaltspflichten der ihr direkt unterstellten Finanzintermediäre, 25 November 1998 (SR); Verordnung des BPV über die Bekämpfung der Geldwäscherei, 30 August 1999 (SR 955.032); Verordnung der Eidgenössischen Spielbankenkommission über die Sorgfaltspflichten der Spielbanken zur Bekämpfung der Geldwäscherei, 28 February 2000 (SR 955.021).
122. BCBS CDD 2001 (8) *et seq.*; See also FATF Cons. Paper 2002 (5) *et seq.*; FATF 40/2003, (5); WB (2).
123. Art. 7 ML Ordinance.
124. The SFBC stresses in the Comment of 8 July 2002 to the Draft Ordinance the importance of a personal client contact. The question remains whether nowadays in a globalized world the personal client contact really is the most efficient way to identify a client or a beneficial owner. Would reliance on a carefully selected third party or well-developed electronic signatures not be as efficient?
125. Art. 7 ML Ordinance.
126. Art. 8 ML Ordinance.
127. Ibid.
128. Schedule: Indicators of Money Laundering.
129. Art. 8, para. 2 ML Ordinance.
130. Art. 17 *et seq.* ML Ordinance.
131. Art. 17 ML Ordinance.
132. Art. 18 ML Ordinance.
133. Art. 20 ML Ordinance.
134. Art. 22 ML Ordinance.
135. WB (5.1).
136. Art. 9 ML Ordinance
137. According to Art. 9, para. 2 lit. a ML Ordinance, the creation of a centralized database of contacting partners and beneficial owners or a centralized database is, however, not required. Subsidiaries must supply the relevant information to the group's executive office.
138. Art. 9, para. 4 ML Ordinance.
139. Art. 322ter and ^{septies} CC.
140. Drafted by several national financial institutions supervisory authorities, among them, the SFBC.

141. PEP Paper (15).
142. 'In accepting and handling funds from such sources, the financial institution must recognize the implications, which include: reputational damage; restitution claims from national governments or private individuals; significant legal and compliance costs; enforcement action by the regulatory authority; and criminal charges of money laundering against employees of the financial institution or the institution itself. Furthermore, to the extent that the proceeds of corruption are routed through a number of firms in the same financial centre then that centre may itself suffer reputational damage and loss of public confidence in its business standards'. (FATF Cons. Paper 2002, §43).
143. BCBS CDD 2001, 42.
144. BCBS CDD 2001, 41 *et seq*.; FATF Cons. Paper 2002, §42 *et seq*.; FATF 40/2003, (6); WB §2.2.
145. BCBS CDD 2001, §43.
146. PEPs are persons with important public functions abroad as well as individuals having close family ties or personal or business connections to PEPs. Domestic PEPs are not covered (Art. 1 lit. a ML Ordinance).
147. BCBS CDD 2001, §43.
148. BCBS CDD 2001, §49, FATF Cons. Paper 2002, §48 *et seq*.
149. http://www.ubs.com/e/index/about/bterms/content_a.html#top
150. See section III.C.2.a.*b*.
151. CDB 03, (34), see section III.C.2.a.*b*.
152. Ibid.
153. FATF Cons. Paper 2002 (48), Rec. 7 FATF 40/2003.
154. FATF Cons. Paper 2002 (53).
155. BCBS CDD 2001 (50). The financial intermediary has to clarify the following issues before entering into a business relationship with a respondent bank: 'information about the respondent bank's management, major business activities, where they are located and its money laundering prevention and detection efforts, the purpose of the account, that identity of any third party entities that will use the correspondent banking services, and the condition of bank regulation and supervision in the respondent's country'.
156. FATF Cons. Paper 2002, §54, cf. the respective Rec. 7 and 9 FATF 40/2003.
157. That is, banks without physical presence.
158. The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, http://www.wolfsberg-principles.com/wolfsberg_principles.html.
159. WB CBP, Art. 4.
160. Art. 6, para. 2 ML Ordinance defines shell banks as 'banks that do not maintain a physical presence in the country under the laws of which they were established'.
161. CDB 03 (34) para. 1.
162. Cf. *WG KYC*, Annex II (18) and FN 9.
163. CDB (22) for the contracting partner and Art. 3 (Form A) for the beneficial owner.
164. Art. 23 lit. a–c ML Ordinance.
165. The bank is responsible to ensure that its internal auditing department and the external auditing firm required by the Bank Act are in a position to verify that the identity of the contracting partner and the beneficial owner have been established (CDB 03 (23)(36)).
166. Art. 23 ML Ordinance.
167. Art. 11 ML Ordinance.
168. WB (8); BCBS 2002 CDD (58); FATF 40/1996 (19), FATF 40/2003 (15).
169. Cf. the remarks of Mark Pieth in 'International Standards against Money Laundering', Chapter 1.
170. FATF 40/2003, Introduction.
171. The question comes up whether the rules developed for AML form an effective and successful means for the fight against terrorist financing, too, but this discussion would be too extensive and will not be followed here.
172. *Botschaft* 26 June 2002; Bundesblatt, 2002, No. 32, p. 5432, (4.2.1).
173. Cf. Art. 1 subsec. c. ML Ordinance.
174. *Botschaft* 26 June 2002, 4.2.1, p. 5432.

175. Art. 3 sec. 2 lit. c Banking Act.
176. Art. 1 CDB 03.
177. As it is required in Art. 9 MLA.
178. Art. 25 ML Ordinance, first sentence.
179. Interpretative Note to FATF Special Recommendation VII: Wire Transfers, 13 February 2003.
180. Art. 15 ML Ordinance. The domicile of the ordering contracting partner and a transaction number can however be replaced by an identification number (Art. 15 para. 1 ML Ordinance).
181. Art. 15, para. 2 ML Ordinance.
182. SFBC-ML Report 2003, p. 39.
183. *Botschaft*, 26 June 2002, 5433.
184. BCBS CDD 2001 (64).
185. http://www.bis.org/press/p970409.htm
186. Art. 23a der Verordnung über die Banken und Sparkassen (SR 952.02).
187. 'Supervisors expect banking groups to apply an accepted minimum standards of KYC policies and procedures to both their local and overseas operations'. (BCBS CDD 2001 [64]). See also Rec. 20 FATF 40/1996; Rec. 22 FATF 40/2003.

6. Country Report: Anti-money laundering rules in the United Kingdom

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I INTRODUCTION: HISTORICAL DEVELOPMENT AND SIGNIFICANCE OF LONDON AS A FINANCIAL CENTRE

A host of legislation designed to counter money laundering may result in the City of London moving beyond its reputation as a money laundering centre. London is a sophisticated and important international financial centre, where capital can move relatively freely and easily. Criticisms of the anti-money laundering legal regime now focus more on the lack of effective enforcement of this legislation. This report reviews the current UK institutions against money laundering before describing the UK criminal and supervisory law.

The UK financial services sector accounts for nearly 5 per cent of UK GDP, employs a million people and produced net overseas earnings of £31.2 bn in 1999.[3] London ranks as one of the world's top three financial centres alongside New York and Tokyo. There are more foreign banks in London than any other global financial centre and London is the largest financial centre for cross border bank lending, accounting for 20 per cent of global cross border bank lending.

The UK retail banking sector is dominated by 12 major retail banks. In March 2001 there were 309 banks authorized to accept deposits under the Banking Act 1987. In addition there were 355 branches of European authorized institutions entitled to accept deposits in the UK. The UK has 67 authorized building societies managing assets in excess of £165 bn, 245 friendly societies with funds in excess of £15 bn and 688 credit unions with assets of £181 million. The FSA classifies financial institutions as 'authorized persons', being those authorized and regulated by the FSA and those European Economic Area (EEA) firms, who conduct business in the UK, but are authorized by their home regulators.

Some 500 foreign banks are based in the UK; banks from 80 countries have subsidiaries, branches or representative offices in London, which predominantly serve overseas clients with the majority of transactions being conducted in foreign currency. These are comprised of investment banks, London headquarters of banks operating overseas, private banks and banking boutiques.

London is the fourth largest insurance market in the world and is the market leader in both the global aviation and the marine insurance markets accounting for 34 per cent and 21 per cent of the markets respectively.

London has a substantial domestic and international securities market in both equities and bonds. In 2000, turnover in international securities was £3.5 bn and £1.9 bn in UK equities. As of March 2001, there were 1882 UK and 482 international companies listed on the London Stock Exchange with a then market capitalization of £1.7 bn and £3.5 bn, respectively. More foreign companies are traded on the London markets than any other global stock market. The turnover of overseas companies on the London Stock Exchange represented 48 per cent of global turnover in foreign equities in 2000 and London ranks as the largest global fund management centre. UK venture capital companies invested £8.3 bn in 1523 companies world-wide during 2000, while UK pension funds managed some £755 bn at the end of 2000.[4] London is the world's largest foreign exchange market with a daily turnover estimated at US$637 bn.[5] In addition, London is the major international centre for primary and secondary dealing in the Euromarket accounting for 70 per cent of global trading in Eurobonds and foreign bonds in 2000.

II DEVELOPMENT OF THE SUPERVISORY SYSTEM AND REGULATORY REGIME

A The Move from Self-Regulation to Statutory Regulation

Prior to 1980, the financial sector in the UK was essentially self-regulatory and without statutory basis.[6] For example, prior to the Banking Act 1979, there was no formal framework for the licensing or supervision of the banking sector. While the Bank of England had statutory powers to issue directives to the banking sector,[7] these powers were never used and the bank relied on informal means of persuasion. Similarly, other sectors of the City such as the London Stock Exchange, Lloyd's of London and the commodities exchanges were self-regulatory, the principle source of regulatory authority being derived from the consent of market participants, rather than from statutory provisions.

However, certain sectors of the financial services industry have long been subject to statutory provisions, including securities dealers not members of the stock exchange, building societies, savings banks, insurance companies and

friendly societies. The origins of the statutory regulation of these types of financial institutions can be traced to the mid-19th century and the desire of Victorian reformers to encourage savings among the working classes through the security provided by statutory regulation. For instance, legislation such as the Building Societies Acts of 1836 and 1874 limited the spheres of activities of institutions and made them subject to government regulation.

Self-regulation were phased out by the end of the 1970s. The banking crisis of 1973–5 led to the enactment of the Banking Act 1979, while the following developments in the 1980s all contributed to a revolution in the supervision and regulation of UK financial services:

- the increasing number of foreign financial institutions in the city after the abolition of exchange controls;
- the attempt to widen share ownership through the creation of a so-called 'share owning democracy' through the privatization programme of the Conservative government;
- the development of global financial markets;
- a series of financial scandals.

The Financial Services Act 1986 established the Securities and Investments Board, the forerunner of the FSA and empowered it to ensure the new Self-Regulating Organizations (SROs) acted in the public interest. SROs were created to regulate brokers, dealers, investment managers, futures brokers and dealers and pension and life assurance product providers. Whilst the Financial Services Act 1986 was publicly characterized as creating a new self-regulatory system, the Act in fact introduced considerable statutory regulation to the UK financial sector for the first time.

At the same time, structural changes within the industry saw the development of financial conglomerates involved in diverse financial business areas and a consequent blurring of the line between the traditional areas of business underpinning the regulatory philosophy of the 1986 regime.

The Labour party (who took over after many years of Conservative Government in 1997) recognized the need to reform a regulatory framework based on outdated notions of clear divisions between the business activities of different financial institutions, which had become increasingly outdated as a result of market place developments. As well, the 'miss-selling of pensions' scandal and a strong desire to put in place enhanced powers to combat financial crime led to the enactment of the Financial Services and Markets Act (FSMA) 2000, which created the Financial Services Authority, the 'super regulator' now responsible for the regulation and supervision of all authorized persons, previously the responsibility of nine self-regulatory organizations with a variety of powers. In December 2001, the FSA took on its full panoply

of powers under the FSMA 2000. It has four statutory objectives under FSMA 2000, one of which is the reduction of financial crime and in particular, limiting the potential risk of regulated firms of being abused by those seeking to launder the proceeds of crime.[8] The Act requires the FSA to highlight to firms the financial risks they are exposed to and as a consequence:

- take appropriate action to prevent financial crime;
- facilitate its detection and monitor its occurrence;
- prompt firms to allocate sufficient resources to the countering of financial crime.

The objective operates alongside the FSA's three other statutory objectives: to promote appropriate consumer protection, to maintain confidence in the financial system and to promote public understanding of the financial system.

B The Development of Law Enforcement

The first dedicated police fraud squad was established by the City & Metropolitan Police in 1946. However, the banking crisis in the 1970s and a growing public concern with what the then Prime Minister Edward Heath characterized as, 'the unacceptable face of capitalism' led to the establishment of more dedicated fraud squads and the allocation of greater resources to combating financial crime. The year 1981 saw the establishment of the Fraud Investigation Group, the first move towards unified fraud prosecution involving specialist professionals such as lawyers and forensic accountants. In 1988, the Serious Fraud Office was established, a unified organization for the investigation and prosecution of serious financial crime.

C The Development of the Anti-Money Laundering Regime

The development of the anti-money laundering (AML) regime has also been a relatively recent phenomenon. Whilst an early and largely unsuccessful attempt to deal with the laundering of the proceeds of drug crime was included in the Misuse of Drugs Act 1971,[9] it was not until the 1980s that public and political concern began to focus on money laundering. In 1986, following the recommendation of the *Hodgson Committee*, powers were enacted to allow for the confiscation of the proceeds of drug trafficking.[10] While the initial focus of anti-money laundering provisions was drug related, the Prevention of Terrorism (Temporary Provisions) Act 1989 extended the net to include terrorism related money laundering.[11] The Criminal Justice Act 1988[12] extended the UK anti-money laundering provisions to include all indictable offences. The first European Money Laundering Directive[13] required states to criminalize

drug-related money laundering, which had already been achieved in the UK by the Criminal Justice Act 1988. The second European Money Laundering Directive[14] extends the obligations to criminalize money laundering, but will have limited impact in the UK regime, since it already meets and exceeds most requirements of the Directive.

1 Secondary legislation

The second prong of the UK anti-money laundering regime is contained in secondary legislation, specifically the Money Laundering Regulations 1993[15] (MLR 1993) and the Money Laundering Regulations 2001 (MLR 2001).[16] The MLR 1993 contain key provisions requiring those operating relevant financial businesses to implement customer identification procedures, record keeping procedures, internal reporting procedures and internal control and communication procedures, whilst the MLR 2001 extended the application to a number of specified money service businesses not regulated by the FSA.

2 Proceeds of Crime Act 2002

This enormously important Act has been brought into force in a series of commencement orders, which include complex transitional provisions.[17] In brief the Act:

- creates a new Asset Recovery Agency (see Part 1 of the Act)
- consolidates and extends the law on confiscation (see Parts 2–4 of the Act)
- creates new rights of civil recovery of the proceeds of crime (see Part 5 of the Act)
- gives revenue functions to the Director of the ARA (see Part 6 of the Act)
- consolidates and extends money laundering offences, removing the previous distinction between drug and non-drug money laundering offences (see Part 7 of the Act)
- creates new orders to widen investigatory powers (see Part 8 of the Act).

The prime purpose of UK's money laundering legislation is not only to outlaw money laundering, but also to ensure that suspicious transactions are reported to the authorities. This is achieved through a stick and carrot approach, the stick being the threat of criminal liability for failing to report, the carrot being a defence to criminal liability by reason of the report. This remains a prime objective of the Proceeds of Crime Act 2002.

D The UK and International Anti-Money Laundering Initiatives

The UK Government has consistently taken a strong role in international

initiatives to combat money laundering. The Bank of England supported action taken against infringements of the Basle Statement of Principles,[18] one of the earliest international initiatives in this area. Moreover, it supported the establishment of the Financial Action Task Force on Money Laundering (FATF) at the 1989 G7 summit in Paris and subsequent FATF membership and is committed to the Financial Stability Forum. The UK anti-money laundering regime has won overall praise from FATF evaluations for not only meeting the 'Forty Recommendations', but in some areas going beyond the requirements of the Recommendations. The FSA *Money Laundering Sourcebook* requires regulated institutions to take note of FATF findings on non-co-operative countries and territories[19] and the FSA plays a fundamental role in assisting the UK Treasury in its work with the FATF.

III MAJOR ANTI-MONEY LAUNDERING THEMES

A The Performance and Innovation Unit's Recommendations (2000)

A report dated May 2000 by the Performance and Innovation Unit of the Cabinet Office entitled 'Recovering the Proceeds of Crime' identified a number of potential weaknesses in the system:

- An irregular reporting pattern.[20]
- The low level of disclosures as a proportion of money supply.[21]
- A reluctance to take on money laundering cases.
- The difficulty of proving that a defendant actually knew or suspected that another had benefited from crime.

The Report contained many recommendations for overcoming these weaknesses, including:

- Increased funding and staff within the National Criminal Intelligence Service (NCIS), the UK's Financial Intelligence Unit.
- More vigorous prosecution of non-compliant financial institutions.
- The simplification of the current law.

Since the publication of the report, some of these weaknesses have been addressed. In particular, NCIS staffing and budget have increased. The regime for bureaux de change and money transmission agents has been addressed under the Money Laundering Regulations 2001. The Proceeds of Crime Act strengthens the anti-money laundering system regime and the FSA has continued to encourage improvement in the quality of disclosures.

B Enforcement and Prosecution

A number of weaknesses remain within the system. Convictions remain very rare. And although the Proceeds of Crime Act 2002 consolidates and simplifies the old system, there are still five separate money laundering offences that may at times be inconsistent with each other. The *mens rea* requirements and the scope of the available defences remain to be tested in the courts. Enforcement of rules and prosecution of the non-compliant remains weak, with compliance consequently in doubt.[22]

1 Industry concerns

The central concerns within the industry over the implications for their business activities are two-fold:

1 The role of the financial institution as the gatekeeper against money laundering within the financial system, in particular in relation to customer due diligence requirements.
2 There continues to be concern over the potential for conflict between their obligations under criminal law and civil law. These will be dealt with in more detail in a later part of this chapter.

IV INSTITUTIONS OF THE AML SYSTEM

A Role of the Government

The Treasury and the Home Office are responsible for the overall co-ordination of the UK's anti-money laundering policies.

1 HM Treasury

The Treasury prepares the legislative and regulatory framework of the financial services sector and leads on the Group of Seven (G7), European Union (EU) and the Financial Action Task Force (FATF) work on money laundering. It is also chairs the Money Laundering Advisory Committee. This committee originated as part of an Asset Recovery Strategy designed by the Home Office. The Money Laundering Advisory Committee was established before the enactment of the Proceeds of Crime Act 2002 as a forum for all relevant stakeholders – financial institutions, trade and consumer organizations, government and law enforcement representatives, etc. – to discuss money laundering issues and to advise Treasury Ministers on approval of industry guidance. Under the Proceeds of Crime Act 2002, whether a defendant has complied with Treasury-approved guidance is taken into account by the courts in certain money laundering prosecutions.[23]

2 The Home Office

The Home Office prepares legislation that relates to money laundering and related offences and is responsible for policy on confiscation and international mutual legal assistance. The Home Office also has broad responsibilities for the police authorities including the Financial Intelligence Unit within NCIS.

B Role of the Supervisory Agency

1 The Financial Service and Markets Act 2000

Most of the Financial Service and Markets Act 2000 and the secondary legislation and rules made under it came into force on 1 December 2001. Section 1 and Schedule 1 of the Financial Services and Markets Act 2000 set out the requirements for the Financial Service Authority's constitution and include provisions about its status and the exercise of certain of its functions. Section 2 sets the objectives, which the FSA should aim to meet, namely: Maintaining market confidence, promoting public understanding of the financial markets, protecting consumers and reducing financial crime.

2 Financial Service Authority (FSA)

The Financial Service Authority[24] is a private company limited by guarantee and is required to hold an annual public meeting to consider the contents of its annual report and to permit those present at the meeting to question it on the discharge of its functions. It has a wide range of rule making, investigatory and enforcement powers under the Financial Service and Markets Act 2000 and is the single regulator for the financial services industry.

In meeting the statutory objective and in combating money laundering, the FSA has developed an approach based on key principles. First, the philosophy is risk based, with resources allocated on the basis of risk and the potential impact. Second, the approach is accountable, to ensure that the FSA's regulatory framework is transparent. Third, the approach aims to be results focussed. Fourth, the approach focuses on the role of senior management and the need to gain acceptance amongst firms and their senior managers of the public interest and self-interest in combating financial crime. The FSA has identified four strategic priorities: influencing the framework of law and international standards; ensuring the role and approach taken by the FSA is understood; identifying and addressing areas of risk; and building effective partnerships with institutions, law enforcement agencies and the government.

The FSA has established the following internal framework:

- A Money Laundering Co-ordination Committee – which ensures effective co-ordination of money laundering activities being undertaken by the supervisory and other areas of the FSA.

- A Financial Crime Policy Unit – responsible for setting policy relating to the FSA's Money Laundering Rules.
- Enforcement teams – responsible for policy in relation to the investigation of non-compliance with the FSA's Rules and Money Laundering Regulations 1993 and also responsible for the formal investigation of potential breaches of both sets of rules.
- Risk Review Department – to assist supervision relating to financial crime, which will work with the Financial Crime Policy Unit and Enforcement Teams.
- Intelligence and Records Department – responsible for liaison with NCIS, Law Enforcement and international agencies.

The Financial Service and Markets Act 2000 contains a number of mechanisms and safeguards to ensure that the FSA's powers are properly exercised. These include:

- Practitioner and consumer panels: ss. 8 to 11.
- Complaints scheme: paragraphs 7 and 8, Schedule 1.
- Reviews and inquiries (the Treasury has the power to commission reviews of the economy, efficiency and effectiveness with which the FSA has used its resources in discharging its functions or arrange independent inquiries into certain matters of regulatory concern): ss. 12 and 14.
- Restrictions on immunity: although the Financial Service and Markets Act 2000 gives the FSA immunity from civil actions (paragraph 19, Schedule 1), its immunity will not apply in relation to acts of bad faith or in respect of damages for breach of s. 6(1) of the Human Rights Act 1998.

a FSA rules

The government has included a great deal of flexibility in the financial services framework by leaving much of the detail to secondary legislation. For instance, the Financial Service and Markets Act 2000 gives the FSA a power to make rules relating to the prevention and detection of money laundering and power to institute proceedings under the Money Laundering Regulations 1993 (s. 146).

The Financial Service Authority's Money Laundering Rules came into force on 1 December 2001. They apply to almost all regulated activities under the Financial Service and Markets Act 2000, except for certain insurance business, carried on by authorized persons from an establishment in the UK. The rules do not replace, or form guidance to, the Money Laundering Regulations

1993; they are a separate set of parallel rules that cover areas such as the requirement to identify new clients, the records that the FSA expects firms to keep and the appointment and responsibilities of the Money Laundering Reporting Officer (MLRO).

Although the FSA's rules run parallel to the 1993 Regulations, there are significant areas of overlap as both require regulated businesses to set up and operate anti-money laundering arrangements. The two regimes give rise to different sets of obligations, the breach of which carry different consequences: namely, criminal liability for breach of the 1993 and 2001 Regulations – unlimited fine and up to two years in prison – and regulatory sanction for breach of FSA's rules – fines and, in an extreme case, removal of authorization.

The FSA also recognizes the vital role played by industry and professional bodies, in particular the Joint Money Laundering Steering Group (JMLSG) in promoting compliance with the FSA Money Laundering Rules and the Money Laundering Regulations 1993. The system in England is no longer of a self-regulatory type. However, the FSA constantly seeks the co-operation of the private sector rather than the imposition of the regulatory powers.[25]

C The UK's Financial Intelligence Unit

1 National Criminal Intelligence Service

The National Criminal Intelligence Service (NCIS) was formed in 1992 as part of the Home Office. Part 1 of the Police Act 1997 gave a statutory definition of NCIS for the first time and made it independent of central government from 1 April 1998 and accountable to a Service Authority.

Its role is to develop: intelligence to combat serious and organized crime; provide both strategic and tactical intelligence and expertise for law enforcement, government and other relevant agencies at a national and international level.

NCIS provides strategic and tactical intelligence on serious and organized crime, nationally and internationally. It is the gateway for UK law enforcement enquiries overseas via Interpol, Europol and the overseas liaison officers networks. It is also the co-ordinating authority on behalf of police forces in the UK for the tasking of the Security Service, in accordance with the Security Service Act 1996.

The Economic Crime Branch is the UK's Financial Intelligence Unit and is located within NCIS. Its most important function is to analyse the SARs it receives from the financial sector and disseminate these to law enforcement and Regional Offices. According to the ECB, only 5 per cent of SARs lead to the requirement for consent from NCIS prior to completion of transactions. The remaining 95 per cent are low-priority reports of suspicious activities that

have occurred, which only require a letter of acknowledgement. As a result, because they are prioritized, the backlog of high priority SARs is extremely low. According to ECB the low priority SARs which do not require immediate action, are the cause for the general perception that there is a severe backlog of SARs endangering the effectiveness of the AML system.[26] Besides the receipt and analysis of SARs, the ECB is involved in training seminars and meetings aimed at the education of financial institutions, regulatory bodies and law enforcement agencies on money laundering and financial investigation.[27]

D Law Enforcement and Prosecuting Authorities

1 Financial investigation officers

Following receipt of an SAR and after initial research, NCIS allocates the information gathered to trained financial investigation officers in the relevant police force, or law enforcement body, for example Customs & Excise, for further investigation. The UK's 52 police forces each have a Financial Intelligence Unit with a specialized role to investigate money laundering as well as following up SARs referred to them by NCIS.

2 Crown Prosecution Service

The Crown Prosecution Service is the main prosecuting authority in England, responsible for prosecuting money laundering offences where the investigation has been conducted by the police or NCIS and until the passage of the Financial Services and Markets Act 2000 for prosecuting breaches of the Money Laundering Regulations 1993, investigated by the Financial Service Authority.

3 Serious Fraud Office

The Serious Fraud Office is an independent government department that investigates and prosecutes serious or complex fraud and is part of the UK criminal justice system. The Serious Fraud Office began operating in April 1988 following the Criminal Justice Act 1987 (as amended). The Attorney General is appointed by the Prime Minister and is responsible to Parliament for the Serious Fraud Office, the Crown Prosecution Service and the Treasury Solicitor's Department.

4 Other law enforcement bodies

In addition, special bodies such as the Inland Revenue work with the Treasury on tax and money laundering initiatives and are responsible for the investigation and prosecution of tax-related crimes. Customs and Excise has primary responsibility for the investigation and prosecution of cases involving importing drugs and the general smuggling of goods, including consequential money

laundering activities. The Financial Services Authority leads on the day-to-day supervision of Britain's credit and financial institutions and has primary responsibility for the investigation and prosecution of cases involving violation of the Money Laundering Regulations 1993 and Financial Service Authority's Money Laundering Rules.

E Role of the Financial Services Industry

1 British Bankers' Association

The British Bankers' Association created in 1919 is the main trade association in the banking and financial services industry representing banks and other financial services firms operating in the UK with 295 members. One of its main objectives is to fight money laundering. It has produced a number of publications, which reflect the policy work of the organization against money laundering.

2 Joint Money Laundering Steering Group

The Joint Money Laundering Steering Group publishes all the relevant documents and information on money laundering produced by the British Bankers' Association. This group is made up of the leading UK Trade Associations in the Financial Services Industry. Apart from the British Bankers' Association, other members include the Association of British Insurers, Association of Private Client Investment Managers and Stockbrokers, Foreign Banks and Securities Houses Association, Investment Management Association, London Investment Banking Association, etc.

a Joint money laundering guidance notes

The aim of the Joint Money Laundering Steering Group is to promulgate good practice in countering money laundering and to give practical assistance in interpreting the UK Money Laundering Regulations. This is primarily achieved by the publication of guidance notes. In some areas, the Guidance Notes deliberately go beyond the strict requirements of the regulations themselves and in some instances reflect the evolution of good industry practice. The guidance notes have continued to provide a safe-harbour for financial sector firms in respect of compliance with the Regulations. However, application of the guidance notes has not been mandatory and compliance with them has largely depended on the strength of the compliance culture within the relevant financial sector firm, or on the vigilance of its regulator.

b The FSA and the Guidance Notes

The FSA recommends that firms read the Joint Money Laundering Steering

Group guidance notes in conjunction with the Financial Service Authority's rules. It has a policy of co-operating with such bodies and promoting amongst individual firms the implementation of good practice standards guidance issued by those bodies. However, it has consistently refused to confirm that compliance with the guidance notes will provide a defence to any alleged breach of the Financial Service Authority's rules or the 1993 Regulations. This is because the Guidance Notes are issued by the trade associations and not by the Regulators.

c The Proceeds of Crime Act and the Guidance Notes

As a result of the Proceeds of Crime Act 2002, the legal status of the Guidance Notes has been strengthened. The Treasury, following recommendations by the Money Laundering Advisory Committee, approved the Guidance Notes on 26 July 2002, for the purpose of the Proceeds of Crime Act 2002.

The Proceeds of Crime Act 2002 has also extended the status of the guidance notes by requiring Courts to take them into consideration when considering whether there has been compliance with s. 330 of the Act (failure to disclose and reasonable grounds for suspicion). The Treasury has proposed that the new Money Laundering Regulations should extend such enhanced status to all contents of the guidance notes.

V CRIMINAL LAW

The Proceeds of Crime Act 2002 has been brought into force in a number of statutory instruments.[28] There is as yet no case law interpreting the new Act. Because the new offences apply only to conduct which started after 24 February 2003,[29] the old provisions will continue to apply for some time to come.

A Relevant Offences

1 Primary legislation

a Description of the pre-Proceeds of Crime Act 2002 regime

The offences include concealing or transferring the proceeds of criminal activity (see s. 93C Criminal Justice Act 1988; s. 49 Drug Trafficking Act 1994; and s. 18 Terrorism Act 2000); acquiring, possessing or using the proceeds of crime (see s. 93B(1) Criminal Justice Act 1988; s. 51 Drug Trafficking Act 1994; and s. 18 Terrorist Act 2000) and assisting another to retain the benefit

or proceeds of criminal activity (see s. 93A(1) of the Criminal Justice Act 1988; s. 50 of the Drug Trafficking Act 1994[30]; and s. 18 of the Terrorist Act 2000). These offence are punishable on conviction by indictment to a maximum of 14 years' imprisonment, or unlimited fine, or both; and on summary conviction with up to six months' imprisonment, or limited statutory fine, or both.

Failure to disclose knowledge or suspicion of money laundering, drug trafficking and terrorism related money laundering only, was criminalized in s. 52 Drug Trafficking Act 1994; and s. 19 of the Terrorism Act 2000. Failure to disclose renders a person guilty of an offence if (1) he knows or suspects that another person is engaged in drug or terrorism related money laundering; (2) the information on which the knowledge or suspicion is based came to the person's attention in the course of his trade, profession, business or employment; and (3) the person does not disclose the information to the police as soon as is reasonably practicable after it comes to his attention. In the case of drug trafficking and terrorist activity, it is an offence for any person who acquires knowledge or a suspicion of money laundering in the course of their trade, profession, business, or employment not to report the knowledge or suspicion as soon as it is reasonably practical after the information came to his or her attention. Failure to report in these circumstances is punishable on indictment with conviction to a maximum of five years' imprisonment, or unlimited fine, or both; and on summary conviction with up to six months' imprisonment, or a limited statutory fine, or both.

In the case of a person who is employed by a financial institution, or is otherwise carrying out a financial activity covered by the Money Laundering Regulations (paras 2.13 and 2.14), internal reporting in accordance with the procedures laid down by the employer will satisfy this requirement. Reports by staff of financial sector businesses should be made through the Money Laundering Reporting Officer (MLRO), or a nominated deputy, who has the responsibility to assess the validity of the grounds for suspicion and to judge, on the basis of the factual information available, whether a report should be made to the NCIS.

The legislation protects those reporting suspicions of money laundering from claims in respect of any alleged breach of client confidentiality. There has been widespread criticism of the restriction of this offence to drug trafficking and terrorism related laundering.

Tipping off is criminalized in s. 93D Criminal Justice Act 1988; s. 53 Drug Trafficking Act 199; and s. 39 Terrorism Act 2000. The offence of tipping off may arise in three instances: (1) where a person knows or suspects that a police investigation into money laundering has been, or is about to be, commenced, (2) if he or she knows or suspects the disclosure of suspected money laundering has been made to the police, or (3) he or she knows or suspects that an

internal report has been made and then in relation to any of these three circumstances, he discloses to any other person, information or any other matter which is likely to prejudice any investigation which may take place.

In relation to terrorism, the Terrorism Act 2000 also provides an objective *mens rea* that it is an offence if any person, who knows or has reasonable cause to suspect, that an investigation is taking place, falsifies, conceals, destroys or otherwise disposes of material, which is likely to be relevant to the investigation.

Tipping off offences cannot arise unless the person concerned knows or suspects that an SAR has been made either internally, or to the NCIS, or alternatively knows or suspects that police or customs are carrying out or intending to carry out a money laundering investigation. Therefore preliminary enquiries of a prospective customer by financial sector staff, either to obtain additional information to confirm the true identity, or to ascertain the source of funds or the precise nature of the transaction being undertaken, will not trigger a tipping off offence before a suspicious transaction report has been submitted in respect of that customer, unless the enquirer has prior knowledge or suspicion of a current or impending investigation. Enquiries to check whether an unusual transaction has a genuine commercial purpose will not be regarded as tipping off. However, if the enquiries lead to a subsequent report being made then the customer must not be informed or alerted.

The duty to disclose suspicious transactions and to avoid tipping off can lead to a potential conflict between the reporting firm's responsibilities under criminal law and its obligations under civil law. Three possible area of conflict may arise:

1. The obligation to comply with an order of discovery of documents in a civil proceedings.[31]
2. Acting as constructive trustee to a victim of fraud and other crimes (a firm's liability as a constructive trustee under English law can arise when it either knows that the funds held by the bank do not belong to its customer, or is on notice that such funds may not belong to its customer. In these circumstances, the firm may then take on the obligation of a constructive trustee for the rightful owner of the funds).[32]
3. The obligation to reply to a subject access request under section 7 of the Data Protection Act 1998.

Another likely source of potential conflict is the interaction of tipping off offences with the Data Protection Act 1998. Under s. 7 of the Data Protection Act, a request (a subject access request) can be made in writing to a data controller (that is any organization which holds personal data). In making such a request, an individual is entitled: (1) to be informed whether the data

controller is processing (which includes merely holding) his personal data; and if so to be given a description of this data, the purposes for which they are being processed and to whom they are or may be disclosed and (3) to have communicated to him in an intelligible form all the information, which constitutes his personal data and any information available to the data controller as to the source of this data. The data controllers must respond to subject access requests promptly and in any case within 40 days from when the data controller has received the request.

The data controllers may withhold information identifying another individual, for example information identifying a bank teller as the source of the data, unless that individual has consented to the disclosure or it is reasonable in all the circumstances to disclose the information without their consent (ss. 7(4) to 7(6) of the DPA). The Data Protection Act provides certain exemptions to the right of subject to access information, of which s. 29 is the most relevant in the present context. This section provides that personal data are exempt from s. 7 in any case to the extent to which the application of that provision would be likely to prejudice the prevention or detection of crime or the apprehension or prosecution of offenders. However, even when relying on this exemption, data controllers should provide as much information as they can in response to a subject access request.

b The Proceeds of Crime Act 2002

The Proceeds of Crime Act 2002 consolidates, up-dates and expands all earlier anti-money laundering legislation. Part 7 deals with the money laundering offences and defences and came into force on 24 February 2003. The Act consolidates all existing money-laundering provisions until now contained in the Criminal Justice Act 1988 (as amended by the CJA 1993) and the Drug Trafficking Act 1994, by creating a specific set of money laundering offences, applicable throughout the UK to the proceeds of all crimes. These offences, described in Part 7 of the Act cover:

1 *Section 327* (*Concealing etc.*) simplifies and replaces s. 49 of the Drug Trafficking 1994 and s. 93C of the Criminal Justice Act 1988 and the corresponding provisions in Scotland & Northern Ireland (s. 14 of the Criminal Justice (International Co-operation) Act 1990 and Article 47 of the Proceeds of Crime (Northern Ireland) Order 1996). The offence is committed where a person conceals, disguises, converts, transfers criminal property or removes from the jurisdiction criminal property. Under s. 340(3), property is criminal property if ‘it constitutes a person’s benefit from criminal conduct or it represents such a benefit . . . and the alleged offender knows or suspects that it constitutes or represents such a benefit’.

2 *Section 328* (*Arrangements*) simplifies and replaces s. 50 of the Drug Trafficking Act 1994 and s. 93A of the Criminal Justice Act 1988, s. 38 of the Criminal Law (Consolidation) (Scotland) Act 1995 and Article 46 of the Proceeds of Crime (Northern Ireland) Order 1996. The prosecutor must establish that the alleged offender entered into or became concerned in an arrangement which he knew or suspected would facilitate another person to acquire, retain, use or control criminal property and that the alleged offender also knew or suspected that the property constituted or represented benefit from criminal conduct.
3 *Section 329* (*Acquisition, use and possession*) unifies and replaces s. 51 of the Drug Trafficking Act, s. 93B of the Criminal Justice Act 1988, s. 37 of the Criminal Law (Consolidation) (Scotland) Act 1995 and Article 45 of the Proceeds of Crime (Northern Ireland) Order 1996.

These offences cover a very wide range of activities. The first is most likely to present intermediaries with the greatest difficulties. If an intermediary discovers that one of its customers has committed a minor crime but does not know if the proceeds are held in its account, potentially the prudent course is to disclose.

'Criminal conduct' is defined as an offence in any part of the UK or which would constitute an offence in any part of the UK if it had occurred there.[33] The Proceeds of Crime Act 2002 does not preserve the *de minimis* threshold in the former legislation (which confined the definition of criminal conduct to indictable offences). It is immaterial when the crime was committed; the definition specifically includes the proceeds of crimes committed before the passing of the Act (s. 340(4)). This has unsurprisingly been criticized.

The prosecution does not need to secure a conviction against the predicate offender. It is questionable whether a conviction against him would be admissible against the defendant. It is not clear whether the prosecution needs to prove the predicate offender's criminal conduct to a criminal or civil standard of proof. This may not be of great practical significance as a higher standard of proof applies where civil proceedings involve allegations of a criminal nature. The penalties for committing the offences in the Act are the same as those in the existing regime: up to six months imprisonment on summary conviction or up to 14 years on indictment, or a fine.

Sections 330–332: Failure to Disclose – the Act distinguishes failure to disclose by those in the regulated sector, from failure to disclose by 'nominated officers in the regulated sector' and 'other nominated officers'. For those in the regulated sector, it creates an objective test in that liability is based on knowledge or suspicion, or 'reasonable grounds' for knowledge or suspicion. In any prosecution for failure to report knowledge or suspicion of money laundering, the court must consider whether the defendant complied with guidance

from regulators or any other appropriate body. This will include guidance notes issued by the Joint Money Laundering Steering Group, now approved by the Treasury. As a result, compliance with guidance is now a safe harbour, yet non-compliance with them is not necessarily conclusive evidence of guilt, as the court is required taking other factors into account when assessing guilt or innocence. Additional offences of not reporting have been introduced for 'nominated officers in the regulated sector' (s. 331) and for 'other nominated officers' (s. 332). These offences apply in circumstances where a 'nominated officer' who has received an internal report has knowledge, suspicion or reasonable grounds to suspect money laundering and does not make a report to NCIS as soon as is practicable after the internal report was received.

Reports from the regulated financial sector are made to NCIS in the disclosure form prescribed by the Service. Other persons may opt, as in the previous regime, to file the report with NCIS, a constable or customs officer. NCIS's standardized form with the same sequential ordering, information and style is available on their website and will doubtless improve the quality of data received.

The 2002 Act sets a time limit of seven working days for NCIS to respond with consent or refusal when a report has been made before a transaction has been completed.[34] If NCIS refuses consent within seven days, there is a 31 working day moratorium period in which the enforcement authorities must obtain a restraint order if they wish to prevent the transaction from going ahead.[35]

The courts will no doubt be asked to decide what are reasonable grounds for knowing or suspecting. The Joint Money Laundering Steering Group Guidance Notes represent the definitive statement of industry practice. A court is required to consider relevant guidance in deciding whether a person has committed an offence which elevates the guidance notes to a new status. The Treasury now chairs the Joint Money Laundering Steering Group and future guidance will be issued under its auspices. The penalties are the same as those in the existing regime: up to six months' imprisonment on summary conviction, or up to 5 years on indictment, or a fine.

Section 333: Tipping Off is an offence that is committed if a person knows or suspects that a disclosure has been made and makes a disclosure to a third person which is likely to prejudice an investigation which might be conducted. The penalties for committing the offence in the Act are the same as those in the existing regime: up to six months' imprisonment on summary conviction, or up to 5 years on indictment, or a fine.

c Fiscal offences

At present it is unclear whether or not the money laundering legislation

includes foreign tax evasion if the evasion would have constituted an indictable offence in the UK (ss. 93A–93C Criminal Justice Act 1988). Case law suggests that it does not. This is based on the principle established in *Government of India* vs *Taylor* [1955] 1 All ER 292 that the English courts will not enforce foreign revenue laws. It is therefore argued that where offshore activity designed to defraud a foreign revenue authority is simply a denial of revenue to that authority, the money laundering legislation should not apply.

However, it could be argued that the term 'criminal conduct' includes any conduct wherever it takes place, which would constitute an indictable offence if committed in the UK, that is, an offence serious enough to be tried in a Crown Court. Therefore, this would include drug trafficking offences, terrorist activity, theft and fraud, robbery, forgery and counterfeiting, illegal deposit taking, blackmail, extortion and tax-related offences including those committed outside the UK where the proceeds of the foreign tax fraud have entered or passed through a UK institution.

Despite this dilemma, fiscal offences may well include other offences of tax evasion which are clearly within the ambit of the legislation such as false accounting, conspiracy to defraud (where the dishonest conduct defrauds not only the revenue authority but also some other party) and the obtaining of money by deception.

As with the former legislation, the Proceeds of Crime Act 2002 does not clear up the uncertainty as to whether evasion of foreign taxes constitutes criminal conduct.

2 Defences

a Pre-proceeds of Crime Act 2002 regime

Only concealing or transferring the proceeds of criminal activity lacks a statutory defence under the currently enforceable legal regime. It is a defence to any allegation of acquisition, if the person concerned acquired property for adequate consideration. It is considered inadequate consideration if the value of the consideration is significantly less than the value of the property. It is a defence to an acquisition offence allegation if the defendant intended to make a disclosure but had a reasonable excuse for having failed to do so.

It is also a defence in relation to assisting and acquisition offences if disclosure of a person's knowledge or suspicion has been made either to the police or to that person's employer in accordance with designated procedures. The latter is also a defence against failure to disclose. Therefore, where a report is made, no assisting offence, acquisition offence or failure to disclose offence will be committed if the disclosure (1) is made either before the person commits the act which he suspects may constitute assisting and continues with

the consent of the police or (2) is done on his own initiative as soon as it is reasonable for a report to be made after the act.

Disclosure of documents or information to a third party (in this case, the police) raises problems with privileges:

- whether it constitutes a waiver of professional privilege and
- whether it constitutes a breach of any express or implied duty of confidentiality owed to, for example, a customer or client.

If professional privilege is waived, then, should the matter become the subject of subsequent legal proceedings, documents, which might otherwise be protected from being produced to the other side by legal professional privilege, will have to be disclosed. However, it is clear that disclosure to the police will not constitute a waiver of professional privilege, nor will it give actionable grounds for a claim for breach of confidence (*British Coal Corporation* vs *Dennis Rye Ltd* (*No.2*)[1988]) 3 All ER 876.

The courts have held that it would be against public policy for professional privilege to be waived in circumstances where documents or information have been supplied in confidence to the police for the purposes of a criminal investigation if there is no intention of abandoning the privilege attached to the documents or information.

As regards breach of confidence, the Criminal Justice Act 1993 makes it clear that disclosure to the police (and employers under the assistance and failure to disclose offences) will not be treated as a breach of any restriction on the disclosure of information imposed by statute or otherwise if the money laundering involved relates to drug trafficking, terrorism or criminal conduct. This would appear to cover any confidentiality restrictions, explicit or implied, imposed by statute, equitable principles or contract. It reflects the common law position that any claim for breach of confidence will fail where there is a public interest in disclosure.

It is important to note, however, that disclosure to third parties other than the police could count as a waiver of professional privilege or lead to a claim for breach of confidence although, in certain circumstances, the public interest considerations outlined above may still apply.

Moreover, there will not be an offence of failing to disclose or tipping off where in the former case a professional legal adviser has failed to disclose any information, or other matter which has come to him in a privileged circumstance and in the latter case the legal adviser has disclosed information or other matters aimed at or to (1) a representative of a client of his in connection with the giving of legal advice to his client, or (2) any person to whom the information is disclosed in contemplation of, or in connection with, legal proceedings and for the purpose of those proceedings.

However, information given with a view to furthering any criminal purpose will not be considered to have been communicated in privileged circumstances.

b Under the Proceeds of Crime Act 2002

a Laundering Criminal Property: Concealing, Assistance and Acquisition

The Proceeds of Crime Act 2002 creates a complete defence to all money laundering offences where:

- a disclosure report is made and where the person acts with the consent of the authorities or
- where the disclosure is made after laundering has taken place provided (a) there is good reason for the delay (b) the disclosure was made at the person's own initiative as soon as practicable.

The Proceeds of Crime Act 2002 provides for disclosures to be made to a constable, customs officer or nominated officer (being a Money Laundering Reporting Officer if made in the course of employment).[36] Section 337 defines protected disclosures and s. 338 authorized disclosures: the defence of authorized disclosure allows a transaction that would or could amount to one of the three main money laundering offences to be completed subject to authorization, where disclosure is made in advance.

It has been kept a further defence for the acquisition, use and possession offence where a person acquires, uses or possesses the property for adequate consideration in an exchange.[37] The Government considered this necessary to protect persons, such as tradesmen, who are paid for ordinary goods and services in money, which they may know or suspect comes from crime. However, the legislation expressly specifies that the provision to a person of goods and services which help in carrying out criminal conduct, is not a defence.[38]

c Failure to disclose

The failure to disclose an offence, which only implicates regulated financial institutions, including accountants and solicitors who provide investment business services as defined by the Financial Service Act 1986, is considered not to be committed if a person:

- has a reasonable excuse for not making the disclosure or

- is a professional legal adviser and the information came to him under privileged circumstances.

The defence of authorized disclosure, which allows a transaction to be completed subject to authorization where disclosure is made in advance, also provides to the regulated financial sector and those with a duty to disclose a defence to the failure to disclose offence, if the disclosure is made as soon as possible after the transaction has been completed, provided that there is a good reason for not having done so previously.

A court has to consider whether a person accused of this offence has followed any relevant guidance issued by a supervisory authority or other appropriate body, approved by the Treasury and published so as to bring the guidance to the attention of persons likely to be affected by it. The Treasury approved the Joint Money Laundering Steering Group Guidance Notes on 26 July 2002 for the purpose of the Proceeds of Crime Act 2002. The Law Society and the Institute of Chartered Accountants have submitted their guidance notes to the Treasury for their consideration and approval.

Members of staff within the regulated financial sector are provided with a defence against not reporting knowledge or suspicion of money laundering if their employer did not provide them with the training required under the Regulations to recognize and report suspicions.[39] The defence is not available where they would have been reasonable grounds to suspect.

d Tipping off

The tipping off offence is not committed if the person[40]:

- did not know or suspect that the disclosure was likely to prejudice any investigation
- is carrying out an enforcement function as described above or
- is a professional legal adviser and the disclosure is made to a client in connection with giving legal advice to that client or to any person in connection with actual or contemplated legal proceedings, provided that the disclosure is not made with a view to furthering a criminal purpose.

A disclosure is treated as a protected disclosure, which does not breach any restriction on the disclosure of information where:

- the information in question came to the discloser in the course of a business in the regulated sector, i.e. essentially a business covered by the Money Laundering Regulations 1993;

- the information makes the discloser know or suspect money laundering, or gives him reasonable grounds to do so and
- the disclosure is made as soon as practicable.

This was intended to address the restrictions on breach of confidentiality and similar restrictions imposed by financial services legislation. However, as with the previous legislation, the protection does not extend to reports made where there are no reasonable grounds to know or suspect money laundering.

3 Statistics on convictions

a Prosecutions

Historically, there have been very few prosecutions and even fewer convictions for money laundering in England and Wales. In the period 1987 to 1998, there were only 357 prosecutions and 136 convictions. There has, however, been an increase in both prosecutions and convictions since 1994, due to the passage of the amendments of the Criminal Justice Act 1988 in 1993, which extended money laundering offences to cover the proceeds of all indictable offences. Provisional data for 1999 has confirmed this tendency for prosecutions with above 100 reported. However, the tendency regarding convictions has reverted since 1997 and provisional numbers for 1999 confirm this decrease in convictions, which is still lower than the convictions achieved in 1997, even though prosecution for that year did not reach 80 (Crime and Criminal Justice Unit – RDS – Home Office, England and Wales).

b Suspicious Activity Reports (SARs)

SARs are regarded as a vital part of the NCIS and other law enforcement agencies intelligence gathering operations and the broader fight against financial crime. SARs can provide new information and intelligence that can substantially move an investigation forward as well as providing an invaluable insight into the presence or whereabouts of assets for later confiscation. On occasions they may also simply provide confirmation of information already known to the investigators. It has been argued that isolating prosecutions that were the result of SARs from those that were not could not be achieved without disproportionate costs.

Since 1997, the Economic Crime Branch at NCIS has received the following numbers of SARs:

1997	14 148
1998	14 129
1999	14 500
2000	18 408
2001	31 251
2002	63 000

They expect over 100 000 reports in 2003.[41] As mentioned above, the Performance and Innovation Unit of the Cabinet Office's report, 'Recovering the Proceeds of Crime' identified two principal weaknesses in the UK system. On the one side, an irregular reporting pattern. For instance, in 1999 only 444 organizations made any disclosures, whereas there are some 7300 organizations regulated directly by the FSA.[42] In 1998 a total of 3600 disclosures (which equates to 24 per cent of all disclosures received in that year, namely 14 129) were from just four banks. At that time there were a total of 554 banks in this sector of which only 125 made any disclosure at all. On the other hand, the overall level of disclosures is modest as a proportion of money supply. In comparison, Australian rates of disclosure are some four and a half times that of the UK.[43]

According to the British Banking Association (BBA), these statistics are a result of the legal status under which most of these 7300 organizations regulated by the Financial Service Association are operating.[44] A parent company may have a number of subsidiaries which the Financial Service Authority counts individually. However, the fact that they are legally related to a parent company means that the main financial institution often performs the supervisory role. As a result, despite the fact that each of these subsidiaries may have a nominated officer, these nominated officers legally fulfil their duty to disclose by filing the SAR with the Money Laundering Reporting Officer of the parent company, who finally assesses and decides whether the report should be filed with the NCIS or not. According to the BBA, these internal disclosures are not reflected in the statistics, giving the impression that very few institutions fulfil their duty to disclose.

Notwithstanding these possible statistical irregularities, academics and members of law enforcement agencies alike agree that before the implementation of the Financial Service Act 2000 the level of SARs was too low when compared with other jurisdictions. A Threat Assessment Report 2002, by the NCIS, indicates a significant rise of SARs in 2002. NCIS explained this increase in part by the implementation of the Financial Services and Markets Act 2000 and in part by the events of September 11th 2001, both of which drew more attention to the need for financial institutions to be aware of all suspicious transactions and report to NCIS accordingly.[45]

4 Ancillary legislation

a Misuse of Drugs Act 1971

The Misuse of Drugs Act 1971 attempted to address the problem of money laundering of the proceeds of illegal drugs. The s. 27 (1) of the Act allowed the court to forfeit property such as money, drugs, weapons, vehicles, etc. found in the possession of the convicted person and used in the continuance of offences under the Act. This section was narrowly construed in *R* vs *Menocal* [1979] 2 All ER 510 and *R* vs *Cuthbertson* [1980] 2 All ER 401, which are discussed below.

b Drug Trafficking Offences Act 1986

As a result of these cases, a legal vacuum was revealed and to address the issues the *Hodgson Committee* was created. The Committee's findings led to the passing of the Drug Trafficking Offences Act 1986. This was the first statute to categorize money laundering as a criminal offence.

B Confiscation and Forfeiture Rules

1 Forfeiture: historical development

Forfeiture rules were developed from common law following convictions for felonies and treason. The convicted felon forfeited his chattels to the Crown and his lands reverted by escheat to his lord; the convicted traitor forfeited all of his property, real and personal, to the Crown.[46] In common law, therefore, real property was forfeited to the sovereign only upon conviction of high treason. For all other felonies, it reverted by escheat to the lord of the convicted felon.[47] This distinction is frequently confused. The reversion of land by escheat on conviction of a felony was in accordance with the strictly hierarchical system of land ownership whereby a few lords owned all the land. When land was sold the grantee was said to hold of that lord. In exchange for the grant, the grantee would promise personal services to the lord: to provide knights, supply goods, etc. If the grantee was convicted of a felony, he was considered to have breached his obligation to serve his lord faithfully. Consequently, the lord no longer had an obligation to the grantee and the property reverted back to him as grantor. Thus forfeiture in early English law was based on the notion of loyalty between the subject and his lord. Hence, it has often been associated with acts or omissions in relation to breaches of contract, treason, felony, etc. As regards the forfeiture of personal property, it was considered a means of raising revenue, which was the reason for the Crown to enforce the forfeiture of all chattels in all cases.

The introduction of taxation and a belief that it was unfair that the families of convicted felons should suffer even though they had committed no offence, led to forfeiture falling into disuse and the Forfeiture Act 1870 abolished forfeiture upon conviction.

2 A distinction between confiscation and forfeiture

The potential for confusion between confiscation and forfeiture was recognized by the *Hodgson Committee*, whose report following *R* vs *Cuthbertson* [1981] in 1984 led to the introduction of a new confiscatory regime for drug trafficking offences. The Committee's report noted that 'there was no generally accepted terminology to describe . . . various situations . . . To some extent we have had to invent our own vocabulary and we have consequently attributed discrete meaning to terms, which in ordinary speech might be treated as synonymous. The four words we use are 'forfeiture', 'compensation', 'restitution' and 'confiscation' . . . By *forfeiture* we mean the power of the Court to take property that is immediately connected with an offence. Spread throughout our law there are very many specific powers of forfeiture such as the one unsuccessfully sought to be exercised in the *Operation Julie* case. There is also a general power contained in s. 43 of the Powers of Criminal Courts Act 1973 . . . *confiscation* is taken to mean the depriving of an offender of the proceeds or the profits of crime. It was the inability of the courts to order confiscation in this sense which was highlighted by the *Operation Julie* case'.[48]

Powers of forfeiture currently appear in numerous statutes, including the Misuse of Drugs Act 1971, the Powers of Criminal Courts Act 1973, the Customs and Excise Management Act 1979 and the Immigration and Asylum Act 1999 (dealing with restraint and forfeiture of transport involved in illegal immigration). Under the relevant provisions, the police and Customs can ask the courts to forfeit certain assets. Forfeiture powers are also available following the application of a Customs officer to the court under s. 42 of the 1994 Drug Trafficking Act to recover cash at borders representing the proceeds of drugs trafficking, or are intended for use in drugs trafficking.

3 Civil forfeiture

a Legislation

With the passing of the Powers of Criminal Courts Act 1973, a general power was introduced to deprive the offender of property used, or intended for use, for purposes of crime. Other specific powers of forfeiture include the power under s. 27(1) of the Misuse of Drugs Act 1971. As discussed above, it was the narrow scope of these forfeiture provisions, as interpreted by the courts, which

led to the introduction of the first legislation which empowered the courts to confiscate proceeds of crime – Drug Trafficking Offences Act 1986 – as opposed to merely forfeiting property associated with committing an offence.

While most forfeiture provisions are conviction led, cash may be forfeited, without the need for any conviction, under the provisions of s. 42 Drug Trafficking Act 1994. Moreover, part II of the Criminal Justice (International Co-operation) Act 1990 introduced a new power for police and customs officers to seize cash discovered in imports or exports, which is reasonably suspected of being derived from or intended for use in drug trafficking.

These powers were introduced because there was increasing evidence that the tougher anti-money laundering systems, which had been enacted in the UK, had resulted in criminals moving drug cash to less well-regulated countries. Moreover, locally, the high standard of proof required in criminal cases – beyond reasonable doubt – made it difficult for prosecutors to press charges and successfully obtain a conviction.

Civil forfeiture was considered to be a solution for these problems. Its unique legal mechanism allows the authorities to bypass the usual protections for the accused of a crime by prosecuting property instead of people. The hearing is a civil allegation *in rem*. In other words, the defendant is the money, no one is on trial and therefore the public purse avoids having to provide Legal Aid to contest the proceedings. Although people are entitled to legal advice, this will not be free. If the person against whom a demand is made is a relatively wealthy person then he will not be entitled to legal aid and will have to pay for his own defence to establish his innocence. The court also has the power to use the money seized to pay for the lawyers and even when the person qualified to obtain legal aid, then he may have to repay the Legal Services Commission part of the legal costs if he wins.

The legislation enables a customs or police officer to seize on import or export cash in amounts of £10 000 or more if there are reasonable grounds to suspect that it directly or indirectly represents any person's proceeds of drug trafficking or is intended by any person for use in drug trafficking. Cash, which has been seized, may not be detained for more than 48 h unless its continued detention is authorized by an order made by a Justice of the Peace (magistrate) and no such order can be made unless the Justice is satisfied that reasonable grounds exist for the suspicion and that the continued detention of the cash is justified while its origin is further investigated or consideration is given to the institution (in the UK or elsewhere) of criminal proceedings against any person for an offence with which the cash is connected.

A magistrates' court may order continued detention of the cash for a period not exceeding three months and such orders may be obtained repeatedly as long as the total period from the first magistrate's order does not exceed two years. But the cash may not be released if an application for forfeiture has been

made or if there are proceedings against any person for an offence with which the cash is connected. No cash may be forfeited until any proceedings against any person for an offence with which the cash is connected have been disposed of. Notice is required to be given to any persons affected by the detention order. Moreover, at any time while the cash is under detention, a magistrates' court may authorize the release of the cash if it is satisfied on an application made by the person from whom it was seized or a person by or on whose behalf it was being imported or exported, that there are no, or are no longer any grounds for, its detention, or on an application by any other person that detention of the cash is not justified.

The customs or police officer may also release the cash if satisfied that its detention is no longer justified but the justice who first ordered the detention must first be notified. But again these provisions are overridden by the rule that the cash must not be released if an application for forfeiture has been made or if there are proceedings against any person for an offence with which the cash is connected. Application for forfeiture of the cash is made to the magistrates' court. No criminal conviction is required. The proceedings are civil proceedings and it must be proved on the balance of probabilities that the cash represents the proceeds of drug trafficking or is intended for use in drug trafficking.[49]

b Case law

The Divisional Court has dismissed numerous appeals by way of case stated by the owner of the money (see *Bassick & Osbourne* vs *Commissioners of Customs and Excise* (1997) 161 JP 377 and *Thomas* vs *Her Majesty's Customs and Excise* (1997) 161 JP 386).

The European Court of Human Rights has upheld the right of courts in the UK to order forfeiture of sums of money of the value of £10 000 or more, if a magistrates' court is satisfied on the balance of probabilities that it is directly or indirectly representing the proceeds of drug trafficking or was intended to be used in drug trafficking in *Phillips* vs *The United Kingdom* (2001) BHRC 280, [2001] Crim LR 817. It should be noted that the European Court of Human Rights dismissed previous complaints for civil forfeiture under the Convention in *Air Canada* vs *The United Kingdom* (1995) 20 EHRR 150, holding that forfeiture according to s. 141 (1) (a) of the Customs and Excise Management Act 1979 did not violate the Convention.

c Civil proceedings and the Proceeds of Crime Act 2002

The Proceeds of Crime Act 2002 introduced a civil recovery scheme empowering the Director of the Assets Recovery Agency to sue to recover proceeds

of crime in the High Court (Part 5 of the Act). The Director may apply to the High Court for an interim receiving order (s. 246) – freezing suspect assets, to be managed by an independent receiver (s. 247). At a full hearing the High Court is asked to make a recovery order (s. 266). Civil rules of evidence and procedure apply.[50] The burden of proof would rest with the Director on the civil standard, namely the balance of probabilities.

Cases are referred to the Agency once the prosecution authorities have concluded, applying their normal evidential and public interest tests, that criminal prosecution is not available. Civil recovery focuses on the origins of the property, not on the guilt of individuals and does not lead to a conviction or imprisonment. Innocent interests in property are protected (though whether this protection will be adequate remains controversial).

The Act also enables the Director of the Asset Recovery Agency to exercise the functions of the Inland Revenue, where she has reasonable grounds to suspect that a person's income or gain was derived from crime (Part 6 of the Act). This applies to individuals, companies or partnerships. The Director may assess for income, capital gains, corporation and inheritance tax. Unlike the Inland Revenue, the Director need not identify the source of income in order to raise a tax assessment on it (s. 319). Subject to that, she applies the law on tax in the same way as the Inland Revenue.[51]

The government's intention in enacting the Proceeds of Crime Act 2002 was to make confiscation and forfeiture easier. In relation to civil forfeiture the new powers are supposed to be used in circumstances where the prosecution does not have sufficient evidence to bring charges in a criminal court. However, this raises questions of procedural justice: if the government is unable to gather enough evidence to charge someone with a crime and obtain a conviction beyond a reasonable doubt, then the same government, through the Assets Recovery Agency, may opt for an easier path and obtain an economic punishment in a civil court where only a balance of probabilities is required.

These proceedings are labelled civil and, indeed, they take place in civil court, therefore in principle the safeguards of Art. 6 of the European Convention on Human Rights concerning criminal proceedings will not apply. Irrespective of the label and the character of the court where the proceedings are conducted, they are designed to avoid the burdens of the criminal track and they have penal consequences attached, namely the forfeiture of property.

Finally, the Act does not make civil action a subsidiary action if prosecution is impossible or difficult. Indeed, s. 240 (2) 'the powers conferred by this Part are exercisable in relation to any property (including cash) whether or not any proceedings have been brought for an offence in connection with the property', would not appear to prevent a civil action being brought by the government against the same person who has been acquitted in the criminal courts of the crime from which he is alleged to have profited.

4 Confiscation and criminal proceedings

a Drug related legislation

In 1984, the *Hodgson Committee* recommended that 'criminal courts should have the power to order the confiscation of proceeds of an offence of which the defendant has been convicted or asked to be taken into consideration. There should be a prescribed minimum amount below which no confiscation order could be made, but once that limit is established there should be no maximum limit . . . Only crown courts should have the power to make confiscation orders, but magistrates should be able to commit defendants to the crown court with a view to a confiscation order being made. Committal for this sole purpose should be possible even though the offence is only summarily prosecutable. Crown courts should be required to consider whether a confiscation order should be made and Magistrates' Courts to consider whether to commit for consideration of the making of a confiscation order'. Following this recommendation, the *Drug Trafficking Offences Act 1986* empowered the Crown Court to make orders to confiscate drug trafficking profits.

The powers apply when a defendant has been convicted of a drug trafficking offence and either the prosecutor asks the court to proceed, or the court decides that it is appropriate to do so. The court then has to decide whether the defendant has 'benefited from drug trafficking'. A person who has received any payment or reward in connection with drug trafficking carried out by himself or another person will have 'benefited from drug trafficking'. The court must make the 'required assumptions' in determining this and in assessing the value of his proceeds of drug trafficking, unless in the defendant's case an assumption is shown to be incorrect, or there would be a serious risk of injustice if the assumption were made.

b Case law

A similar approach to civil forfeiture is apparently applied in the recent series of cases concerning confiscation proceedings against those convicted of drug trafficking and other offences. The uniqueness of these cases is that they do not involve applying the presumption of innocence to a person who has, *a fortiori*, already been found guilty of an offence and the courts have interpreted that he is not entitled to the presumption any longer.

The courts held that calculation of the appropriate sentence (including confiscation) could not be constrained by Article 6(2) of the European Convention on Human Rights. In *McIntosh* vs *Lord Advocate* [2001]UKPC D1, [2001] HLRL 20, [2001] Cr App R 27, the High Court of Justiciary in

Scotland held, by a majority, that the presumption of innocence in Article 6(2) did apply to confiscation orders made under the Proceeds of Crime (Scotland) Act 1995 and the Drug Trafficking Offences Act 1994. However, the Privy Council unanimously reversed the High Court's decision.

Lord Bingham rejected the argument that Article 6(2) applied to confiscation proceedings arguing that although the sentencing court was making an assumption that the defendant had engaged in other criminal conduct, that person was never formally charged or notified of a criminal charge relating to those offences and 'the process involves no inquiry into the commission of drug trafficking offences'. Unless the Strasbourg jurisprudence led to a different conclusion, which in his view it did not, Lord Bingham was not prepared to conclude that 'a person against whom application for a confiscation order is made is, by virtue of that application, a person charged with a criminal offence'.

Mackintosh is consistent with the findings of *Welch* vs *The United Kingdom* [1995] 20 EHRR 247, where it was held that Article 6(2) was not violated by a similar provision in the Drug Trafficking Offences Act 1986. Then the House of Lords in *R* vs *Rezvi* [2002] 1 All ER 801, [2002] 2 Cr App R 2 and *R* vs *Benjafield* [2002] 1 All ER 815, [2002] 2 Cr App R 3, ratified this approach noting that: 'confiscation proceedings are part of the sentencing process following a conviction and do not involve a fresh criminal charge'. In *Benjafield* the House of Lords concluded that 'making due allowance for the differences between the confiscation procedures under the 1988 Act and under the 1994 Act, the reasoning in *R* vs *Rezvi* applies with equal force in this case'. The House of Lords followed the Strasbourg majority decision in *Phillips* vs *The United Kingdom* where it was held that article 6(2) of the convention did not apply to confiscation proceedings; and in addition it was decided unanimously that although Article 6(1) applied, it was not violated.

The approach to Article 6(2) in this case appears to be that the UK and European courts have accepted the view that the presumption of innocence does not apply once a person has been proven guilty. This, indeed, seems to be the basis of Lord Hope's approach in *McIntosh*, when he commented that the defence argument:

> overlooks the fact that the procedure on which the prosecutor is now engaged assumes that the accused has already been convicted of the offence with which he was charged. Article 6(2) provides that everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law. That stage is now passed. The court is concerned only with confiscation of the kind, which the law prescribes, where the conviction is for a drug trafficking offence. The respondent is not now being charged with another offence, nor is he at risk in these proceedings of being sentenced again for the offence of which he has been convicted. The assumptions on which the court is being asked to proceed do not require the court

to hold that he has been engaged in criminal conduct. They have much more to do with the civil process of tracing (a restitutionary remedy) especially where, as in this case, the court is asked to bring the value of implicative gifts into the assessment.

5 Other criminal proceedings

Part VI of the *Criminal Justice Act 1988* introduced a separate confiscation regime for all other indictable offences and specified summary offences. Under the original provisions a court had to be satisfied that the benefit the offender gained from the offence or offences of which he had been convicted and any offences taken into consideration was at least £10 000 before any order could be made. Sections 71–4 prescribed the circumstances in which a confiscation order could be made. Sections 75–89 related to the enforcement of confiscation orders including provision for the making of restraint orders – s. 77 – and charging orders – s. 78.

Section 71 was amended by the *Criminal Justice Act 1993* which inserted express provision – now s. 71 (7A) of the 1988 Act – that the standard of proof in determining any question arising as to whether a person has benefited from an offence, or the amount to be recovered in his case, should be that applicable in civil proceedings. It also allowed for the postponement of the determination of certain matters (whether the defendant had benefited, whether the benefit was at least the minimum amount, the amount to be recovered) for a period not exceeding six months (unless there were exceptional circumstances). Money laundering and other offences were also added.

Additional amendments strengthening the legislation were introduced by the *Proceeds of Crime Act 1995*, which brought the confiscation laws relating to the proceeds of crime in general into line with the more robust confiscation provisions in the drug trafficking legislation and in particular:

- it abolished the minimum amount requirement;
- introduced measures which have often been described as 'draconian' in the case of a 'course of criminal conduct' so that a confiscation order may relate to the benefit of criminal conduct in respect of which there has been no conviction and which has never been formally taken into consideration in court proceedings;
- made provision in the case of a 'course of criminal conduct' for the court to make assumptions similar to the required assumptions in drug trafficking cases, for the purposes of determining whether the defendant has benefited from relevant criminal conduct and if he has, of assessing the value of the benefit he received from it;
- significantly amended the provisions relating to a prosecutor's statement as to the matters relevant to determining whether the defendant has

benefited from any relevant criminal conduct or to an assessment of the value of the defendant's benefit from such conduct;

- made provision for ordering the defendant to supply the court with relevant information with the court being entitled to draw such inferences as it thinks appropriate from any failure without reasonable excuse to comply with the order;
- inserted a further group of sections into Part VI which allow for the making of applications up to six years from the date of conviction for decisions of the court to be reviewed.[52]

a The Proceeds of Crime Act 2002

The Proceeds of Crime Act 2002 brings together and strengthens in one piece of legislation the confiscation powers the courts currently have against those convicted of offences or suspected of having committed a crime. The measures are, to a great extent, similar to those in the existing regime. However, the extension of powers available to the investigating and prosecuting authorities under the Proceeds of Crime Act 2002 requires some further explanation.

a Criminal Assets

Under the new Act, courts are able to issue a restraint order in order to seize a suspect's assets at the start of a criminal investigation rather than waiting until the suspect is about to be charged (s. 40(2)). Also, where the court finds that a convicted defendant has a 'criminal lifestyle', it would assume that all his assets are derived from crime, unless he can prove the contrary or unless there would be a serious risk of injustice in doing so. The Act provides a definition of a criminal lifestyle in s. 75: a defendant has a criminal lifestyle if and only if any of the following conditions are satisfied:

1 the offence is specified within Schedule 2 of the Act;
2 it constitutes a conduct forming part of a course of a criminal activity or
3 it is an offence committed over a period of at least six months and the defendant has benefited from the conduct which constitutes the offence.

The Act also sets up a criminal Assets Recovery Agency which is entrusted with confiscating the profits of crime (Parts 1 and 2 of the Act). The Director of the Asset Recovery Agency and prosecutors will have new powers to challenge the Crown Court's decision where a criminal confiscation order is considered to be too low or one is not made (s. 31).

b New Police and Customs Powers

Chapter 3 of Part 5 of the Act allows the Government to introduce powers for the police and customs to seize cash derived from, or intended for, use in crime and to secure its forfeiture in proceedings in the magistrates' court. This would extend in-country existing powers to seize suspected drug cash discovered at the border and would permit more effective disruption of criminal enterprises, which continue to rely heavily on cash transactions.[53]

c Case Law

The powers of Customs and Excise to seize and confiscate have been reviewed in *Hoverspeed Limited et al.* vs *Custom and Excise* [2002] CA 1804; [2003]2 WLR 950. The case concerned applications for judicial review of aspects of the policies and procedures adopted by Customs and Excise in relation to the importation of alcohol, cigarettes and hand rolling tobacco bought in shops on the continent. The claimants challenged the lawfulness of the procedures by which the goods and the car, which belonged to one of the claimants, were seized, because Customs officers considered that they had not been purchased for personal consumption. At first instance, the court held that the Excise Duty (Personal Reliefs) Order 1992 wrongly reversed the burden of proof by requiring the individual to prove that he is not holding excise goods over the minimum indicative level for a commercial purpose and that the quantity when it is above the minimum indicative level must be used solely as a form of evidence and not as a persuasive presumption that the goods are held for a commercial purpose. However, the Court of Appeal allowed the appeal in part, holding that in order to justify any check made pursuant to the Customs and Management Act 1979 s. 163 or s. 163A the burden of proof lay with Customs. In circumstances where Customs were unable to provide any reason for suspecting an individual traveller who was subsequently discovered to be in possession of excise goods in excess of the quantities permitted, no inference could be drawn to the effect that reasonable grounds for suspicion had existed. However, Customs were fully entitled to use trends and profiles as part of the basis upon which to formulate reasonable grounds for suspicion (*Commission of the European Communities* vs *Belgium* [1989] E.C.R. 997, *Commission of the European Communities* vs *Netherlands* [1991] E.C.R. I-2637, *Germany* vs *Deutsches Milch-Kontor GmbH* [1994] E.C.R. I–2757). Finally, seizure of the excise goods in question was not automatically rendered invalid because the decision to search had been invalid. Accordingly the Court of Appeal held that the decision to quash the seizures could not be upheld. It is as yet uncertain to what extent, if any, this review of customs powers to stop vehicles will affect the new powers to seize cash derived from or intended for use in crime.

d Powers of Investigation

The Act introduces in Part 8, new powers of investigation, which will help trace the proceeds of crime and investigate money laundering. These powers, available after authorization by a judge, include:

- A customer information order which requires banks or other financial institutions to identify any account held by a person under investigation.
- An account monitoring order which requires a bank or other financial institution to provide transaction information on a suspect account for a specified period.

The Director of the Assets Recovery Agency is also given the power, as part of a confiscation or civil recovery investigation to:

- compel a person to answer questions, provide information and produce documents; and
- empower civilian financial investigators with law enforcement authorities, provided they have been accredited by the Agency.

6 Treatment of third parties

Section 77(1) Criminal Justice Act 1988 as well as s. 26(1) Drug Trafficking Act 1994 allow the High Court to make a restraint order, restraining 'any person' not just the criminal defendant, from dealing with realisable property.

This obviously allows the court to restrain all signatories to a joint bank account, co-owners of real property or any other person who has an interest in, or control over property in which the defendant – or the recipient of a gift from the defendant – has any interest, whether whole, partial or beneficial.

Section 82(4) Criminal Justice Act 1988 and s. 31(4) Drug Trafficking Act 1994 both state that power shall be exercised with a view to allowing any person other than the defendant or the recipient of any such gift to retain or recover the value of any property held by him and thereby protect the legitimate property interests of third parties in property which may be realisable property.

The options for a third party who finds himself restrained from dealing with assets can be summarized as follows:

- Show that the property is not realizable property, that is, that the defendant has no interest in the property and that the third party has not been the recipient of a gift caught by the act.
- If the property is realizable, then show that it can be disentangled from the value of the defendant's interest.

- Show that it is unnecessary for the court to restrain the asset as other assets are sufficient to satisfy the confiscation order.
- Show that the third party is a dependant of the defendant who ordinarily is supported by the defendant so that the third party can come under the umbrella of the defendant's exception for living expenses.[54]

Courts are not necessarily bound to accept a third party's claim, yet the court requires some evidence before restraining a third party from dealing with any asset held in the name of the third party. On an application from a third party, the court will also require sufficient evidence before releasing the disputed asset. There is no clear guidance from the courts applicable to restraining orders, but it has been accepted that by analogy some principles of the *Mareva* injunction may be applicable.[55]

These principles are clearly expressed in *SCF Finance* vs *Masri* [1985]2 All ER 747 and may be summarized as follows:

- If there is good reason to suppose that an asset held in the name of a third party is in reality the asset of the defendant it may be restrained.
- Where it is asserted that an asset belongs to a third party the court does not have to accept that assertion without inquiry, although the court may do so.
- In deciding whether to accept such an assertion the court will be guided by what is just and convenient between all the parties including the third party.
- If the court decides upon an inquiry, the court may direct the trial of an issue in advance of the main hearing or may await the trial of the main action, again depending on what is just and convenient.

Third parties do not have a right to be heard in a Crown Court on the extent of their interest in assets in which the defendant also has an interest. In *Robson* [1990] 92 Cr App Rep 1, the court of appeal stated that there was nothing in the Drug Trafficking Offence Act 1986 – similar provisions in this respect are contained in the Drug Trafficking Act 1994 – giving a third party the right to make representations to the Crown Court as to his interest in property if the defendant was not prepared to call the third party as part of his case. The reason for this outcome was that the order was brought against the defendant to pay a sum of money, which if the defendant did not pay, then raised the possibility that the civil court would sell particular property in order to satisfy the order.

It is at this juncture that the third party has a right to be heard. Section 29(8) of the Drug Trafficking Act 1994 requires the High Court to hear the third party before enforcing a charge or empowering a receiver to sell any property or ordering a third party to pay any sum of money to a receiver.

In *Hunter* vs *Chief Constable of the West Midlands* [1981] 3 All ER 727, the House of Lords held that the initiation of proceedings in a court of justice for the purpose of mounting a collateral attack on a final decision adverse to the intending plaintiff reached by a court of competent jurisdiction in previous proceedings in which the plaintiff had a full opportunity of contesting the matter was – as a matter of public policy – an abuse of the process of the court. In the light of this precedent, it may be not particularly wise for a third party to seek to make representations at the confiscation hearing against the defendant in the criminal court, since failing to succeed on the merits may be a barrier – abuse of process – to arguing the point again in the civil court.

Regarding an order of forfeit, it normally affects the rights of the defendant in the property only and a third party may apply for the return of the property subject to s. 43 (4) b Power of Criminal Courts Act 1973. Namely, a third party normally can recover if he can show that he did not consent to the defendant's possession of it or if he did not know or had no reason to suspect the use that the defendant would make of the property. In other words, an order may not be made against a third party's property unless the property has been used to commit or facilitate the commission of an offence, or was intended to be used for that purpose. This section refers to Police Property Act 1897, which applies only to personal property capable of being seized; hence it does not apply to real property. Also, it does not necessarily require that the property must relate directly to the offence of which the defendant is convicted. In the case *O'Farrell* [1988] 10 Cr App R 74, the court of appeal held that the court had power to make a forfeiture order under s. 43 Power of Criminal Courts Act 1973 which forfeited the defendant's working capital for future dealings in drugs.

Finally, s. 27 Misuse of Drugs Act 1971 allows the forfeit of anything shown to the satisfaction of the court to relate to the offence as defined in s. 1(3) Drug Trafficking Act 1994. This forfeit can only apply to tangible things within the jurisdiction of the English court. Furthermore, the property forfeited must relate directly to the offence of which the defendant is convicted, as opposed to s. 43 Power of Criminal Courts Act 1973, which in this respect is wider. Another difference with the latter is that the court shall not order anything to be forfeited unless a third party claiming to be the owner or having an interest in the property has had an opportunity to be heard.

In some cases, forfeiture may occur without a conviction. Generally in these circumstances, the object of the order must fall within the proscribed class and the forfeiture must be in the public interest. In this case, the owner of the property has the burden of proof to show why the property should not be forfeited. In particular, third party claim of innocence conduct does not necessary suffice for a discharge or variation of a forfeiture order.

In *Allgemeine Gold – und Silberscheideanstalt* vs *The United Kingdom* (1987) 9 EHRR 1, the European Court of Human Rights accepted the punishing of innocent conduct as being in accordance with Article 1 of Protocol 1, relating to the unpaid sale of Krügerrands that were seized when they were smuggled into the UK. The court held that the striking of a fair balance depended on many factors including the behaviour of the owner of the property and the degree of fault or care that he had displayed. The court found that the procedures available to the owner to enable reasonable account to be taken of the degree of fault or care of the owner, or, at least, the relationship between the owner's conduct and the breach of the law, were adequate for the purpose of the requirements of the second para. of Article 1 of Protocol 1. In *Allgemeine Gold – und Silberscheideanstalt* vs *The United Kingdom* the innocent third party whose assets were seized was in business and was expected to take commercial risks when selling assets on credit.

7 Statistics

a Confiscation

Data on the level of confiscation and enforcement is not collected in any systematic way. However, available data shows that, despite legislation that provides for confiscation upon conviction for all crimes, the UK's confiscation track record is poor. Confiscation orders are very low and even fewer are acted upon and collected.

a Confiscation Orders

For example, the number of confiscation orders relative to drug trafficking convictions in 2000 shows that only 13 per cent of Crown Court drug trafficking convictions led to confiscation orders being made. Drug trafficking offences relate to the business end of the drugs market. It can therefore reasonably be expected that those convicted have benefited from their crimes. Despite this, the proportion of drug trafficking convictions, which lead to confiscation orders, is low and declining.

The all crimes provisions of the Criminal Justice Act 1988 are used to a lesser extent.

The Cabinet Office Performance and Innovation Unit review gave two reasons for this striking difference between confiscation cases and orders. On the one hand, the budget restrictions on confiscation partly explain these discrepancies; on the other hand in some cases, there will be a victim involved and a compensation order will be more appropriate than a confiscation order. In addition, the report argues that there is little known about the spending and

Table 6.1 *Numbers of offenders ordered to pay compensation orders for drug trafficking offences by amount – excluding offenders committed for sentence or where the sentence could have been awarded at the magistrates' court*

	1995	1996	1997	1998	1999	2000	2001
Total sentenced for drug trafficking offences	6 199	7 373	8 370	6 998	6 577	6 458	6 653
Confiscation order not made	4 637	5 816	6 904	5 755	5 568	5 622	5 876
Confiscation order made under £1 000	1 117	1 117	1 032	855	682	525	454
£1 000 and under £3 000	224	217	224	185	147	159	155
£3 000 and under £10 000	120	118	127	111	99	69	77
£10 000 and under £30 000	56	64	56	56	45	51	47
£30 000 and under £100 000	20	32	19	26	23	20	30
£100 000 and under £300 000	12	6	6	7	9	11	10
£300 000 and under £1 million	9	1	1	1	2	1	3
£1 million and over	4	2	1	2	2	–	1
Total confiscation orders made	1 562	1 557	1 466	1 243	1 009	836	777
Orders made as a percentage of eligible offences	25	21	18	18	15	13	12
Total amount confiscated (£)	18 337 490	10 471 336	5 620 003	6 970 535	16 107 414	5 002 493	7 979 793
Average amount of confiscation order (£)	11 740	6 725	3 834	5 608	15 964	5 984	10 270

Source: Table 7.21 Criminal Statistics England and Wales 2001 – Statistics relating to Crime and Criminal Proceedings for the year 2001, published December 2002

Table 6.2 Numbers of Criminal Justice Act confiscation orders

	Potential CJA confiscation cases	Confiscation orders made	Percentage where confiscation made
1994	60 795	21	0.03
1995	61 909	50	0.08
1996	59 346	159	0.2
1997	62 511	151	0.2
1998	52 456	136	0.3

Source: Recovering the Proceeds of Crime, June 2000

saving habits of offenders and there may be a significant proportion of cases in which there are no substantial assets available for confiscation.[56]

Moreover, the report also states that 'there is more than likely to be as much as £460 million of proceeds from property crimes and £190 million from drug trafficking crimes available for confiscation per annum' – vastly more than the total value of confiscation orders made each year.

Finally, the definition of 'drug trafficking' in s. 1 Drug Trafficking Act 1994 encompasses drug trafficking anywhere in the world, which may then be taken into account when it comes to determining the amount of confiscation orders. Conversely, the definition of 'relevant criminal conduct' under s. 71 Criminal Justice Act 1988 is in large part territorially bound, hence wholly foreign criminal conduct would fall outside its confiscation regime.[57]

b The Collection of Confiscated Assets

Even where confiscation orders are made, the amounts collected are significantly lower than the sums ordered to be confiscated. This is despite the requirement of the law that confiscation orders cannot be made at a level above the offender's ability to pay (that is, his or her 'realizable assets'). For instance, between 1993 and 1999 the amounts ordered to be confiscated under the drug trafficking legislation was £114.3 million and only £48.4 million was actually collected. On average, under half (about 40 per cent) of the assets ordered to be confiscated were successfully collected. (Recovering the Proceeds of Crime, June 2000).

The collection rate for all crime cases under the Proceeds of Crime Act 1995 shows for the same period that £13.6 million was collected out of £44.5 million ordered to be confiscated. (Recovering the Proceeds of Crime, June 2000).

The figures above do not reflect the significant time lag that occurs between the making of an order and collection. The time lag is not routinely measured, but little is normally collected in the year of the confiscation order. For example, in 1997 Customs obtained drug trafficking confiscation orders of some £7.5 million, but only 11 per cent of this (some £0.8 million) had been collected by November 1998.

Overall, the amount confiscated and collected under the confiscation regime is very small by comparison with, for example, estimates made by NCIS of the amount of criminally drug related derived funds in circulation of 1 per cent of GDP, that is approximately £8.5 bn, in the UK Threat Assessment on Serious and Organized Crime by NCIS 2000.

b Forfeiture

There is very little information related to recovery through forfeiture orders. Statistics on forfeiture show that these orders are more routinely applied than confiscation orders, for instance in 1998 there were 27 forfeiture orders for every confiscation order made.

Finally, forfeiture orders are also used to recover cash found at borders believed to represent the proceeds of drug trafficking or intended for use in drug trafficking. The recent track record of forfeiture of cash detained at borders shows that over the period 1996/2000 only £11.2 million has been forfeited, an average of only £2.24 million per year. Statistics show that cash detained at borders is extremely low: data compiled by the Office for National Statistics suggests that approximately £970 million cash left the country in just the one year, 1994 for example, to pay for the supply of drugs.[58]

Table 6.3 Number of offenders given forfeiture orders 1995–2001

	Magistrates' Court	Crown Court	Total	Total related to drug offences
1995	18 857	6 402	25 259	15 134
1996	20 497	9 747	30 244	18 626
1997	23 445	10 700	34 145	22 023
1998	27 356	10 515	37 871	25 709
1999	27 942	10 190	38 132	26 647
2000	26 442	9 464	35 906	24 720
2001	27 881	9 107	36 988	24 641

Source: Criminal Statistics England and Wales 2000 – Statistics relating to Crime and Criminal Proceedings for the year 2000, published December 2001

It is important to highlight the low priority given to cash seizure by Customs in the UK. This is noticed by the report of Recovering the Proceeds of Crime, June 2000, showing that in 1998, drugs with a total street value of £710 million were seized, while cash of only £1.9 million was detained for the same period.

C Mutual Legal Assistance

Under the UK system, the UK can in principle assist any country in the world, whether that country can assist the UK under its laws or not. The Act does not in general require dual criminality, namely the overseas criminal conduct need not constitute an offence had it occurred in the UK. The UK can provide most forms of legal assistance without bilateral or international agreements – but assistance in the restraint and confiscation of proceeds of crime is dependent upon a bilateral agreement or other international agreement.[59]

The relevant legislation under UK law is primarily set out in Part I of the Criminal Justice (International Co-operation) Act 1990 ('the 1990 Act'), which replaced s. 5 of the Extradition Act 1873 and s. 5 of the Evidence (Proceedings in other Jurisdictions) Act 1975. The 1990 Act was subsequently amended by s. 164 of the Criminal Justice and Public Order Act 1994, on 3 February 1995. This enables the UK to assist overseas authorities in serious or complex fraud cases through use of the Serious Fraud Office's investigation powers.

Further relevant provisions may be found in Part VI of the Criminal Justice Act 1988, as amended by:

- the Criminal Justice Act 1993 and the Proceeds of Crime Act 1995; the Drug Trafficking Act 1994, s. 39 and the Drug Trafficking Act 1994 (Designated Countries and Territories) Order 1991 and
- the Criminal Justice (International Co-operation) Act 1990 (Enforcement of Overseas Forfeiture Orders) Order 1991, as amended.

The new Proceeds of Crime Act does not materially affect the Mutual Legal Assistance regime in the UK.

The 1990 Act was intended to ratify and implement the 1959 European Convention on Mutual Assistance in Criminal Matters (and its Additional Protocol insofar as it relates to fiscal offences). It extends to England, Scotland, Wales and Northern Ireland. The Channel Islands, the Isle of Man and the colonies are governed by their own legislation.

In case of uncertainty with regards to the scope of the 1990 Act and its application, this uncertainty must be resolved by resorting to the intention of the European Convention.

In addition to the 1959 Convention, the UK has ratified: the 1990 European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention). The UK has adopted the Commonwealth Scheme Relating to Mutual Assistance in Criminal Matters (the 'Harare scheme') and has also signed a number of mutual legal assistance treaties, for instance with Nigeria and the USA.

This area of law remains unsettled and is set to undergo further changes with the Crime (International Co-operation) Bill 2002 which aims to enable the UK to meet its commitments under several European Union initiatives.[60] While most of the Bill is uncontroversial there are parts that have raised debate in particular in relation to the widening of police powers and the provisions permitting prosecuting authorities in the UK to make requests for information about banking transactions in other countries directly to the foreign country without passing through a UK judicial authority. However, the final form of these provisions and their implementation remain to be seen.

1 System

Any competent court or tribunal, judicial or prosecuting authority can make requests for legal assistance in criminal matters. Requests may also be made by any other competent authority that the Home Office considers has the function of making requests for the purposes of criminal proceedings or criminal investigations. Such authorities include Attorneys General, investigating judges, examining magistrates, public prosecutors and Ministries or Departments of Justice having responsibilities for criminal matters.[61]

The Home Office's Judicial Co-operation Unit has drawn up *Guidelines for Judicial and Prosecuting Authorities* that must be followed by foreign authorities when making requests for mutual legal assistance (MLA). Diplomatic channels, such as Embassies or High Commissions in London, may be used where required by the law and practice of the requesting country. But direct communication with the Home Office is preferred as this can help speed up the execution of requests.

Requests must be made in writing in English or be submitted with an English translation. If no translation is provided the Home Office will ask for one.

Subsequent to the passing of the amendment to the 1990 Act contained in the Criminal Justice and Public Order Act 1994, the Home Office can refer requests for assistance in serious or complex fraud, or any part of such a request, to the Director of the Serious Fraud Office to obtain such of the evidence as may appear to the Director to be appropriate. Under the law in the UK, the Director must be satisfied on reasonable grounds that the criminal conduct in the requesting country involves 'serious or complex fraud'. Frauds

involving sums less than one million pounds would not normally be regarded as 'serious'. However, fraud can be 'complex' even if the sums involved are less than £1 million.

Before referring a request to the Director, the Home Office will seek a written assurance from the requesting authority that any statement, which might be made by a person in response to a requirement imposed by virtue of the Director's investigation powers, will not be used in evidence against that person, without the consent of the Home Office. This assurance is required because witnesses do not in general have a right to refuse to answer questions where use is made of the Serious Fraud Office's investigation powers. The assurance is therefore an important safeguard for the witness in the event of self-incrimination. The statement may, of course, be used against the accused person(s) named in the request if that is considered appropriate in the requesting country. The Director must send the evidence obtained by the Serious Fraud Office to the Home Office for transmission to the requesting authority.

UK law enables a restraint or freezing order to be obtained on behalf of another country in our High Court only where that country has been designated by subsidiary legislation. Normally, a country will be designated for assistance in relation to drug assets when it ratifies the 1988 UN (Vienna) Drugs Convention; or for assistance in relation to the proceeds of all crimes when it ratifies the 1990 Council of Europe (Strasbourg) Confiscation Treaty or when a bilateral confiscation agreement with the UK is in place.

2 Case law

The Court of Appeal has held that the request for assistance must be made at government level, by a foreign government to the UK government, followed by action by the domestic investigatory authorities. An application for a search warrant by an officer of the Metropolitan Police does not amount to the initiation of proceedings by a foreign government under the Diplomatic Privileges Act 1964 (*Propend Finance Pty Ltd* vs *Sing*, *The Times* 2 May 1997, Transcript, Smith Bernal, 17 April 1997).

The courts have not offered banks any special position in the Mutual Legal Assistance legislation. In *Securities and Exchange Commission* vs *Certain Uncommon Purchasers of the Common Stock of and Call Options for the Common Stock of Santa Fe International Corporation*, 23 February 1984 (1984) XXIIIM I.L.M. 511,[62] Drake J. upheld a request by the District Court for the Southern District of New York for evidence in respect of civil proceedings pending in the USA brought by the US Securities and Exchange Commission. The English High Court had ordered the examination of two witnesses, employees of the London branch of a Luxembourg bank, who sought to set aside the order on the ground that Luxembourg law forbade them from revealing the identity of the clients of the bank. Drake J. upheld the New

York court's request for judicial assistance. His Lordship held that banking confidentiality was not a form of recognized privilege against answering questions in court, unlike for example legal professional privilege. However, His Lordship recognized that there is a public interest in maintaining the confidential relationship between a banker and his client, so that the Court should judge any request for confidentiality very seriously. Nevertheless, from the ruling it was apparent that there is similarly a public interest in preventing the banker–client confidentiality relationship from being used to cloak improper or fraudulent activities, evidence of which would otherwise be available for legal proceedings in the UK or elsewhere.

a Main exceptions

Section 4 (3) of the 1990 Act gives the main relevant exception, for fiscal crimes:

> (3) Where it appears to the Secretary of State or, as the case may be, the Lord Advocate that the request relates to a fiscal offence in respect of which proceedings have not yet been instituted he shall not exercise his powers under subsec (2) above unless:
>
> (a) the request is from a country or territory which is a member of the Commonwealth or is made pursuant to a treaty to which the UK is a party or
> (b) he is satisfied that the conduct constituting the offence would constitute an offence of the same or a similar nature if it had occurred in the UK.

Moreover, the UK may decline requests that might prejudice UK investigations, proceedings, national security or other essential interests. No request will be declined without stating the reasons.

The Home Secretary is required to consider if the request ought to be refused because it concerns a political offence. Whether a political offence has been committed will be determined according to English law. In *R* vs *Secretary of State for the Home Department ex parte Fininvest SpA* [1997] 1 All ER 942 it was established that the mere fact that offences had come to light because of a decision made by members of a foreign judiciary to expose and punish corruption in public life did not transform offences of false accounting and bribery into political offences for the purposes of British law.

The UK will decline requests where a trial in the requesting country leads to double jeopardy (principle of *ne bis in idem*). If the subject of the request has been convicted or acquitted in the UK or any third country of an offence arising from the conduct described in the request, the UK will not offer legal assistance for a trial of the same conduct. However, according to the Home Office, in practice requests for legal assistance are rarely declined.[63]

b Evidential – standard for request

Where authenticated documentary evidence, including certified banking evidence, is requested, the Home Office may nominate a court to receive such of the documentary evidence as may appear to the court to be appropriate. Normally, the custodian of the documents is required by the court to make a statement on oath. This may, for example, indicate whether the documents were created in the ordinary course of business or came into the custodian's possession from a third party and whether the documents are originals or genuine copies of the originals. Such a statement is for 'chain of evidence' purposes. If banking evidence is required, an official of the bank concerned normally provides the statement.

The bank is under no obligation to inform the account holder that it has been ordered to disclose the information. In most cases, the nominated court will obtain the banking information without itself informing the account holder. This might not be appropriate if the account holder is a third party not complicit in the offence or if the account is administered by, for example, a firm of solicitors or accountants. The decision whether to notify the account holder of the proceedings is entirely a matter for the court. Before an account holder is notified, the Home Office consults with the requesting authority to ensure that execution of the request would not breach the requesting authority confidentiality requirements.

Under UK law, the evidence received by the court must be sent to the Home Office for transmission to the requesting authority.

c Sharing seized assets with another country

There is no statutory provision that allows the UK to share assets with another country. However, there are administrative possibilities. There is an inter-departmental Recovered Assets Fund, into which 50 per cent of all frozen assets under the confiscation regime are placed. There is a bidding process for money from this fund in which asset sharing is prioritized. Asset sharing with other countries can be considered where such a request has been made through the usual Mutual Legal Assistance arrangements. The Recovered Assets Fund is administered by the Recovered Assets Committee, an interdepartmental working group with input from the Home Office and the Treasury. Guidelines stipulate what the money from the Fund can be spent on and sharing assets is one of the possibilities listed. The new Proceeds of Crime Act 2002 will not affect this regime.

3 Critique of the AML system

The UK has come under fire for responding too slowly to overseas requests

for assistance in money laundering cases, with requests regularly taking months to process, in some cases up to two years. The Home Office's response is to re-iterate its commitment to fighting money laundering, referring to the passing of the Proceeds of Crime Act 2002 and attendant changes in the regime as evidence of its commitment.[64]

D Administrative Co-operation

There are close relations between all relevant agencies and organizations dealing with anti-money laundering in the UK. No major difficulties between organizations are reported. Some critics, however, have complained that responsibility for UK anti-money laundering policy making and law enforcement is divided between too many government departments and agencies, necessarily resulting in a lack of co-ordination, no matter how close relations between agencies and departments may be.

1 Administrative networks

The FSA is a member of the Shared Intelligence Service and the Financial Fraud Information Network (FFIN). Other members of the network are the Department of Trade and Industry, the Take-Over Panel, the London International Financial Futures Exchange, the Serious Fraud Office, the police, NCIS, the Law Society, the London Metal Exchange, the Home Office and the London Stock Exchange. These networks are used to share intelligence between investigation and enforcement agencies in the area of financial crime.

2 FSA and NCIS partnership agreement

NCIS and the FSA signed a Partnership Agreement on 27 July 2001 in which they recognize the threats posed by financial crime and in particular money laundering and acknowledge the need for co-operation between them to combat those threats. Under the terms of the agreement, NCIS is to provide a single point of contact that will act in response to all requests for assistance from the FSA. Where NCIS is acting as the co-ordination point for cases involving NCIS, FSA and other law enforcement agencies, the single point of contact has to keep the FSA informed of all relevant developments. Subject to all relevant legal restrictions on the disclosure of information, NCIS is to inform the FSA of all matters coming to its attention that might be of interest to the work of the FSA. NCIS is to answer FSA requests for assistance or information within five working days in 90 per cent of cases (Ch. 4 of the Agreement, 'NCIS Core Commitments'). Similarly, the FSA will also provide a single point of contact to receive request from NCIS for assistance. Where the FSA is the co-ordination point for cases involving several law enforcement agencies, the FSA will provide NCIS with all relevant information. The FSA

will respond within five working days to NCIS requests for assistance, with the exception of providing statistics, which may take longer to compile (Ch. 5 of the Agreement, 'Financial Services Authority Core Commitments'). These obligations will no doubt be facilitated by secondments of personnel.

FSA and NCIS systematically share data on detailed cases and NCIS shares data on the levels of SARs filed by each financial institution with the FSA. The FSA is now also trying to get more sophisticated knowledge on the *quality* of the filed SARs, to see if there are financial institutions that must improve the quality of their internal reporting.

VI SUPERVISORY LAW

International and European minimum standards have driven many of the reforms in the anti-money laundering system and in general terms there has been a move away from self-regulation towards regulation ever since the introduction of the 1979 Banking Act. However, it is also accepted by government that the financial industry should play a role in the rule-making process. The government adheres 'to the principle that the Money Laundering Regulations should set out a framework of obligations to maintain systems and controls, with the representatives of the regulated sector determining how these systems can best be set in place' (Money Laundering Advisory Committee Discussion Paper III). The government is, then, pragmatically disposed in favour of co-ordination and co-operation with the financial industry, to ensure that the rules that are drawn up are practically workable and will be followed by firms. One might describe this process as 'co-regulation' or 'consultative regulation'.

A good illustration of the attitude of the government towards the role of industry in regulation is provided by the reforms of the industry Guidance Notes, the Joint Money Laundering Steering Group (JMLSG) and the founding of the Money Laundering Advisory Committee (MLAC), in May 2002.[65]

The Proceeds of Crime Act gave the Guidance Notes new legal status in that they have to be approved by Treasury ministers after a consultation process with all stakeholders, within the MLAC and also the courts are now *required* to take the Guidance Notes into account as indicators as to whether a company has met its obligations.

A Anti-money Laundering Regulation

1 1993 money laundering regulations

The 1993 Money Laundering Regulations[66] were created to ensure compliance with the European Money Laundering Directive 91/308. The Regulations

do not outlaw money laundering or require suspicions to be disclosed. These offences are contained in the Proceeds of Crime Act 2002. It is important to note that a person not maintaining the requisite procedures will commit an offence, whether or not they are involved in money laundering. The Regulations are designed to increase awareness and reduce the opportunities of the would-be launderer. In essence, these procedures are designed to achieve two purposes. First, to enable suspicious persons and transactions to be recognized as such and reported to the authorities and, second, to ensure that if a client comes under investigation in the future, the intermediary is able to provide evidence within the audit trail.

The Regulations came into force on 1 April 1994. They impose five main duties on firms as follows:

1 internal controls and communication of policies
2 identification procedures. This is probably of the most practical importance.
3 record keeping
4 recognition of suspicious transactions and reporting procedures and
5 education and training of employees.

Breach of the Regulations results in a criminal offence punishable with up to two years imprisonment, a fine or both. To date there have been no convictions of an offence under the Regulations, in part attributed to the police's lack of understanding of the regulated sector. To remedy this the FSA has been given prosecuting power (except in Scotland) under the Financial Services and Markets Act 2000.[67]

The Regulations provide that in determining whether a person has complied with the requirements, the court may take account of any relevant supervisory or regulatory guidance.[68] By far the most significant and widely followed guidance is that provided by the JMLSG.[69] Such Guidance provides a safe harbour. Failure to follow guidance does not mean the firm has breached the Regulations. It will have to prove that it has complied with the duties under the Regulations.

2 2001 money laundering regulations

The Money Laundering Regulations 2001 extend the scope of the Money Laundering Regulations 1993 so that they now include bureaux de change, money transmission agents and cheque cashers. They are regulated by HM Customs and Excise who are the prosecuting authority in the event of breach of the Money Laundering Regulations 1993.

The FSA has issued Money Laundering Rules that complement the Money Laundering Regulations 1993 and JMLSG Guidance Notes. Following the

FSA Rules (together with the Guidance to the Rules and relevant Evidential Provisions collected in the FSA Money Laundering Sourcebook) allows a firm to meet FSA requirements.

Financial firms can have civil liability to private third parties for breaches of the rules. If the FSA Rules are breached, firms may be liable for losses suffered by private persons as a result of the breach. This right of action is contained in s. 150 FSMA 2000. In addition, victims may be able to maintain a civil action based on constructive trust principles. The elements of civil and criminal liability are similar.

3 Scope

a Territorial scope

The UK is primarily concerned with money laundering taking place in the UK and does not, in principle, seek to apply its anti-money laundering legislation extra-territorially. FSA Rule 1.1.5 states that the *Money Laundering Sourcebook* applies only to activities carried on from an establishment in the UK.

However, where a UK financial institution has overseas branches, subsidiaries or associates, where control can be exercised over business carried out outside the UK, the UK firm should consider putting in place a group money laundering strategy to protect its global reputation and its UK regulated business (Money Laundering Guidance Notes, 3.29). However, the statutory duty of the FSA is defined in extra-territorial terms, as s. 6(1) of the Financial Services and Markets Act 2000 includes conduct 'which would be an offence if it had taken place in the UK'.

b Covered activities/institutions

The primary legislation applies to all persons and businesses within the ambit of UK law.

The Money Laundering Regulations 1993 ('1993 Regulations') place additional administrative requirements on persons and firms operating within the financial sector. Regulation 4 lists, in great detail, the relevant financial businesses that are covered. In essence the 1993 Regulations apply to those persons carrying on 'relevant financial business' as follows:

- accepting deposits, by a person with permission under the Financial Services and Markets Act (FSMA) 2000 Part IV to accept deposits;
- business of the National Savings Bank;
- business carried out by a credit union within the meaning of the Credit Unions Act 1979 or the Credit Unions (Northern Ireland) Order 1985;

- any home-regulated activity carried on by a European institution in respect of which the establishment conditions in FSMA 2000, Schedule 3, para. 13, or the service conditions in para. 14 of that Schedule, have been satisfied;
- business that consists of one or more of the following carried on in the UK:

  - dealing in investments as principal or agent
  - arranging deals in investments
  - managing investments
  - safeguarding and administering investments
  - sending dematerialized instructions
  - establishing collective investment schemes
  - advising on investments

- any activity carried out for the purpose of raising money authorized to be raised under the National Loans Act 1968 under the auspices of the Director of National Savings;
- operating a bureau de change; transmitting money, or any representation of monetary value, by any means; or cashing cheques that are made payable to the customers or advancing loans against cheques;
- insurance business carried out by a person who has received official authorization pursuant to Art. 6 or 27 of the first European Life Assurance Directive;
- any of the following activities other than an activity falling within the previous categories of relevant financial businesses: accepting deposits and other repayable funds from the public; lending; financial leasing; money transmission services; issuing and administering means of payment (credit cards, traveller's cheques, bankers drafts); guarantees and commitments; trading for one's own account or for the account of customers in money market instruments, foreign exchange, financial futures and options, exchange and interest rate instruments and transferable securities; participating in securities issues and providing services related to such issues; advising to undertakings on capital structure, industrial strategy and related questions and advice on services relating to mergers and the purchase of undertakings; money broking; portfolio management and advice; safekeeping and administration of services; and safe custody services.

In summary, the following institutions are covered within the Money Laundering Regulations:

- all banks, building societies and other credit institutions;
- all individuals and firms engaging in investment business within the meaning of the Financial Services Act 1986;
- all insurance companies undertaking long-term life business, including Lloyd's of London;
- bureaux de change, cheque encashment centres and money transmission services etc. and
- any firm undertaking as its principal business any of the financial activities listed in the schedule to the Regulations.

The scope of the 1993 Regulations is therefore very wide, encompassing not only regular businesses such as banks, building societies, stockbrokers and life insurers, but also professionals like solicitors and accountants. The scope of the Regulation was extended on 12 November 2001 by the Money Laundering Regulations 2001 to include those 'money service businesses' that had not been regulated activities under the FSMA until then within the definition of 'relevant financial business'.

c Second European money laundering directive

The second European Directive (2001/97/EC) broadens the scope of these regulations further yet, although the effects in the UK will be less than in many other countries, since the UK legislation in most respects is already more thorough than required by European law. The UK system already meets the requirements of the Directive in several respects: under existing legislation, all indictable (and some summary) crimes are predicate offences for the purposes of money laundering and the definition of relevant credit/financial institutions already includes EU institutions operating in the UK according to the conditions of the Financial Services and Markets Act (Reg. 4.1.e). The main change under the Directive will therefore be the extension of the regulations to new professions and activities. Member States are obliged to implement the Directive in national law by 15 June 2003; in the UK, this will be done through a revision of the 1993 Money Laundering Regulations (MLAC Discussion Paper II). As at October 2003, the Treasury announced that the introduction of the new Regulations was delayed pending an internal review.

4 2003 draft money laundering regulations

The draft money laundering regulations set out the obligations in relation to businesses as well as individuals within a business. They specifically refer to the need to obtain evidence of identity from clients, but also reinforce the need to train all employees at all levels, from senior management to administrative staff. Previously only those authorized by the FSA were within the scope of

the regulations (unless the proceeds related to terrorism or drug trafficking). However, the new regulations will apply to the proceeds of *any* crime and there is no lower limit for how much money is involved. Furthermore, the type of organization that is liable to report such findings will be extended to cover the following professional individuals or businesses:

- auditors, accountancy firms and tax advisors
- estate agents
- solicitors or other legal professions
- auctioneers, where payments are made in cash and for more than €15 000
- casinos and bureaux de change.

Under the draft 2003 Money Laundering Regulations, all staff working within these organizations have a personal obligation to be fully aware of the money laundering provisions. This will mean implementing appropriate internal training programmes and employers have a duty of care to ensure all their staff have had sufficient training on the new rules.

The maximum penalty for any individual found guilty of breaching the regulations, or failing to report their suspicions, is five years in prison.

The expansion of the regulated sector following implementation of the Second European Money Laundering Directive will lead to the development of existing guidance by law and accountancy bodies and the drafting of new guidance notes for previously unregulated industries, such as casinos, estate agents, auctioneers and fine art dealers. This new diversity in the regulated sector may lead to differences in interpretation of the Regulations: the MLAC will have a role to play in resolving any conflicts arising from such differences of approach. Money Service Business activities (running a bureau de change, cheque cashing and money remittance) have been subject to the Money Laundering Regulations 1993 since 1994. Since November 2001, money service businesses not currently regulated by the FSA for certain other activities have been subject to a supervisory regime operated by HM Customs and Excise under the Money Laundering Regulations 2001.

The Money Laundering Rules, plus the additional Evidential Provisions and associated Guidance, issued by the Financial Services Authority (FSA) and collected in its *Money Laundering Sourcebook*, to meet its anti-money laundering objective of the Financial Services and Markets Act 2000, apply to all relevant firms in respect of their regulated activities. Special provisions are included for lawyers and accountants who are supervised and regulated by their designated professional bodies.

FSA Guidance 1.1.3 indicates the width of its scope in the following terms: ‘It includes all firms excepts those within the limited exception for firms

concerned only with certain insurance activities and UCITS qualifiers. The scope extends to incoming firms (such as branches of institutions established elsewhere in the European Economic Area), except those operating on a services basis only'.

a Accounts pre-dating the 1993 regulations: an initiative by the six major banks

The anti-money laundering regulation applies only from 1 April 1994 onwards, that being the date on which the 1993 Money Laundering Regulations came into effect. Prior to that date, there was no requirement to establish the identity of customers. Clearly, therefore, there were risks associated with some of the 'older' accounts. Six major UK banks (Abbey National, Barclays, HBOS, HSBC, Lloyds TSB and the Royal Bank of Scotland Group) issued a *Joint Statement of Principles* on 16 July 2002,[70] in which they announced a major initiative to re-confirm the identity of their existing customers, particularly relevant for those accounts opened by 31 March 1994 and using a risk-based approach in doing so. Banks are not required to do so under the British anti-money laundering regime, although the regulator has been supportive of this private initiative and conceivably could have taken regulatory steps to redress the issue at some point in the future had nothing been done. Through the use of computer systems and automated checks, banks will attempt to minimize the impact on their customers.

5 Substantive requirements: regulatory obligations of financial operators

There are two main due diligence requirements: first, the requirement of identification of the client and second, the requirement to collect appropriate Know Your Customer-information.

a Customer due diligence (CDD): general principles of identification

The identification requirements are set out in the 1993 Money Laundering Regulations, Reg. 7–11. The identity of counterparties and customers new to the firm after 1 April 1994 (the date on which the 1993 Regulations came into force) must be established as soon as reasonably practicable:

- whenever a business relationship involving regular transactions is to be established and
- in the case of one-off transactions: (a) where it is known or suspected that the transaction relates to the money laundering; (b) where payment is to be made by, or to, the counterparty or customer of over €15 000;

and (c) in the case of two or more apparently linked one-off transactions, where these cumulatively amount to €15 000 or more.

The requirement in Regulation 7(1) is for the applicant for business to produce satisfactory evidence of his identity, or for the firm to take such measures as will produce that satisfactory evidence.

a Definitions

Identity is defined in the Guidance Notes as 'a set of attributes which together uniquely identify a natural or legal person'. Date of birth may be an important aspect of identification. However, there is no requirement to verify the date of birth provided (Guidance Notes 4.20–21).

An 'applicant for business' is the term used by the 1993 Regulations to mean a person seeking to form a business relationship with, or carry out a one-off transaction with, a person who is carrying on 'relevant financial business'.

'Transaction' is very broadly defined, to include the giving of advice (with some exceptions) (FSA Guidance 3.1.2, Guidance Notes 4.24 and 4.41).

Where evidence is not obtained, or not obtained in a reasonable time, the business relationship in question ought not to continue (FSA Guidance 3.1.1 and Guidance Note 4.17).

FSA Guidance 3.1.4 states that in assessing a relevant firm's compliance with its duty to identify a client in accordance with Regulation 3.1.3 the FSA will have regard to the firm's compliance with the Joint Money Laundering Guidance Notes for the Financial Sector and with the guidance on financial exclusion at Regulation 3.1.5.

Information on residency and/or nationality can be useful to assess if a customer comes from a high-risk country (Guidance Note 4.22). Where a passport is taken as evidence of identity, the number, date and country of issue must be recorded.

Once identification procedures have been satisfactorily completed and the business relationship has been established, as long as contact or activity is maintained and proper records are being kept, there is no need for further evidence of identity when transactions or activity are subsequently undertaken (Guidance Note 4.25).

Regulation 11 states that the required evidence must be reasonably capable of establishing that the applicant is the person he claims to be and for the person who obtains the evidence to be satisfied that it does indeed establish that fact.

FSA Rule 3.1.3 states that:

- A relevant firm must take steps to find out who its client is by obtaining

sufficient evidence of the identity of any client who comes into contact with the firm to be able to show that the client is who he claims to be.
- Where the client with whom the relevant firm has contact is, or appears to be, acting on behalf of another, the obligation is to obtain sufficient evidence of both their identities.

Because no single form of identification can be fully guaranteed as genuine, or respecting correct identity, the identification process will have to be cumulative. Unless the applicants fall within the definition of ‘financial exclusion’, no single document or source of data must be used to verify both name and permanent address (Guidance Note 4.44).

When an existing customer closes one account and opens another, or enters into a new agreement to purchase products or services, there is no need to re-verify identity or address. However, procedures should be in place to guard against impersonation fraud and the current residential address should be confirmed if possible, particularly when there has been no recent contact or correspondence with the customer or when a previously dormant account is re-activated. (Guidance Note 4.45).

Other than in financial exclusion cases, an introduction from a respected customer personally known to a Director or Manager, or an introduction from a member of staff, cannot replace the regular verification procedures (Guidance Note 4.50).

There will be situations when commercial judgement may need to be applied. Where sufficient information or identification evidence cannot be obtained about a client or prospective client and where the firm does not suspect criminal activity, a commercial decision will need to be taken as to whether to proceed with the business. However, if the business does continue, any misgivings should be recorded and the reasons for taking the business justified in relation to the risks. Extra attention should be paid to monitoring that particular account. Every opportunity should be taken to obtain and verify any missing information at the earliest opportunity. If criminal money is suspected then a report must be made in accordance with established procedures (Guidance Note 4.51).

Where the person who approaches the firm is clearly acting as an agent for another, reasonable measures must generally be taken for the purposes of establishing the identity of any person on whose behalf an applicant for business is acting. However, in accordance with Regulation 10 and FSA Rule 3.2.2, where the agent is regulated in a FATF member country, an assurance from that applicant that it has identified its principal and kept records will be sufficient. In such a case, the Guidance Notes recommend: (1) that each introduction be treated on a case-by-case basis; and (2) that the firm obtain a copy of the evidence taken by the introducer. In other cases it will be necessary to

identify the underlying principal. None of these exemptions apply if money laundering is known or suspected.

Since 'money service businesses' are not regulated activities under the FSMA, the FSA *Money Laundering Sourcebook* does not apply to them. Consequently, the general exemption from the requirement to verify the identity of applicants for business, which are themselves bound by the 1993 Regulations, does not apply with relation to money service businesses. The identity of such businesses will therefore have to be verified to the same extent as any other non-regulated customer, although the Money Laundering Regulations 2001 provide that satisfactory evidence of identity in these cases shall also include the applicant's registered number as allotted to them by Customs and Excise.

Where a firm believes that its client is acting on its own account and where the client is a bank, broker, fund manager of other regulated firm and where all business is to be undertaken in the name of the firm, there is no obligation to look beyond the regulated firm.

In other circumstances, identification evidence should be obtained for:

- the named account holder(s)/the person in whose name an investment is registered;
- any known beneficial owner of funds being invested who is not a signatory, or named investor;
- all signatories to an account or business relationship; those who regularly provide instructions
- any intermediary parties.

In the case of joint applicants, identification should be obtained for all account holders. However, in the case of applicants who have the same surname and address the name and address of the first named should be verified but only the name need be verified for the second applicant.

1 Trusts

In the case of trusts, the identity of those providing funds, that is, the settlor(s) and those who are authorized to invest or transfer funds, or to make decisions on behalf of the trust, that is the principal trustees, should be verified.

2 Business applicant

Where an investor sets up a savings account or a regular savings scheme, where the funds are supplied by the investor for investment in the name of another, the person who funds the subscription or makes deposits, should be regarded as the applicant for business.

3 Personal pensions

Unless personal pensions are connected to an insurance policy, they are not exempt under the Money Laundering Regulations, or the FSA Rules and identification evidence must be obtained at the outset for all investors. Pension advisers who are covered by the 1993 Regulations can be relied upon to confirm that identity has been taken, but those who are not covered by the Regulations have to be charged with collecting the relevant identification evidence on behalf of the pension fund provider. When a pension is transferred from one provider to another, confirmation that identification evidence has been obtained must be given (Guidance Notes 4.36–4.37).

4 Providing identity evidence: timing

Regulation 11 states that what constitutes an acceptable time span for obtaining satisfactory identity evidence must be determined in the light of all the circumstances. This will include the nature of the business, the geographical location of the parties and whether it is practical to obtain the evidence before commitments are entered into or money changes hands. However, any occasion when business is conducted before satisfactory evidence of identity has been obtained must be used in exceptional circumstances only and the justification recorded (Guidance Note 4.38).

FSA Rule 3.1.8 clarifies this requirement by stating that:

A relevant firm must obtain identification evidence as soon as reasonably practicable after it has contact with a client with a view to:

- agreeing with the client to carry out an initial transaction or
- reaching an understanding (whether binding or not) with the client that it may carry out future transactions.
- If the client does not supply identification evidence within the time scale in (1), the relevant firm must:
    - discontinue any regulated activity it is conducting for him and
    - bring to an end any understanding it has reached with him; unless, in either case, the relevant firm has informed the National Criminal Intelligence Service (NCIS).

Nothing in the last Rule requires a relevant firm to continue with a transaction that conflicts with its obligations, if any, with respect to the rights of a third party.

The failure or refusal by an applicant to provide satisfactory identification evidence within a reasonable timeframe and without adequate explanation may lead to the suspicion that the depositor or investor is engaged in money laundering. In such circumstances, the firm should consider making a suspi-

cion report to NCIS based on the information in their possession before any funds are returned to where they came from (Guidance Note 4.43).

b Identity – UK Resident Private Individuals

Independent verification for all private individuals whose identity must be verified for: the true, full name or names and the current permanent address including postcode. If an applicant has recently moved, the previous address must also be validated. Financial firms must adopt a risk-based approach to determine what is reasonable to obtain sufficient evidence of identity. The extent and number of checks depends on the circumstances of the opening of the account/business relationship and the applicant (Guidance Notes 4.72–4.76).

As stated before, the process must be cumulative. More than one source must be used. A firm may want to inspect various documents (passport, residence permit, driving licence, recent utility bill, local authority tax bill, etc.) as well as making use of electronic databases (Guidance Notes 4.78–4.85).

c Identity – Non-UK Resident Private Individuals

In the case of non-UK resident who make face-to-face contact and wish to open an account or establish another business relationship, passports or national identity cards should be available as evidence of the name of the customer in question. Additionally, firms must obtain evidence of the applicant's permanent residential address from the best available sources (Guidance Notes 4.86–4.89).

d Identity – Financial Exclusion

'Financial exclusion' refers to the financially or socially disadvantaged. Britain recognizes, as a claim of social justice, that these groups have the right to open accounts and obtain other financial services. Just because they cannot produce evidence of their identity should not stop them from participating in the financial system. The FSA Guidance (3.1.5–3.1.7) and the Guidance Notes (4.101–4.115) make clear that firms are to be guided by the criterion of *reasonableness* in such cases. The firm must still make efforts to establish the identity of the person involved, even in the absence of all or most documentation. Contact can be made, for instance, with persons in a position of responsibility who know the applicant. When a firm treats someone as a financially excluded person, it must record its reasons for doing so (FSA Rule 7.3.2).

e Identity – Companies

Companies are probably the most likely vehicles for money launderers. Accordingly, financial firms must be careful in their dealings with them. The identity of a corporation comprises: its registered number; its registered corporate name and any trading name used; its registered address and any separate principal trading address; its directors; its owners and shareholders; and the nature of the corporation's business (Guidance Note 4.151).

Documentary evidence. How much documentary evidence is needed to establish these facts depends on the nature of the product or service that the corporation needs and the risk the financial firm associates with this business (Guidance Note 4.152).

Identity of individual directors. There is, in principle, no need to verify the identity of individual directors or shareholders of clients that are companies listed on a recognized stock exchange. This also applies to subsidiary companies. Prudence may dictate that it is necessary to verify that instructions actually come from the company involved, e.g. by obtaining the board resolution authorizing the individual to do so. If the business is high risk, then additional checks are probably necessary (Guidance Notes 4.156–158).

1 Lower-risk corporations

If the business of private companies is considered low risk, then all that is normally required will be independently obtained information about the company's incorporation and registered address and a list of its shareholders and directors, or if this cannot be obtained, an undertaking from a firm of lawyers or accountants confirming the documents that have been submitted to the registry. Only when reliable documents cannot be obtained, will the individual identities of the principal owners and directors of a company have to be inspected. The place of origin of documents must be considered, as standards of control vary from country to country (Guidance Notes 4.159–161).

2 Higher-risk corporations

If the business is high risk, then the identity of all persons with a significant interest in the company (usually 20 per cent or more) must be verified, as well as evidence of the principal beneficial owner and anyone else who has principal control over its assets. Generally, the chain should be followed through corporate controllers to identify the ultimate beneficial owner. In addition, consideration must be given as to whether to verify the identity of any company directors. International Business Companies that are registered in an off-shore jurisdiction, but operate from another jurisdiction, must be followed with particular attention (Guidance Notes 4.163–4.164 and 4.169).

Registered public companies. For registered public companies, a copy of

the latest corporate report and accounts, if available, should be obtained upon starting a full banking relationship, or its file at the Registrar of Companies or similar documentation, as well as a certified copy of the resolution of the Board of Directors to open the account and confer authority on those who will operate it (Guidance Note 4.162).

3 Credit and financial institutions

Identification is not required for applicants who are UK or EU regulated credit or financial institutions. For non-EU countries, the confirmation of the existence of a credit or financial institution can be checked by the home country Central Bank or supervisor, with another office, subsidiary, branch or correspondent bank in that country, or with an EU regulated correspondent bank of the overseas institution, or obtaining from the relevant institution evidence of its licence or authorization to conduct financial or banking business. Unregulated financial and credit institutions such as bureaux de change must be verified in accordance with the procedures for non-financial companies. (Guidance Note 4.170–172).

Credit and financial institutions (whether regulated or not) that are located in non-co-operative countries (NCCT) or countries with material deficiencies should be treated as unregulated credit and financial institutions in line with the applicable procedures for non-financial companies and businesses (Guidance Note 4.173).

4 Identity – trusts, fiduciaries and nominees

Trust and similar instruments such as nominee companies and fiduciaries are popular instruments for money laundering as they tend to complicate identification and can be used to mask the origin of the money. Some trusts are higher risk than others. In particular, so-called absolute and bare trusts established in the UK are considered to present the lowest risk for financial firms. Discretionary and off-shore trusts are perceived to be at the other end of the risk scale (Guidance Notes 4.116–117).

Special attention must be paid when trusts, special purpose vehicles or International Business Companies connected to trusts are set up in off-shore locations with strict banking secrecy or confidentiality rules. Those created in jurisdictions without sufficient anti-money laundering must be treated with particular caution (Guidance Notes 4.117 and 4.120).

(a) Low-risk trusts

For conventional UK trusts, such as those established to comply with the Married Women's Property Act 1882, identification evidence must be obtained for those who have control over the funds (the principal trustees, who may include the settlor) and the providers of the funds (the settlors except when

they are deceased). Copies of relevant documents should be certified by a UK solicitor, banker or other professional person (Guidance Notes 4.127–131).

(b) High-risk trusts

Unless the applicant is a financial sector firm from a jurisdiction with sufficient anti-money laundering legislation, the financial firm must identify the trust company or corporate service provider according to the requirements for professional intermediaries or companies, together with the underlying principals on whose behalf the applicant is acting (Guidance Note 4.121).

For overseas trusts (nominee or fiduciary accounts), where the applicant is a financial sector firm from a jurisdiction with adequate anti-money laundering legislation, an introduction or intermediary certificate stating that all underlying principles have been identified may be relied upon; the trustees/nominees must be asked from the outset about the capacity in which they are operating or making the application and their regulated states and documentary evidence of the appointment of the current trustees should also be obtained (Guidance Note 4.122).

Applications to open an account or undertake a transaction for a third party without the applicant identifying their trust or nominee capacity are considered suspicious and must lead to further enquiries (Guidance Note 4.124).

If a UK bank is itself the applicant to an off-shore trust on behalf of a customer, if the corporate trustees are not regulated, then the UK bank must undertake due diligence on the trust itself (Guidance Note 4.125).

Where trustees are not regulated for money laundering purposes, the identity of two of the authorized signatories and their authority to operate the account should also be verified. When the identity of beneficiaries has not previously been verified, verification should be undertaken when payments are made to them. (Guidance Note 4.122).

Whenever money is received on behalf of a trust, reasonable steps must be taken to ensure that the source of the funds is properly identified and the nature of the transaction in question is properly understood. Trustees must authorize payments in writing. If a trustee is replaced, his successor must be verified before he is allowed to exercise control over funds (Guidance Notes 4.132–133).

5 Identity – Client accounts opened by professional intermediaries

Accountants, stockbrokers, estate agents, fund managers, solicitors and other intermediaries often hold funds on behalf of their clients in client accounts with other financial sector firms. These accounts can either be omnibus accounts holding the funds of multiple clients, or they can be opened specifically for one client. In such cases, the professional intermediary is the firm's customer and those situations differ from those where an

intermediary *introduces* a client who then becomes a customer himself (Guidance Note 4.141).

If the UK or EU firm in question is itself covered by the 1993 Regulations or their equivalent, identification is not necessary. However, unless the intermediary is himself regulated by the 1993 Regulations or their foreign equivalent, the firm must not only verify the identity of the professional in question, but also the identity of the person on whose behalf the intermediary is conducting business (Guidance Note 4.142 and 4.143).

In case of solicitors and accounts, the Solicitors' Act and the accountants' professional code of conduct will preclude them from divulging information to banks or building societies about their underlying clients. In those cases it will not be possible for another firm to establish the identity of the clients on whose behalf the solicitor or accountant is acting. Firms must take a commercial decision, based on their dealings with and knowledge of the solicitor or account in question, as to the nature and extent of business they are prepared to conduct under these terms (Guidance Note 4.144–145).

For private companies, that is those not quoted on a recognized stock exchange, identification is obtained for the principal underlying beneficial owner(s) of the company; and those with principal control over the company's assets, for example principal or shadow directors. Firms should be vigilant for circumstances that might indicate any significant changes in the nature of the business or its ownership and make enquiries accordingly (Guidance Note 4.33).

6 *Non-face-to-face customers*

(a) Low risk businesses

There are different requirements for low risk business for non-face-to-face customers than for regular customers. Following complaints from the Treasury and the FSA that those requirements were too onerous for firms, they have been reduced in the most recent Guidance Notes. The Guidance Notes currently require at least one measure of evidence additional to that which would be obtained for a face-to-face customer. This requirement can be met by ensuring that payment is obtained from an EU bank account.

In the event that internal procedures require sight of a current UK passport where there is no face-to-face contact, then a copy certified by a lawyer, banker or other regulated professional should be requested. In the case of a passport or national identity card from a foreign national or a UK resident overseas, the copy can be certified by an embassy, consulate or high commission of the country of issue, or by an official within the firm or group, or by a lawyer (Guidance Note 4.53).

Regulation 8 provides a concession where a business applicant would generally need to be identified but a payment is to be made by him and it is reasonable for the payment to be sent by post or other electronic means effective to

transfer funds (or for the details of the payment to be provided in that way) and where the payment is debited from an account held in the applicant's name at an institution which is an authorized bank or building society. However, this concession may not be used if money laundering is known or suspected or if the payment is made for the purposes of opening an account, or to open such an account which could be used to make payment to someone other than the applicant of the business regardless of whether it is made directly or indirectly to such a person. If this concession is used, a record must be kept of how the transaction arose, including details of the UK or EU authorized credit institution's branch sort code number and the account number from which the cheque or payment is drawn (Guidance Note 4.66).

For the purpose of Regulation 8 and FSA Rule 3.2.4(1), to avoid criminal money being laundered by a customer for a third party, a cheque, draft, or electronic payment drawn on a bank or building society may only be relied upon without further verification of identity where there is no apparent inconsistency between the name in which the application is made and the name on the payment instrument. Payments from joint accounts are considered acceptable for this purpose. The overriding requirement is that the name of the account holder from where the funds have been provided is clearly indicated for any payment received (Guidance Note 4.63).

(b) Third parties that verify identity or introduce business

In some circumstances, it is reasonable for financial firms to rely on another regulated firm either to:

- undertake the identification procedures when introducing a customer and to obtain any additional KYC information from the client; or
- to confirm the identification details if the customer is not resident in the UK; or
- to confirm that verification of identity has been undertaken if an agent is acting for underlying principals (Guidance Note 4.191).

Where an intermediary introduces a customer and then withdraws from the ensuing relationship completely, the underlying customer is the applicant for business and must be identified in line with the requirements for personal, corporate or business customers. The introducing firm or person in respect of each business applicant should therefore complete a relevant introduction certification. To ensure that product providers can meet their obligations that satisfactory identification evidence has been obtained and will be retained for the necessary statutory period, each introduction certificate must either be accompanied by certified copies of the identification evidence that has been obtained or by sufficient details/reference numbers that will permit the actual evidence obtained to be re-obtained at a later stage (Guidance Note 4.192).

For written applications from authorized UK or EU financial intermediaries, unless other arrangements have been agreed that the product provider will verify identity itself, a financial intermediary must provide with each application a customer introduction certificate together with certified copies of the evidence of identity, or the relevant reference numbers, which should be placed on the customer's file (Guidance Note 4.194).

In case of non-written applications from intermediaries, that is through the phone or e-mail, where the postal concession is not available, the intermediary should be asked for specific confirmation that the identity of the client has been identified. A record must be kept of the answers provided by the intermediary and retained for the relevant period (Guidance Note 4.197)

If a customer is introduced by one branch of a financial sector group to another, his identity does not have to be re-verified or records duplicated, provided that:

- the identity of the customer has been verified by the introducing parent company, branch, subsidiary or associate in line with requirements;
- no exemptions or concessions have been applied in the original verification procedures that would not be available to the new relationship;
- a group introduction certificate is obtained and placed with the customer's account penning records and
- where it concerns non-UK or EU introducers, arrangements are in place that ensure that the identity is verified in accordance with all relevant UK requirements and that the underlying records of identity in respect of introduced customers are retained for the necessary period (Guidance Note 4.200).

(c) Exemptions from identification requirements

Where a firm had an existing customer at 1 April 1994, identification evidence was not required to be obtained. Similarly, the transitional provisions for the FSA Rules provide that identity does not have to be re-established for those who are existing customers at the date of commencement of the *Money Laundering Sourcebook* (Guidance Note 4.228).

The 1993 Regulations and the FSA Rules provide for the following main exemption from the requirements of identification, that stem from the European Money Laundering Directive:

1. where the applicant is a UK or EU credit or financial institution
2. for one-off (single or linked) transactions under €15 000
3. for the introduction of one-off transactions from overseas
4. for small life insurance contracts and long term insurance business policies with respect to occupational pension schemes.

It must be noted that all the exemptions are subject to the overriding condition that there be no knowledge or suspicion of money laundering on the part of the firm or its employees (Regulation 10 and FSA Rule 3.2.1(1)).

Identification procedures must however be undertaken for linked transactions that, taken together, exceed the €15 000 exemption limit, that is in cases of two or more one-off transactions when it appears at the outset that the transactions are linked and the aggregated amount of these transactions will amount to more than €15 000, or when it comes to the attention of an employee handling the transaction at any later stage that the transactions are linked and the €15 000 limit has been reached (Guidance Notes 4.235–4.240).

When an applicant who is undertaking a one-off transaction is introduced by another regulated person or firm that is subject to anti-money laundering legislation within the UK, EU or a country with legislation at least equivalent to that required by the European Money Laundering Directives, particularly with respect of verification of identity and record keeping, the UK firm does not have to verify identity, even if the transaction exceeds €15 000, so long as the introducer has given the UK firm a written assurance that in all such cases, evidence of identity has been taken and properly recorded (Regulation 10(c) and FSA Rule 3.2.2 and Guidance Note 4.247).

According to Regulation 10(1)(f) and FSA Rule 3.2.2, identification procedures may be waived for long term insurance business in respect of which a premium is payable in one instalment of an amount not exceeding €2500 or a regular premium is payable and where the total payable in respect of any one calendar year does not exceed €1000.

Regulation 10(1)(e) and FSA Rule 3.2.2(5) stipulate that no identification is necessary in relation to insurance business consisting of a policy of insurance in connection with a pension scheme taken out by virtue of a person's contract of employment or occupation where the policy contains no surrender clause and may not be used as security for a loan.

b Customer due diligence (CDD): requirement to collect appropriate Know Your Customer information

a Regular Due Diligence Standard

The second main requirement of the Know Your Customer (KYC) rules is that the financial firms must collect sufficient information on the nature of the business that the customer is expected to undertake, so as to establish information of that customer's expected or predictable 'pattern of transactions'. A *risk-based approach* is to be used to determine the additional information that will be required for the financial firm for this purpose (Guidance Note 4.9).

Information collected at the beginning of the business relationship for these purposes might include:

- the purpose or reason for opening the account or entering into the particular business relationship with the relevant financial firm;
- the anticipated level and nature of the activity that can be expected and
- the expected origin of funds used in the business relationship.

Especially for more complex financial products such as private banking accounts, investment banking and fund management arrangements, corporate accounts and the like, the purpose and expected level of use may not be immediately apparent and may therefore require additional documentation or information.

1 Documentation

Details of employment may be sought for the opening of a bank current account, the sources of wealth may have to be documented when opening certain types of business relationship, especially in the area of private banking (Guidance Note 4.10).

After the opening of the account/establishment of the initial business relationship, the financial firm is required to take reasonable steps to keep its information on the nature of the relationship up to date, in the context of regular business. Up-date information flowing from meetings with the customer or any other communication should therefore be filed appropriately, allowing immediate access of that information to the Money Laundering Reporting Officer (MLRO) or his staff, or the relevant supervisor (Guidance Note 4.11).

2 Keeping a record of the client's identity

Whenever a client's identity is verified, the bank must keep a record of the evidence that was used. Money Laundering Regulation 12 (1993) states that this evidence must be kept for five years from the date when the relationship with the customer in question ends. Records are also necessary of all transactions comprising relevant financial business, regardless of whether the identity of the client had to be verified. Details such as: name and address of clients and counter parties; the numbers of bank accounts from which and into which payments are made and details relating to the custody of investment should be kept by banks, again for a period of at least five years after the end of the relevant transaction.

There are no formal requirements for the way in which records ought to be kept, as long as records can be retrieved without delay when needed.

The FSA *Money Laundering Sourcebook* (MLS) further stipulates that records must be kept of reasons for any decision to treat a client as financially

excluded; of those steps taken to recover debts from insolvent clients; of all actions taken in relation to internal and external reports; and of all information presented to the firm's MLRO as a suspicion in those cases where the MLRO has not passed on the information to NCIS.

3 Increased diligence in special cases

FSA Rule 5.1.2 requires that relevant firms must take reasonable steps to ensure that they obtain and make proper use of any UK government or Financial Action Task Force (FATF) findings on countries with inadequacies concerning their approach to money laundering.

'Proper use' means: applying the information in respect of introduced businesses (either for isolated transactions or business relationships); applying the information whenever first obtained to know your business information; disseminating the information to relevant staff as part of the requirements for awareness and training.

The FSA publishes findings on its website. All firms ought to check this information regularly to comply with the requirements.

Appendix D of the Money Laundering Guidance Notes lists countries with inadequate anti-money laundering strategies. Firms doing business with individuals and firms from locations with inadequate strategies must be aware of the specific background and the government or FATF recommendations with respect to doing business with that jurisdiction. Those circumstances must be taken into account when business is introduced, or transactions occur. However, the Money Laundering Reporting Officer (MLRO) is not required to report all transactions from such countries to NCIS when there is no suspicion. When the purpose of the transaction is unclear, a suspicion report should be filed.

4 Terrorist financing

There are two elements to the UK's anti-terrorist financing laws: the freezing of terrorist assets and the development of international standards.

5 Freezing of terrorist assets

The international framework for doing this is founded largely on UN Security Council Resolutions 1267 (Taliban), 1333 (Osama bin Laden), 1373 (Terrorism) and 1390 (Taliban/UBL), as well as the International Convention for the Suppression of the Financing of Terrorism. Acting under the Terrorism (UN Measures) Order 2001 and the Al-Qa'ida and Taliban (UN Measures) Order 2002, the UK has frozen the assets of over 100 organizations and over 200 individuals. A complete list of all those listed is available at the Bank of England website.

7 Developing international standards for combating terrorist financing
This includes the FATF's eight Special Recommendations on Terrorist Financing, which the UK has yet to implement in full. The UK meets most Special Recommendations already and after the passage of new regulations dealing with wire transfers by money remitters will fully meet all the Special Recommendations.

8 Terrorism Act 2000
The Terrorism Act 2000 consolidates the previously piecemeal offences under former legislation. Section 18 stipulates that a person commits an offence if he enters into or becomes concerned in an arrangement which facilitates the retention or control by or on behalf of another person of terrorist property: (a) by concealment, (b) by removal from the jurisdiction, (c) by transfer to nominees, or (d) in any other way. Terrorism is defined to include those that threaten or use violence (whether in the UK or abroad) or serious damage to influence government for political or religious reasons. Second, an arrangement that facilitates the retention or control of terrorist property. This is a strict liability offence, which means the prosecution does not have to prove any mental state of mind on the part of the Defendant. Defences include proving that there were no reasonable grounds to cause the Defendant to suspect, or makes a disclosure.

Other offences proscribe the use and possession of terrorist property or the entering into funding arrangements for terrorist property. These offences include a mental element.

The Terrorism Act also creates a failure to disclose offence. It is confined to subjective belief or suspicion that an offence has been committed which was acquired during the course of a trade, profession, business or employment. The Terrorism Act also creates a tipping off offence.

From time to time firms may be asked to provide information in respect of a terrorist investigation under Schedule 1 of the Terrorism Act 2000. Information sought may include: whether a business relationship exists or has existed between the firm and a customer; the full name, date of birth, address or former address, evidence of identity and starting date of the business relationship. There are serious penalties for non-compliance with such requests, although a firm can defend themselves if they can prove that the information requested was not in their possession or that it would not be reasonable to comply with the request.

The Terrorism Act 2000 states that in the case of terrorist funding it is a criminal offence for any person who acquires knowledge or a suspicion of money laundering in the course of their trade, profession, business or employment not to report that knowledge or suspicion as soon as reasonably practical after the information came to that person's attention. Failure to report to the

proper authorities in these circumstances is punishable on conviction by a maximum of five years imprisonment or a fine or both, in addition to possibly giving rise to the offence of money laundering which carries a penalty of fourteen years imprisonment.

(a) Test of disclosure

The Anti-Terrorism Crime and Security Act 2001 strengthens the test of disclosure in respect of terrorist funding from 'subjective' to 'objective' by making it an offence not to make such a report wherever information received in the course of business in the regulated sector provides 'reasonable grounds' to suspect terrorist funding. In recognition of this stronger test, the court will be asked to consider if a defendant has followed relevant guidelines approved by HM Treasury (Guidance Note 2.6). The Treasury has drafted a *Guidance on Terrorist Financing*, which is included in the most recent version of the JSMLG Guidance Notes. In particular, a 'terrorist financing typology' has been added to an appendix, containing help for banks while making their prudential determinations.

c Notification of unusual/suspicious activities

a Legal Requirements: Definition of Notification Case (Unusual or Suspicious Monitoring System)

Staff of financial firms have the statutory and regulatory obligation to report information or other matters that come to their attention in the course of their business activities to the proper authorities when that information, in their opinion, amounts to knowledge or suspicion of money laundering. Under the Proceeds of Crime Act 2002, a new offence has been introduced: not only failing to disclose knowledge or suspicion is punishable, but also failing to disclose when there are *reasonable grounds* for knowledge or suspicion.

1 Definitions

'Knowledge' has been defined by the courts in *Baden Delveaux* vs *Société General* [1992] 4 All ER 161 to include the following:

- actual knowledge
- wilfully shutting one's mind to the obvious
- wilfully and recklessly failing to make such enquiries as a reasonable and honest person would make
- knowledge of circumstances that would indicate facts to an honest and reasonable person

- knowledge of circumstances that would put an honest and reasonable person on enquiry.

'Suspicion' is a personal and subjective concept that falls far short of proof based on firm evidence. It has been defined by the courts as being beyond mere speculation and based on some foundation, that is 'a degree of satisfaction not necessarily amounting to belief at least extending beyond speculation as to whether an event has occurred or not' and 'although the creation of suspicion requires a lesser factual basis than the creation of a belief, it must nonetheless be built upon some foundation' (Guidance Note 5.5).

Someone who thinks that a transaction is suspicious, therefore, does not have to know the exact nature of the criminal funds, or that the funds were definitely arising from the crime (Guidance Note 5.6).

The new *reasonable grounds* offence introduces an objective test of suspicion instead of the previous subjective one. It will likely be defined in similar terms to the *Baden* principles defining knowledge.

In order to satisfy the objective test, staff within regulated firms will likely need to be able to demonstrate that they took all reasonable steps in the particular circumstances to know the customer and the rationale for the sought transaction or instruction (Guidance Note 5.9).

b Guideline Concepts to Identify Suspicious Cases

Guideline 5.7 suggests that firms adopt a risk-based approach to develop systems to identify suspicious cases as some products and services are more vulnerable to misuse than others. According to Guideline 5.8, wherever there is a business relationship, a suspicious transaction will often be one that is inconsistent with a customer's known, legitimate activities or with the normal business with that type of account. 'Know your customer' is thus key for firms to be able to meet their obligations to report suspicious transactions. The Guidelines suggest staff keep the following questions in mind to determine if any given transaction is suspicious:

- Is the size of the transaction consistent with the normal activities of the customer?
- Is the transaction rational in the context of the customer's business or personal activities?
- Has the pattern of transactions conducted by the customer changed?
- Where the transaction is international in nature, does the customer have any obvious reason for conducting business with the other country involved? (Guidance Note 5.9)

Moreover, Appendix B of the Guidance Notes contains detailed 'Money laundering typologies and cases', based on FATF typologies and cases, that might be of use for staff in determining possible cases of money laundering.

c Notification Procedure

Money Laundering Regulations 1993, Reg. 14 requires every firm to designate someone in the firm to whom a report must be made whenever knowledge or suspicion of money laundering is formed. This person, the Money Laundering Reporting Officer (MLRO), must then determine whether the information rightfully gives rise to the suspicion or knowledge of money laundering. He must have access to information that may be of assistance in determining if this is the case. His responsibilities should include: receiving internal reports; taking reasonable steps to access any relevant know your business information; making external reports to NCIS; obtaining and using national and international findings; and making annual reports to the firm's management.

According to the FSA, the MLRO must be a senior officer of the firm and must be free to act on his own accord.[71] Firms also have the obligation to provide sufficient resources to the MLRO, including sufficient time and (if necessary) support staff (ML 7.1.7R). The MLRO can be appointed for one firm, or form a group of firms. He must be based in the UK (ML 7.1.10). The MLRO may delegate duties, depending on the size and structure of the firm (or group), but he has to ensure that all MLRO functions are complied with. The MLRO must in turn pass on issue to NCIS as he thinks appropriate. He is expected to liaise with NCIS on any question related to whether to proceed with a transaction in the circumstances (ML 7.1.1). Where convenient, the firm can decide to give the MLRO also the functions of the 'appropriate person' mentioned in the Money Laundering Regulations 1993. 'The appropriate person' is appointed to handle the internal and external reporting required under the 1993 Regulations (ML 7.1.4). The firm must ensure that its MLRO is able to monitor the day-to-day operation of its anti-money laundering policies and respond promptly to any reasonable request for information made by the FSA (ML 7.1.9).

FSA Evidential Provision 4.3.1 states that to take reasonable steps the firm should:

- require that the MLRO considers a report in the light of all relevant information accessible to, or reasonably obtainable by, the MLRO;
- permit the MLRO to have access to any information, including know your business information, in the firm's possession that could be relevant and
- ensure that where the MLRO or his duly authorized delegate suspect

that a person is engaged in money laundering a report is made by the MLRO or his deputy and is not subject to consent or approval of anyone else in the firm.

In filing a report to NCIS, a standard form must be used, as provided in Appendix H of the Guidance Notes. NCIS will acknowledge receipt of disclosure and written consent will be given by NCIS to continue with the business relationship/transaction. This consent letter gives the reporting firm a defence against possible later accusations of assisting in the laundering of the proceeds of crime.

d Subject of Obligation (Manager or Bank Clerk)

FSA Rule 4.1.2 requires that any member of staff of a firm who handles, or is managerially responsible for, handling transactions that may involve money laundering makes a report promptly to the MLRO if he knows or suspects that a client or the person on whose behalf the client is acting is engaged in money laundering. The firm must also have arrangements in place to discipline any member of staff who fails, without reasonable excuse, to make a required report of this sort.

A firm may, of course, want to set up internal systems that allow its staff to consult with their line manager before sending a report to the MLRO. However, where a firm sets up such a system it must ensure that the system will not be used to prevent reports reaching the MLRO in the appropriate case. All financial firms therefore have the obligation to ensure that all relevant employees are familiar with the person to whom they ought to report suspicions; that there be a clear reporting chain between line managers and the MLRO, when the firm sets up internal systems; and that disciplinary actions are imposed on staff for failing to meet their requirements to report to their line manager/MLRO (Guidance Note 5.22).

e Sanctions for Failing to Notify

Failing to disclose knowledge of money laundering is a criminal offence. Under the Proceeds of Crime Act 2002, any person within the financial sector (anyone who falls within the scope of the Money Laundering Regulations) who fails to report their knowledge, suspicion or reasonable grounds for knowing or suspecting that another person is laundering the proceeds of any criminal conduct as soon as is reasonably practical after the information came to his attention in the course of his business, is punishable for committing the offence of failing to report. This offence is punishable on conviction by a maximum of five years imprisonment, or a fine, or both and may also give rise

to the offence of money laundering, which carries a maximum penalty of 14 years.

The requirement to report *includes* cases where a business or transaction was turned away or was not proceeded with because the circumstances were suspicious (Guidance Note 2.9).

An employee of a regulated firm meets his statutory obligation by reporting his suspicion to the MLRO in accordance with established internal procedures (Reg. 14, Guidance Note 5.20).

1 Training

It is a defence for a financial sector employee who is charged with a failure to report offence that he had not received the proper training, which is required to be given under the Regulations. The defence is not available if the employee would have had reasonable grounds to suspect that money laundering was taking place even in the absence of training.

The MLRO (or his duly authorized delegate) must act honestly and reasonably and to make his determinations of whether to send on a Suspicious Activity Report to NCIS or not in good faith. If the MLRO decides, in good faith, not to pass on any suspicions report, there will be no liability for non-reporting if the judgement is later found to have been wrong (Guidance Note 5.35).

However, FSA Rule 4.3.2 and FSA Evidential Provision 4.3.3(1)c makes clear that the decision whether to report or not must not be subject to the consent or approval of any person other than the MLRO or an approved deputy on the MLRO's behalf.

f Obligations to Freeze

Obligations to freeze funds take the form of a restraint order, to be made *ex parte* to a judge in chambers. The regime has been drastically changed by the Proceeds of Crime Act 2002. Under the old regime, the only person who could ask for a restraint order was the prosecutor and the restraint order could only be applied for when the defendant was to be charged. This is relatively late in the process, especially compared to European systems.

Under the new regime, the class of people who can apply for restraint orders is widened and the moment at which they can do so is sooner, that is at the start of an investigation rather than the commencement of criminal proceedings. The class of those who can apply for a restraint order is widened to include accredited financial investigators (s. 42(2)), although they must always seek permission from a senior police officer (s. 68). In s. 3 of the Proceeds of Crime Act 2002, the Director of the Assets Recovery Agency is given the task of establishing a system of accreditation. The Secretary of State

was given an order-making power in s. 453 to prescribe the types of investigators who may receive accreditation for these purposes in order to build in some safeguards to prevent frivolous requests for freezings.[72] The Home Office has limited accreditation to those with a role in law enforcement, so that for example, members of the Benefit Agency or local authorities may be accredited, but private investigators may not be.

The Director of the Assets Recovery Agency will also *ex officio* have the power to request a restraint order.

A restraint order may include exceptions, as stipulated in s. 42(3) of the new Act, in particular to provide for living expenses, reasonable legal expenses, to carry on trade or business, or to pay off debts.

Standing UK law enables a restraint or freezing order to be obtained on behalf of another country in our High Court only where that country has been designated by subsidiary legislation. Normally, a country will be designated for assistance in relation to drug assets when it ratifies the 1988 UN (Vienna) Drugs Convention; or for assistance in relation to the proceeds of all crimes when it ratifies the 1990 Council of Europe (Strasbourg) Convention or when a bilateral confiscation agreement with the UK is in place.

In *Governor and Company of the Bank of Scotland* vs *A Ltd, B & C* [2001] 1 WLR 751, a freezing order was made which was to be kept secret, even from the customer and which omitted the normal safeguards to the customer (for example, an order should include a cross-undertaking in damages, a right to apply for discharge on short notice and a return date for an *inter partes* review). On appeal, this freezing order was found unjustifiable and described as ‘a most unfair and unwarranted development . . . beyond the legitimate use of a court’s power’ ([2000] Lloyd’s Rep. Bank 271 at 282) – the freezing order was discharged as a matter of principle.

NOTES

1. Oxford Analytica Ltd. Members of the team are: Sara Fyson, Consultancy and Research Project Manager; Leonardo Raznovich, Researcher; Michiel Visser, Researcher; Paul Clement, Oxford Analytica Contributor; Daniel Nino Tarazona, Oxford Analytica Contributor, Dr Kern Alexander, Oxford Analytica Contributor.
2. Nicola Padfield is a Senior Lecturer at the Institute of Criminology, University of Cambridge and co-author of a Guide to the Proceeds of Crime Act 2002 (with Biggs, S. and Farrell, S.), Butterworths. This chapter is largely as submitted by Oxford Analytica: the up-dates have concentrated on the implementation of the Proceeds of Crime Act 2002.
3. *UK 2002 Yearbook*, Office for National Statistics, London.
4. National Association of Pension Funds.
5. Bank for International Settlements survey.
6. For a discussion of the pre-1980 regulation of UK financial services see Michael Taylor, Ch. 1, Blackstone’s Guide to the Financial Services Act 2000, Blair *et al*. 2001.
7. s.4 (3) Banking Act 1946.
8. s.6 (1) Financial Services and Markets Act 2000.

9. s.27 (1) Misuse of Drugs Act 1971.
10. Drug Trafficking Offences Act 1986.
11. The PTA 1989 has been repealed and replaced by the Terrorism Act 2000.
12. As amended by the Criminal Justice Act 1993.
13. Directive 91/308, OJ 1991 L166/77.
14. Directive 2001/97, OJ 2001 L344/76.
15. SI 1993/1933.
16. SI 2001/3641.
17. Proceeds of Crime Act 2002 (Commencement No. 1 and Savings) Order SI 2002 No. 3055; Proceeds of Crime Act 2002 (Commencement No. 1) Order SI 2002 No. 3015; Proceeds of Crime Act 2002 (Commencement No. 2) Order SI 2002 No. 3055; Proceeds of Crime Act 2002 (Commencement No 3) Order SI 2002 No. 3145; Proceeds of Crime Act 2002 (Commencement No 4, Transitional Provisions and Savings) Order SI 2003 No. 120; Proceeds of Crime Act 2002 (Commencement No. 5, Transitional Provisions and Savings) Order SI 2003 No. 333; Proceeds of Crime Act 2002 (Commencement No 5) (Amendment of Transitional Provisions) Order SI 2003 No. 531.
18. Statement on the Prevention of the Criminal use of the Banking System for the Purpose of Money Laundering, December 1988.
19. *Money Laundering Sourcebook* 5.1
20. For details see Suspicious Activity Reports below.
21. In comparison, Australian rates of disclosure are some four and a half times that of the UK: Para. 9.16 of PIU Report.
22. This was illustrated in the Abacha case in 2001, involving the handling by UK banks of accounts linked to General Sani Abacha, former President of Nigeria. An investigation revealed that 15 of the 23 UK banks involved had ‘significant control weaknesses’ in their anti-money laundering controls, including weaknesses in verifying the identity of the beneficial owners of companies, an over reliance on introductions from existing customers and inadequate Know Your Customer (KYC), see ‘FSA publishes results of money laundering investigation’, FSA press release, 8 March 2001.
23. See for example s.331(7).
24. See www.fsa.gov.uk.
25. Interview with the representative of the Financial Services Authority, August 2002.
26. Interview with representative from the National Criminal Intelligence Service (Economic Crime Unit), August 2002. But now see the KPMG review of the regime for handling SARs, which was laid before Parliament and published on 1 July 2003. According to the Director of Economic Crime for NCIS, there has been a three-fold surge in reporting since 11 September 2001 and the KPMG report will lead to targeting of SARs on the basis of quality, timeliness and stated law enforcement needs (see NCIS press release of 1 July 2003).
27. See NCIS website for more details.
28. See endnote 20.
29. See Statutory Instrument 2003, No. 120.
30. See *R* vs *Macmaster* [1999] 1 Cr App Rep 402 where it was held that the offence does not require the purpose for which the facilitation took place to be proved.
31. *C* vs *S* (Money Laundering: *Discovery of Documents*) (Practice Direction) [1999] 1 WLR 1551, the Court of Appeal gave guidance on dealing with problems arising from the offence of tipping off contained in the money laundering provisions of the Criminal Justice Act 1988.
32. See *Bank of Scotland* vs *A Ltd, B & C* [2001], the Lord Chief Justice, Lord Woolf, gave some guidance in order to tackle this dilemma. Lord Woolf held that the proceedings for directions would serve the purpose of a protective umbrella over a conscientious bank.
33. Section 340(2) PCA 2002.
34. Section 335(5) of the PCA 2002.
35. Section 335(6) of the PCA 2002.
36. Regarding the defences available under Part 7 of the new Act in relation to the offences of (1) concealing (2) arrangements and (3) acquisition, use and possession, no offence is committed in case of disclosure as indicated above, if (1) an authorized disclosure is made

– that is disclosure to a constable, customs officer, or a nominated officer, appointed by the alleged offender's employer where the disclosure is made in the course of employment – either before the prohibited act is committed but where there was good reason not to have made the disclosure previously and the disclosure, when made, is made on the alleged offender's own initiative and is made as soon as practicable; (2) The person intended to make an authorized disclosure but had reasonable excuse for not doing so; or (3) The act is done in carrying out an enforcement function relating to any enactment relating to criminal conduct or benefit from criminal conduct.

37. See s. 329(2)c of the PCA 2002.
38. See s. 329(3)c of the PCA 2002.
39. See s. 330(7) of the PCA 2002. The Proceeds of Crime Act 2002 (Failure to Disclose Money Laundering: Specified Training) Order, S.I. 2003 No 171, which came into force with the offences on 24 February 2003, provides that the training specified for the purposes of s. 330 is the training required under Reg. 5(1)c of the Money Laundering Regulations 1993 (S.I. 1993, No. 1933).
40. See s. 333(2) of the PCA 2002.
41. NCIS press release of 1 July 2003.
42. Para. 9.30 of PIU Report.
43. Para. 9.16 of PIU Report.
44. Interview with former representative of the British Bankers Association, August 2002.
45. Interview with representative of the National Criminal Intelligence Service, August 2002.
46. See W. Holdsworth, *History of English Law*, pp. 68–71 (3rd edn. 1927); F. Pollock and F. Maitland, *History of English Law*, p. 351 (2nd edn. 1909).
47. Escheatment is the process of turning over unclaimed or abandoned property to a state authority, such as if a person dies without a will.
48. *Profits of Crime and their Recovery*: the Report of a Committee Chaired by Sir Derek Hodgson, 1984, Cambridge Studies in Criminology.
49. Home Office Working Group on Confiscation Third Report: *Criminal Assets*: November 1998, p. 27.
50. See amendments to the Civil Procedure Rules.
51. See S.I. 2003, No. 968
52. In the case of decisions not to assess the proceeds of crime or where there is no benefit, review can only occur in the light of new evidence or evidence which was not considered at the time. In the case of a review of the value of the benefit, there is no such restriction.
53. See S.I. 2002, No. 3115; S.I. 2002, No. 3016.
54. See Mitchell and Talbot on *Confiscation and the Proceeds of Crime*, 1997 2nd edn., p. 58.
55. The *Mareva* injunction is a special form of injunction preventing a party from disposing of assets or removing them from the jurisdiction and it is granted if the Plaintiff can show that (1) The assets of the defendant are within the jurisdiction and (2) there is a real risk that the defendant will remove the assets from the jurisdiction and that any order the Plaintiff might obtain for damages will remain unsatisfied.
56. This refers to M. Levi and L. Osofsky's work on *Investigating, Seizing and Confiscating the Proceeds of Crime*, Home Office Police Research Group Crime Detection and Prevention Series Paper 61, 1995.
57. See Savla, *Money Laundering and Financial Intermediaries*, 2001, p. 25.
58. Drug Cash Trafficking Strategic Threat Assessment, HM Customs & Excise.
59. For the relevance of Treaty provisions to the exercise of the Secretary of State's discretion under the 1990 Act, cf. *R* vs *Secretary of State ex parte Fininvest SpA*.
60. The European level agreements being implemented are: (1) The Schengen Convention 1990, The Convention on Simplified Extradition Procedure between member states of the EU (1995). (2) The Convention relating to Extradition between the Member States of the EU (1996). (3) The Convention on Driving Disqualifications (1988). (4) Convention on Mutual Assistance in Criminal Matters between the Member States of the EU (2000) = MLAC. (5) Council Framework Decision on Combating Fraud and Counterfeiting of non-cash means of Payment (2001). (6) Protocol to the Convention on Mutual Assistance in Criminal Matters between the Member States of the EU (2001). (7) Council Framework Decision on

Combating Terrorism (2002). (8) Draft Council Framework Decision on the Execution of Orders Freezing Assets or Evidence.

61. Seeking Assistance in Criminal Matters from the UK. Guidelines for judicial and prosecuting authorities (2nd edn.), Judicial Co-operation Unit, Organized Crime and International Crime Directorate, Home Office, October 1999.
62. (1984) XXIII I.L.M. 511, discussed in Sandeep Savla, *Money Laundering and Financial Intermediaries*, Kluwer, 2001, pp. 157–8.
63. Interview with representative of Home Office, August 2002.
64. Interview with representative of the Home Office, August 2002.
65. See also the task force to streamline and modernize the system for reporting suspected financial activity announced on 1 July 2002 (see NCIS press release).
66. Introduced under s.2(2) European Communities Act 1972.
67. Section 402 FSMA 2000.
68. Regulation 5(3).
69. 3.1.4 of FSA's Money Laundering Rules explicitly states that the Rules are not guidance for the purpose of the Money Laundering Regulations.
70. See http://www.newsroom.barclays.co.uk/news/data/734.html
71. Interview with representative of the Financial Services Authority, August 2002.
72. See now S.I. 2003, No. 172: An accredited financial investigator who is: (a) a constable of a police force in England and Wales; (b) a member of staff of a police force in England and Wales; (c) a customs officer; (d) a member of staff of the Financial Services Authority; (e) a member of staff of the Inland Revenue; (f) a member of staff of the Medicines and Healthcare Products Regulatory Agency; (g) a member of staff of the Department for Work and Pensions; (h) a member of staff of the Investigation Branch of the Department for Environment, Food and Rural Affairs; (i) a member of staff of the Rural Payments Agency; or (j) a member of staff of the Department of Trade and Industry.

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Proceeds of Crime Act 2002 (Commencement No. 2) Order SI 2002, No. 3055.
Proceeds of Crime Act 2002 (Commencement No. 3) Order SI 2002, No. 3145.
Proceeds of Crime Act 2002 (Commencement No. 4, Transitional Provisions and Savings) Order SI 2003, No. 120.
Proceeds of Crime Act 2002 (Commencement No. 5, Transitional Provisions, Savings and Amendment) Order SI 2003, No. 333.
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Proceeds of Crime Act 2002 (Appeals under Part 4) Order SI 2003, No. 458.
Proceeds of Crime Act 2002 (Application of Police and Criminal Evidence Act 1984 and Police and Criminal Evidence (Northern Ireland) Order 1989) Order SI 2003, No. 174.
Proceeds of Crime Act 2002 (Cash Searches: Code of Practice) Order SI 2002 No. 3115.
Proceeds of Crime Act 2002 (Crown Servants) Order SI 2003, No. 173.
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Proceeds of Crime Act 2002 (Failure to disclose money laundering: specified training) Order SI 2003, No. 171

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Criminal Law Act 1977.
Customs and Excise Management Act 1979.
Crime and Disorder Act 1998.
Proceeds of Crime (Scotland) Act 1995.
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INTERNATIONAL INSTRUMENTS

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2nd European Money Laundering Directive 2001/97 OJ 2001 L344/76.
European Convention on Mutual Assistance in Criminal Matters 1957.
European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime 1990.
19988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention).
Commonwealth Scheme Relating to Mutual Assistance in Criminal Matters ('Harare scheme').

7. Country Report: The US anti-money laundering system

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I OVERVIEW OF THE US ANTI-MONEY LAUNDERING SYSTEM

A Development and Philosophy of the US Supervisory System for Financial Institutions and Anti-Money Laundering

The US anti-money laundering regime is based primarily on two statutory schemes: (1) the Money Laundering Control Act (MLCA), a penal statute (codified at 18 USC. §§1956 and 1957); and (2) the Bank Secrecy Act (BSA), a regulatory statute (codified at 31 USC. §5311 *et seq*.). Both laws have been amended most recently in October 2001 by the International Money Laundering Control and Abatement Act of 2001, adopted as Title III of the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism (US PATRIOT) Act of 2001, Pub L. No. 107–56 (2001) (hereinafter the 'PATRIOT Act').

Initially, the BSA, while defining the universe of 'financial institutions' broadly (see s. 3.21 *infra*), was implemented with respect to a more limited scope of depository and other financial institutions and required only that covered institutions keep accurate records of financial transactions and report certain domestic and foreign transactions involving currency exceeding certain threshold amounts. Even these modest requirements were challenged by banks on privacy grounds, but were twice upheld by the US Supreme Court in the 1970s (see *Cal. Bankers Ass'n* vs *Shultz*, 416 US 21 (1974); *USA* vs *Miller*, 425 US 435 (1976).

As part of the Reagan Administration's 'War on Drugs', money laundering was made a federal criminal offense in 1986 and the BSA was amended to

criminalize 'structuring' of transactions to avoid BSA reporting. The Financial Crimes Enforcement Network of the US Treasury Department (FinCEN), which functions as the US Financial Intelligence Unit (FIU) was founded in 1990 to support US law enforcement anti-money laundering efforts. The Annunzio-Wylie Money Laundering Act of 1992 amended the BSA to add a suspicious activity reporting requirement to the anti-money laundering arsenal and to require certain financial institutions to implement anti-money laundering-focused BSA compliance programs. Annunzio-Wylie also criminalized the operation of an illegal money transfer business and mandated that the appropriate authorities re-examine federally chartered or insured financial institutions convicted of involvement in money laundering.

The Money Laundering Suppression Act of 1994 further expanded federal anti-bank secrecy laws to include state and tribal casinos and other gaming establishments and streamlined currency transaction reporting and record-keeping requirements for wire transfers. Casinos were initially subject only to currency transaction reporting and compliance program requirements, resisting Treasury's initial attempt in 1997 to impose suspicious activity reporting on them. Additional types of gaming establishments, such as 'card clubs', were subjected to BSA requirements in 1998.

The late 1990s also saw streamlining of the suspicious activity reporting system, including the centralization of reporting to FinCEN. At the same time, the Treasury Department further expanded the implementation of the BSA to non-bank financial institutions not subject to a federal supervisory authority, such as check cashing services, traveler's check businesses and currency exchange firms, imposing currency transaction reporting requirements on them in 1997 and requiring registration with the Treasury Department.

By 2001, the USA had an anti-money laundering system in place that was primarily based on self-regulation by financial institutions, with compliance being monitored by the Treasury Department and several other Federal and state supervisory agencies.[3] Money laundering law enforcement efforts were focused primarily on narcotics trafficking and organized crime, with co-ordination diffused throughout federal and local law enforcement agencies. Efforts in the late 1990s to increase mandatory regulations, such as 'Know Your Customer' standards, had met with fierce industry opposition, particularly from smaller businesses, preventing their implementation.

A significant, although perhaps not fundamental, change in the US government's anti-money laundering strategy came in response to the terrorist attacks on the USA on September 11th 2001. Soon after the attacks, it was discovered that the hijackers had made extensive use of the US financial system to fund their activities in the USA. Congress responded with the passage of the PATRIOT Act on 26 October 2001, which included substantial revisions to both the BSA and criminal money laundering statutes, as well as to forfeiture

laws. The PATRIOT Act requires Treasury to expand the application of the BSA's reporting, record-keeping and compliance program requirements to cover additional types of financial institutions, including securities brokers and dealers, insurance companies, mutual funds and informal money transfer businesses, in order to regulate and restrict certain 'high-risk' banking and depository relationships. To that end, the PATRIOT Act also imposes on financial institutions certain mandatory procedures relating to customer identification and the establishment of accounts. The Treasury Department and other relevant agencies have issued numerous regulations in the year following the passage of the PATRIOT Act, substantially modifying the BSA regulatory scheme by expanding reporting, customer identification and compliance program requirements for most covered financial institutions, although many regulations are still in proposed or interim form at the time of this writing. The PATRIOT Act expands the reach of US law enforcement over money laundering crimes and continues the trend of extending the risk of violation of anti-money laundering laws beyond their original focus on criminal enterprises and further into the realm of legitimate business activity.

B Hot Topics in Financial Institution Regulation and the US Anti-Money Laundering System

Financial institution compliance with the PATRIOT Act has been the most prevalent issue in the USA since the Act's passage. Compliance with the Act's requirement that all financial institutions under the BSA have a written anti-money laundering compliance program in place has been a primary area of concern for many of the entities falling within the BSA's definition of financial institutions, but not previously subject to BSA regulatory requirements, such as securities broker-dealers and insurance companies. Similarly, the imposition of enhanced due diligence requirements for certain types of banking relationships, as well as the Act's prohibition on maintaining correspondent accounts for foreign shell banks, have led to a significant amount of discussion and re-engineering of financial institution compliance programs.

Suspicious activity reporting is now required for securities brokers and dealers, registered commodities traders and others. The Treasury is once again considering subjecting all casinos and gaming establishments to suspicious activity reporting requirements, a proposal that has encountered a certain degree of opposition, although less so to date than in 1998–1999. Overall, the trend toward a greater degree of government supervision and an increase in mandatory compliance measures has been met with grudging acceptance by the financial community. This is likely due to the connection of such measures to anti-terrorism initiatives adopted in response to the September 11th 2001 attacks – which targeted the US financial community

directly – and a greater willingness of the financial community to co-operate with law enforcement. Financial institutions must now weigh the risks of being branded as unco-operative in the 'War on Terror' against the costs of compliance and potential losses of international banking businesses arising from the unwillingness or inability of foreign financial institutions to comply with information requests from the US financial community required by the PATRIOT Act.

On the criminal side, as the scope of predicate offenses for money laundering offenses expands, businesses that are not financial institutions and consequently not subject to BSA requirements are beginning to consider whether the expanded risks of violations require them to expand their compliance programs to include anti-money laundering measures. Use of the money laundering statutes as tools to prosecute corporate financial fraud, as evidenced by the recent use of the money laundering laws to secure the first major plea in the Enron scandal, will likely accelerate this trend.

C Overview of the Current US Anti-money Laundering System

Federal criminal money laundering laws are enforced primarily by the Justice Department, both in Washington, DC and through local US Attorneys. The Criminal Division of the Justice Department has an Anti-Money Laundering and Asset Forfeiture Section dedicated to co-ordinating money laundering investigations and litigation. Money laundering allegations are investigated by both federal and local law enforcement agencies, including the Federal Bureau of Investigation, Drug Enforcement Administration, US Customs Service, the Criminal Investigative Division of the Internal Revenue Service, the Secret Service and many others. Due to the requirement that money laundering must involve the proceeds of an underlying criminal act, it is common for law enforcement to detect money laundering in the context of major crimes such as narcotics trafficking, racketeering, smuggling and tax evasion.

The BSA is, for the most part, not self-executing and requires implementing regulations to be issued by the Executive Branch. The Department of the Treasury is the primary administrative agency that issues BSA implementing regulations, which impose record-keeping, reporting, customer due diligence and compliance program requirements on certain US financial institutions, primarily depository institutions, brokers and dealers in securities and commodities, casinos, insurance companies and money services businesses. The main purpose of the BSA is to provide law enforcement with access to information directly from financial institutions about suspicious financial activity, customer identity and certain types of domestic and foreign transactions. Other supervisory agencies outside the Treasury Department, such as the Board of Governors of the Federal Reserve System and the Securities and

Exchange Commission, also issue BSA implementing regulations and monitor compliance through their examination functions.

FinCEN, the US FIU, is a bureau of the Treasury Department and has two primary functions: (1) to assist federal and local law enforcement in the detection and analysis of financial crimes and (2) to administer certain anti-money laundering provisions of the BSA.[4] While FinCEN has limited enforcement powers of its own, it plays a key role in co-ordinating between law enforcement and financial institutions. Self-regulatory organizations (SROs) and industry groups, including trade associations, also play an important role in promoting compliance. These include the New York Stock Exchange, the National Association of Securities Dealers, the American Bankers Association and others.

II CRIMINAL LAW

A Relevant Offenses

1 Money laundering offenses

The principal criminal anti-money laundering laws in the USA were enacted with the passage of the Money Laundering Control Act of 1986 (the 'Act') (see Pub. L. No. 99–570, 100 Stat. 3207–18, (1986) (codified at 18 USC. §§1956–1957). Originally designed to attack organized crime, these anti-money laundering laws, although complex and sometimes difficult to prove, have also provided the government with powerful weapons to dismantle complex financial frauds and to disrupt terrorist funding. For example, the US government was able to make significant progress in its criminal investigation of top Enron executives after former Enron employee Michael J. Kopper pled guilty in the summer of 2002 to conspiracy to commit money laundering under 18 USC. §1957, discussed *infra*. Charging Mr Kopper with money laundering gave the US government considerable leverage because the money laundering charge carried a maximum potential prison term of twice the amount allowed for the underlying predicate offense of wire fraud. Federal prosecutors also recently charged Enron's former chief financial officer Andrew S. Fastow, with, among other things, money laundering.

The Act holds criminally liable any individual who conducts a monetary transaction knowing, or with reason to know, that the funds involved were derived from specified unlawful activity. 18 USC.A. §§1956, 1957 (2000, Suppl. 2003); see generally Barrett Atwood and Molly McConville (1999). In general, the knowing engagement in a financial transaction involving the proceeds of a specified unlawful activity (SUA) (the term used to refer to predicate offenses), which promotes the criminal enterprise, violates the tax laws, disguises ownership, or avoids reporting requirements is a money laundering

offense under s. 1956. Section 1956 covers also the knowing and intentional transportation or transfer of monetary funds derived from specified unlawful activities. Section 1956 is subdivided into three subsections: subsec. 1956(a)(1), which deals with money laundering involving 'domestic financial transactions', subsec 1956(a)(2), which addresses 'international' money laundering; and subsec 1956(a)(3), which permits the use of government 'sting' operations to expose criminal activity. Sections 1956(a)(1) and (2) often overlap in their coverage of many types of transactions. Section 1957 prohibits the knowing engagement in transactions using or involving property derived from specific unlawful activities.

2 Texts

a Domestic money laundering: 18 USC. §1956(a)(1)

(a) (1) Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity:

(A) (i) with the intent to promote the carrying on of specified unlawful activity; or
(ii) with intent to engage in conduct constituting a violation of s. 7201 or 7206 of the Internal Revenue Code of 1986 [tax evasion] . . .; or
(B) knowing that the transaction is designed in whole or in part:
(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or
(ii) to avoid a transaction reporting requirement under State or Federal law,

shall be sentenced to a fine of not more than US$500 000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than 20 years, or both.

b International money laundering: 18 USC. §1956(a)(2)

(2) Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the USA to or through a place outside the USA or to a place in the USA from or through a place outside the USA:

(A) with the intent to promote the carrying on of specified unlawful activity; or

(B) knowing that the monetary instrument or funds involved in the transportation represent the proceeds of some form of unlawful activity and knowing that such transportation, transmission, or transfer is designed in whole

or in part:

(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or

(ii) to avoid a transaction reporting requirement under State or Federal law,

shall be sentenced to a fine of not more than US$500 000 or twice the value of the monetary instrument or funds involved in the transportation, transmission or transfer, whichever is greater, or imprisonment for not more than 20 years, or both.

c Government sting operations: 18 USC. §1956(a)(3)

(3) Whoever, with the intent:

(A) to promote the carrying on of specified unlawful activity;

(B) to conceal or disguise the nature, location, source, ownership, or control of property believed to be the proceeds of specified unlawful activity; or

(C) to avoid a transaction reporting requirement under State or Federal law, conducts or attempts to conduct a financial transaction involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity, shall be fined under this title or imprisoned for not more than 20 years, or both. For purposes of this paragraph and paragraph (2), the term 'represented' means any representation made by a law enforcement officer or by another person at the direction of, or with the approval of, a Federal official authorized to investigate or prosecute violations of this section.

d Trafficking in criminally derived property: 18 USC. §1957

(a) Whoever . . . knowingly engages or attempts to engage in a monetary transaction in criminally derived property that is of a value greater than US$10 000 and is derived from specified unlawful activity, shall be punished as provided in subsec. (b).

3 Description and analysis of statutes

a Domestic money laundering: 18 USC. §1956(a)(1)

a Predicate Offenses

All of the distinct money laundering crimes set forth in ss. 1956 and 1957 share a common list of predicate offenses referred to as 'specified unlawful activities', which are defined in subsec 1956(c)(7). The list covers hundreds of US federal felony crimes, including narcotics trafficking, wire fraud, Racketeer Influenced and Corrupt Organizations Act crimes, Foreign Corrupt Practices Act (FCPA) violations, copyright infringement, environmental offenses, espionage and conducting financial transactions with intent to engage in violations of the Internal Revenue Code. It also includes a much shorter list of offenses against foreign nations. Originally this second list included only offenses involving a controlled substance, kidnapping, robbery, extortion, destruction of property by means of explosive or fire, a crime of violence, or bank fraud.

The PATRIOT Act recently added several crimes to the domestic and foreign lists of specified unlawful activities. An offense related to bribery of foreign public officials was added to the list of foreign offenses by s. 315 of the PATRIOT Act, to close a loophole in the Money Laundering Control Act of 1986 that allowed foreign officials to launder corruptly obtained money through US banks where no felony FCPA violation was involved (see Rueda, 2001). Section 315 of the PATRIOT Act also added any offense with respect to which the USA would be obligated by a bilateral treaty to extradite the alleged offender or submit the case for prosecution if the offender were found within US territory and offenses involving smuggling and export control violations (see Pub. L. No. 107–56, §315, 115 Stat. 272, 308–09 (2001). The PATRIOT Act also added 18 USC. §2339B, which criminalizes the provision of material support or resources to an organization designated by the Secretary of State as a 'foreign terrorist organization' to the list of predicate offenses under 1956(c)(7)(D). Ibid. 115 Stat. at 377–8.

Foreign offenses not appearing on the list of offenses against a foreign nation, particularly tax evasion, have been reached in a few cases by 'boot-strapping' them onto a domestic SUA. For example, in *USA* vs *Trapilo*, the US Department of Justice (DOJ) brought money laundering charges against defendants who sold liquor in Canada that was smuggled in from the USA. *USA* vs *Trapilo*, 130 F.3d 547 (2nd Cir. 1997). The resulting profits were brought back into the USA to buy additional liquor. The defendants were charged with violating the federal wire-fraud statute[5] for defrauding the Canadian government of tax revenues (ibid.). The wire fraud offense served as

the predicate for a money-laundering offense because it is a domestic 'specified unlawful activity' (ibid. at 549, 553). The court upheld the indictment (ibid. at 553).

The *Trapilo* case permits prosecutors to charge wire or mail fraud violations for schemes 'occurring predominantly offshore and involving foreign tax fraud and foreign, not domestic, victims' (see Comisky and Shepard, 2000). The District Court for the Southern District of New York has subsequently followed the reasoning in *Trapilo* to deny the dismissal of a complaint in a civil forfeiture action that alleged a scheme to avoid Russian taxes as a predicate offense for a money laundering offense. (See *USA* vs *US$15 270 885.69*, No. 99 Civ. 10244 (RCC), 2000 US Dist. LEXIS 12602 (S.D.N.Y., 25 August 2000).

b Other Elements of the Crime

1 The defendant conducted or attempted to conduct a financial transaction

The statute defines 'financial transaction' as follows:

> . . . (A) a transaction which in any way or degree affects interstate or foreign commerce (i) involving the movement of funds by wire or other means or (ii) involving one or more monetary instruments, or (iii) involving the transfer of title to any real property, vehicle, vessel, or aircraft, or (B) a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree[.] (18 USC.A. §1956(c)(4) (2000, Suppl. 2000)).

The term 'transaction' is also defined broadly to involve almost any type of exchange of funds or property between persons, including all types of transactions involving financial institutions. (See 18 USC.A. §1956(c)(3) (2000, Suppl. 2003). Thus, while this section focuses on transactions involving financial institutions, it is not limited to that context.

2 The transaction involved property that represents the proceeds of specified Unlawful Activity

Property involved in money laundering prosecutions often involves criminally derived assets that are commingled with legitimate ones. The most frequently reported instance of such mixing involves the deposit of criminally derived funds into bank accounts containing legitimate funds (see Obermaier and Morvillo, 2002). Most courts do not require the government to 'trace' the illegal funds to satisfy the requirement that the property at issue represent the proceeds of a specified unlawful activity. (See *USA* vs *Moore*, 27 F.3d 969, 976–7 (4th Cir. 1994).

3 The defendant knew the property involved in the transaction represented Proceeds of Some Form of Unlawful Activity

The government must establish that the offender knew 'that the property involved in a financial transaction represents the proceeds of some form of unlawful activity . . .'. 18 USC.A. §1956(a)(1) (2000, Suppl. 2003). The statute requires that the defendant know that the proceeds come from some form (although not necessarily which form) of activity that constitutes a *felony* under state, federal or *foreign* law (see ibid. §1956(c)(1). Although knowledge in the statute refers to 'actual knowledge' rather than a 'should have known' or 'reckless disregard' standard, some circuits have permitted a showing of 'willful blindness', that is, a deliberate closing of the eyes to obvious facts, to satisfy this requirement. (See *USA* vs *Campbell*, 977 F.2d 854, 857 (4th Cir. 1992) (realtor possessed requisite knowledge where drug dealer purchased house with large, under the table, cash payment). Hence, circumstantial evidence can be used to establish 'knowledge'. (See, for example, *USA* vs *Arteaga*, 117 F.3d 388, 399 (9th Cir. 1997) (upholding money laundering conviction despite verdict resting on 'lengthy chains of circumstantial proof'); *USA* vs *Young*, 45 F.3d 1405 (10th Cir. 1995) (holding circumstantial evidence sufficient to prove defendant's knowledge of partner's drug dealing); *USA* vs *Heaps*, 39 F.3d 479 (4th Cir. 1994) (deciding circumstantial evidence sufficient to prove defendant's knowledge of unlawful source of funds).

c Mens Rea

The domestic money laundering statute contains four different alternative knowledge and intent requirements (see 18 USC.A. §1956(a)(1) (2000, Suppl. 2003). The government must show that that the defendant acted with any one or more of the following degrees of knowledge or purpose: (1) intending to promote specified unlawful activity[6]; (2) intending to evade taxes or prepare false tax returns or other tax-related documents; (3) knowing that the transaction is designed to disguise or conceal the proceeds involved in the transaction[7] or (4) knowing that the transaction is designed to avoid a statement or federal reporting requirement.

d Penalties

The criminal penalty for a violation of 18 USC. §1956(a)(1) is a maximum fine of US$500 000 or twice the value of the property involved in the transaction, whichever is greater, or a maximum term of imprisonment of 20 years, or both (see 18 USC.A. §1956(b)(1) (2000, Suppl. 2003).

In addition, violations of ss. 1956(a)(1), (2), (3) and s. 1957, are subject to a civil penalty in an amount not to exceed the greater of: (a) the value of the

property involved in the transaction or (b) US$10 000 (see 18 USC.A. §1956(b)(1) (2000, Suppl. 2003).

Further, the property involved in a violation of s. 1956(a)(1) is subject to criminal forfeiture (see II.B.1.b.*infra*.)

The PATRIOT Act recently amended the penalty provisions of s. 1956 to provide for long-arm jurisdiction over foreign persons, including foreign banks, with respect to civil actions brought to enforce criminal judgments (see Pub. L. No. 107–56, §317, 115 Stat. 272, 310–11 (2001) (codified at 18 USC. §1956(b)(2)). Under the new provision, US district courts now have jurisdiction over civil lawsuits to recover criminal judgments if the defendant has been served with process pursuant to the Federal Rules of Civil Procedure or the applicable laws of the foreign jurisdiction and (1) the money laundering offense occurred in the USA; (2) in the case of converted property, the property was the property of the USA by virtue of a civil or criminal forfeiture judgment or (3) in the case of a foreign financial institution, the defendant maintains a correspondent bank account at another bank in the USA.

The Annunzio-Wylie Anti-Money Laundering Act of 1992 added 18 USC. §1956(h), which provides that anyone who engages in a conspiracy to commit a violation of 18 USC. 1956 shall be punished as if s. 1956 had been violated (see Pub. L. No. 102–550, 106 Stat. 4044 (1992).

e Aggravated or Serious Cases

There are two specific offense characteristics that call for an increase in an individual defendant's sentence under the US Sentencing Guidelines. The first is where the defendant knew or believed that the property involved represented drug proceeds. The second is where the violation involved funds or assets with a value greater than US$100 000 (see USS.G. §2S1.1(b).

b International money laundering: 18 USC. §1956(a)(2)

a Predicate Offenses

See s. II.A.3.a.*a. supra*.

b Other Elements

1 Transportation

This provision focuses on a more narrow set of transactions than the 'financial transactions' provision: those involving the transportation or transfer of 'monetary instruments or funds'. Unlike s. 1956(a)(1) provision, however, a violation of s. 1956(a)(2) does not necessarily require two parties, since it

covers the mere 'transport' of instruments or funds (see 18 USC.A. §1956(a)(2)) (2000, Suppl. 2003).

2 Monetary instruments or funds

'Monetary instruments' are defined as cash and other instruments for which title passes on delivery (see18 USC.A. §1956(c)(5) (2000, Suppl. 2003). The word 'funds' is undefined and its scope is unclear. It is possible to argue that, similar to the non-bank transaction reporting requirements in the BSA, this provision does not cover standard transfers between corporate bank accounts through wire or other means (see 31 USC.A. §5315 (2000, Suppl. 2003). On the other hand, the addition of 'funds' to the provision may broaden the coverage of s. 1956(a)(2) to encompass such transactions. This interpretation is untested in the courts. In any event, there is significant overlap in the coverage of ss. 1956(a)(1) and (2), which would likely allow the application of one or both provisions to the facts at issue if the requisite elements were otherwise present.

3 Across the US Border

An essential element of international money laundering is that the monetary instruments or funds cross the international borders of the USA. S. 1956(a)(2) is not violated if the transaction occurs completely outside of the USA. *USA* vs *Kramer*, 73 F.3d 1067 (11th Cir. 1996).

c Mens Rea

The international money laundering statute contains three different alternative knowledge and intent requirements (see 18 USC.A. §1956(a)(2)(A),(B) (2000, Suppl. 2003). The government must show that the defendant acted with any one or more of the following degrees of knowledge or purpose: (a) the intent to promote the carrying on of a specified unlawful activity or (b) knowing that the monetary instrument represents the proceeds of some form of unlawful activity and knowing that the transaction is designed: (i) to conceal or disguise that instrument or (ii) to avoid a state or federal transaction reporting requirement. Unlike the 'domestic financial transaction' money laundering provision, the intent to promote prong does not require 'knowledge' that the transported funds come from illegal activity. Thus, the transfer of funds derived from legitimate activities abroad into the USA to promote the carrying on of a specified unlawful activity would still violate the statute (see *USA* vs *One 1997 E35 Ford Van*, 50 F. Suppl. 2d 789 (N.D. Ill. 1999).

d Penalties

The criminal penalty for a violation of 18 USC. §1956(a)(2) is a maximum

fine of US$500 000 or twice the value of the property involved in the transaction, whichever is greater, a maximum term of imprisonment of 20 years, or both.

As discussed above in section II.A.3.a.*d*., the government may also seek civil penalties for violations of s. 1956(a)(2).

Further, the property involved in a violation of s. 1956(a)(2) is subject to criminal forfeiture (see section II.B.1.b. *infra*).

Also as discussed above in paragraph II.A.3.a.*d*., conspiracy to commit a violation of the international money laundering prohibitions carries the same penalties as the completed offense.

c Government sting operations: 18 USC. §1956(a)(3)

a Predicate Offenses

See section II.A.3.a.*a*. *supra*.

b Other Elements

1 The defendant conducted or attempted to conduct a financial transaction
This is similar to the requirement under domestic money laundering (see section II.A.3.a.*b*.1 above).

2 Involving property represented to be the proceeds of, or funding for, Specified Unlawful Activity
Section 1956(a)(3) requires that a government law enforcement officer, or another person acting on their behalf, represent to the defendant that the property at issue is the proceeds of, or will be used to fund, a specified unlawful activity. For example, in Operation Casablanca, US Customs agents bribed Mexican banking officials to launder money that was expressly represented to be the proceeds of narcotics trafficking (see Rueda, 2001).

Less direct statements, however, have also been upheld as sufficient to establish the representation element. In *USA* vs *Kaufmann*, for example, the Seventh Circuit affirmed the defendant's conviction despite the lack of an express representation that the money used to purchase a Porsche automobile from the defendant constituted drug proceeds *USA* vs *Kaufmann,* 985 F.2d 884 (7th Cir. 1993). Instead, the defendant was told that the buyer was a drug dealer who needed to pay for the car in cash and that the car should be titled in a friend's name. The Seventh Circuit concluded that the circumstances were sufficient for the defendant to infer that the property represented the proceeds of a specified unlawful activity and concluded that '[i]t is enough that the government prove that an enforcement officer or authorized person made the

defendant aware of the circumstances from which a reasonable person would infer that the property was drug proceeds', ibid. at 893.

3 Believing the proceeds to be product of specified unlawful activity
In effect, this element requires that the government show that the defendant believed the representation made by the undercover law enforcement officer (see *USA* vs *McLamb*, 985 F.2d 1284, 1292–93 (4th Cir. 1993).

c Mens Rea

The government must show that that the defendant acted with any one or more of the following degrees of purpose: (1) intending to promote specified unlawful activity; (2) intending to disguise or conceal the proceeds involved in the transaction or (3) intending to avoid a statement or federal reporting requirement.

These intent and knowledge requirements are similar to those found in the domestic money laundering section with one important exception. Under the domestic money laundering counterparts of the second and third prongs (18 USC. §§1956(a)(1)(B)(i)–(ii)), the government is only required to prove that the defendant knew that *the transaction* is designed to disguise or conceal proceeds or avoid reporting requirements. The government sting provisions, on the other hand, focus on the individual defendant's intent. Whether a greater quantum of evidence may be required in practice by the different formulation of the scienter requirement under the domestic money laundering statute is unclear (see Obermaier and Morvillo, 2002).

d Penalties

The penalty for a violation of 18 USC. §1956(a)(3) is a fine under the general fine provisions of Title 18 or imprisonment of not more than 20 years, or both. The maximum fine for individuals under Title 18 is US$250 000, while the maximum fine for organizations is US$500 000 (see 18 USC.A. §§3571(b) and (c) (2000, Suppl. 2003). An alternative fine equal to twice the gross pecuniary gain or twice the gross loss to another person may also be imposed (see *ibid*. §3571(d).

As discussed above in section II.A.3.a.*d*., the government may also seek civil penalties for violations of s. 1956(a)(3). Further, the property involved in a violation of s. 1956(a)(3) is subject to criminal forfeiture (see section II.B.1.b. *infra.* Also as discussed above in section II.A.3.a.*d.*, conspiracy to commit a violation of the government sting provisions carries the same penalty as the completed offense.

e Aggravated or Serious Cases

See section II.A.3.a.*e supra*.

d Trafficking in criminally derived property: 18.USC. §1957

a Predicate Offenses

Section 1957 incorporates the predicate offenses listed in 18 USC. §1956(c)(7)(D) by reference in that it requires that the property at issue be derived from a specified unlawful activity (see ibid. §1957(a) (2000, Suppl. 2003). The term 'specified unlawful activity' is defined as having 'the meaning given that term in s. 1956 of this title', ibid. §1957(f)(3).

b Other Elements

Section 1957 is in some ways broader in scope than s. 1956 and consequently easier to prove. It criminalizes the knowing engagement in a 'monetary transaction' (versus the 'financial transactions' addressed in s. 1956(a)(1)) in 'criminally derived property' (versus the focus of s. 1956 on 'proceeds of unlawful activity') that has a value greater than US$10 000 and is in fact derived from a specified unlawful activity. ibid. §1957(a). Importantly, unlike s. 1956, the government is not required to prove that the defendant intended – or even knew – that the transaction was designed to further or conceal a criminal activity (see ibid. §1957(c) (2000, Suppl. 2003). Rather, it need only show that the defendant knew it was receiving 'dirty' money, regardless of whether the defendant knew the specific source of that money (see, for example *USA* vs *Hawkey*, 148 F.3d 920 (8th Cir. 1998). There are some jurisdictional limitations to this provision, but it applies if the recipient is a 'US person' or otherwise within US jurisdiction when committing any part of the violation (see 18 USC.A. §1957(d)(2) (2000, Suppl. 2003). The definition of a 'monetary transaction' (18 USC. §1957(f)(1)) includes many of the standard transactions in which companies with bank accounts presumably would engage, i.e., 'the deposit, withdrawal, transfer, or exchange' of funds or monetary instruments through financial institutions.

c Mens Rea

As with s. 1956, s. 1957 focuses on 'knowledge' and incorporates a standard of 'willful blindness'. This analysis relies on the facts of each case. However, as noted above, proving 'knowledge' under s. 1957 is in most

cases more easily accomplished because specific knowledge regarding criminal actions by the payor is not necessary; circumstantial evidence raising sufficient 'red flags' that the money is 'criminally-derived' (as opposed to derived from specified criminal activities) has been sufficient to impute liability (see, for example *USA* vs *Wynn,* 61 F.3d 921 (D.C. Cir. 1995) (willful blindness shown by pattern of cash payments totaling over US$500 000 for store merchandise).

d Penalties

The penalty for a violation of 18 USC. §1957 is a fine as provided for under the general fine provisions of Title 18 or imprisonment of not more than ten years, or both. The maximum fine for an individual under Title 18 is US$250 000, while the maximum fine for an organization is US$500 000 (see 18 USC.A. §§3571(b) and (c) (2000, Suppl. 2003). An alternative fine equal to twice the gross pecuniary gain or twice the gross loss to another person may also be imposed (see ibid. §3571(d).

As discussed above in section II.A.3.a.*d*., the government may also seek civil penalties for violations of s. 1957. Further, the property involved in a violation of s. 1957 is subject to criminal forfeiture (see section II.B.1.b. *infra.* Also as discussed above in section II.A.3.a.*d*, conspiracy to commit a violation of the trafficking prohibitions carries the same penalty as the completed offense.

e Aggravated or Serious Cases

See section II.A.3.a.*e supra*.

4 Conviction statistics

Federal law enforcement officials have cited the need to target more 'managers' in money laundering organizations as well as organizations that launder over US$100 000 (see US Dept. of Justice and US Dept. of the Treasury, NATIONAL MONEY LAUNDERING STRATEGY at 28 (2002), hereinafter 2002 NATIONAL MONEY LAUNDERING STRATEGY). In fiscal year 2000, approximately 17 per cent of persons sentenced in federal court for money laundering violations received a longer sentence because of their role as a 'leader, organizer, manager, or supervisor' of the targeted laundering activity. The 2002 NATIONAL MONEY LAUNDERING STRATEGY cites a lack of fully effective interagency co-ordination in the investigation of major money laundering cases as the biggest impediment to increasing the prosecution of major cases.

Table 7.1 Money Laundering Defendants Sentenced by Prison Length

	Length of imprisonment (months)				
Average (months)	34	32	36	38	38
Number of defendants	895	913	1 001	991	918
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001

Source: US Sentencing Commission

5 Ancillary legislation

a Illegal money transmitting businesses: 18 USC. §1960

18 USC. §1960 prohibits the ownership, control, or operation of an unlicensed money transmitting business. Section 1960 was recently amended by the PATRIOT Act to, among other things, clarify that this prohibition extends to any businesses engaged in the transportation or transmission of funds that the defendant knows are derived from a criminal offense, or are intended to be used for an unlawful purpose (see Pub. L. No. 107-56, §373, 115 Stat. 272, 339–40 (2001). Under this definition, the government is not required to show that the defendant operated a storefront or traditional formal business open to the public (see H. R. Rep. No. 107-250, at 54 (2001).

b Criminal penalties for failure to file currency transaction reports: 31 USC. §5322

Section 5322 prohibits a person from willfully violating the BSA requirements set forth in, among others, 31 USC. §§5313 (reports on domestic coins and currency transactions) and 5316 (reports on exporting and importing monetary instruments), or any regulations issued pursuant to the authority of these statutes (see 31 USC.A. §5322(a) (2000, Suppl. 2003).

The penalty for a violation of s. 5322(a) is a maximum fine of US$250 000 or a maximum term of imprisonment of five years, or both (see ibid. §5233(a). Section 5322 provides for an enhanced penalty in cases that involved a simultaneous violation of 'another law of the USA or as part of a pattern of any illegal activity involving more than US$100 000 in a 12-month period' (see ibid. §5322(b). In such cases, the maximum fine is increased to US$500 000 and the maximum term of imprisonment is increased to 10 years.

c Structuring transactions to evade reporting requirements: 31 USC. §5324

Section 5324 prohibits individuals from knowingly taking certain actions for the purpose of avoiding BSA currency reporting requirements (see ibid. §5324). The penalty for a violation of s. 5324 is a fine under the general fine provisions of Title 18 or imprisonment of not more than five years, or both (see ibid. §5234(d)(1). The maximum fine for an individual under Title 18 is US$250 000, while the maximum fine for an organization is US$500 000 (see 18 USC.A. §§3571(b) and (c) (2000, Suppl. 2003). An alternative fine equal to twice the gross pecuniary gain or twice the gross loss to another person may also be imposed (see ibid. §3571(d).

Similar to 31 USC. §5322, s. 5324 provides for an enhanced penalty in cases that involve a simultaneous violation of 'another law of the USA or as part of a pattern of any illegal activity involving more than US$100 000 in a 12-month period'. 31 USC.A. §5324(d)(2) (2000, Suppl. 2003). In such cases, the maximum fine shall be twice the amount set for in subsecs. (b)(3) or (c)(3) of s. 3571 of Title 18, whichever is applicable and the maximum term of imprisonment is increased to 10 years.

d Bulk cash smuggling: 31 USC. §5332

The PATRIOT Act added bulk cash smuggling to the currency reporting crimes under the BSA (see Pub. L. No. 107-56, Sec. §371, 115 Stat. 272, 336–37 (codified at 31 USC. §5332 Note). One major goal of this new provision is to target non-traditional sources of terrorist financing, such as *hawala*, that often rely on the bulk movement of currency to avoid paper or electronic trails (see 2002 NATIONAL MONEY LAUNDERING STRATEGY, at 15–16).

Bulk cash smuggling involves the knowing concealment of more than US$10 000 in currency or other monetary instruments on one's person or in any container for transport across the US border (see 31 USC.A. §5332(a)(1) (2000, Suppl. 2003). A defendant must intend to evade a currency reporting requirement under 31 USC. §5316 to violate the prohibition against bulk cash smuggling (see ibid.)

The criminal penalty for a violation of s. 5332 includes a term of imprisonment not to exceed 5 years (see ibid. §5332(b)(1). In addition, any property involved in the offense shall be subject to forfeiture (see ibid. §5332(b)(2).

6 Executive order 13224 on terrorist financing

Following the September 11th terrorist attacks the US Government added terrorist financing to the 2002 NATIONAL MONEY LAUNDERING STRATEGY in an effort to enhance co-ordination of government efforts to target terrorist financing schemes and eliminate them.[8]

On 23 September 2001, President Bush signed an Executive Order freezing the assets of 27 individuals and entities suspected of terrorist involvement. Exec. Order No. 13224, 66 Fed. Reg. 49079 (Sept. 25, 2001). Under Executive Order 13224, all property and interests in property of these persons that are in the USA or come within the control of US persons, including their overseas branches, are blocked. Any transaction or dealing by US persons or within the USA in such blocked property, including the making or receiving of any contribution of funds, goods, or services to or for the benefit of the listed persons, is prohibited. Several Treasury Department announcements since the Executive Order have expanded the list of covered persons.

Though stopping short of targeting those who do business with suspected terrorists, the Executive Order also applies pressure to foreign financial institutions and other entities that continue to permit transactions by the persons designated in the Order by blocking property of individuals or entities found 'to assist in, sponsor, or provide *financial*, *material*, or *technological* support for, or financial or other services to or in support of, such acts of terrorism' [Emphasis added]. Thus, not only are the assets of the designated persons subject to blocking if they come within US jurisdiction, but so are the assets of a foreign financial institution that provides financial services to such persons. It remains to be seen, however, how aggressively such institutions will be targeted. Given the elusiveness of the designated individuals and terrorist groups, it is quite possible US authorities will concentrate their enforcement efforts on financial institutions as part of a strategy to deny terrorist access to the financial system.

B Overview of Seizure and Forfeiture

Forfeiture laws are intended to prevent criminals from keeping either the fruits of their crimes or the tools used to commit them. Under civil asset forfeiture statutes, primarily 18 USC. §981 in the context of money laundering crimes, the government initiates a civil *in rem* proceeding against the property itself. These statutes are based on the legal fiction that the property itself is in essence the wrongdoer (see Obermaier and Morvillo, 1 *White Collar Crime: Business and Regulatory Offenses*, §6A.01, at 6A-4 (2002).

Criminal forfeitures arise within the context of a criminal prosecution of the underlying offense and are directed against the individual defendant. In general, the criminal wrongdoer is required to forfeit any property involved in the offense to the government as part of the punishment for the offense. Criminal forfeiture proceedings thus are governed by the constitutional protections applicable to criminal trials (see ibid. §6A.03, at 6A-26).

1 Civil and criminal asset forfeiture

a Civil asset forfeiture

Although set forth in the federal criminal statutory scheme, the forfeiture statutes, primarily 18 USC. §981 in the context of money laundering, provide for 'civil' *in rem* proceedings directed against the property at issue rather than an individual. Section §981 permits the civil forfeiture of property involved in certain federal crimes including, among others, 18 USC. §§1956, 1957, and 1960 (see 18 USC. §981(a)(1)(A) (2000, Suppl. 2003). The Civil Asset Forfeiture Reform Act of 2000 (CAFRA) recently dramatically expanded the list of crimes subject to civil forfeiture to include all of the offenses listed as specified unlawful activities under 18 USC. §1956(c)(7) (see Pub. L. No. 106-185, 114 Stat. 202, 210 *et seq.* (2000). Thus, prosecutors no longer are limited to initiating civil forfeiture proceedings based on money laundering charges but may rely on any of the listed predicate offenses.

The PATRIOT Act separately amended 31 USC. §5317 to provide that violations of the currency-reporting statutes, including the structuring of transactions, are subject to forfeiture using the procedures outlined in 18 USC. §981(a)(i)(A).[9] Section 5317 provides the statutory authority for criminal and civil forfeiture with respect to violations of provisions of the BSA: the currency reporting requirements in 31 USC. §5313 (reports on domestic coins and currency transactions), 31 USC. §5316 (reports on exporting and importing monetary instruments) and 31 USC. §5324 (structuring transactions to evade reporting requirements). The PATRIOT Act also provides that assets involved in violations of the new bulk cash smuggling offense are subject to civil forfeiture (see Pub. L. No. 107-56, §371, 115 Stat. 272, 336–38 (2001).

b Criminal asset forfeiture

Upon conviction of certain money laundering offenses (18 USC. §§1956, 1957, and 1960), s. 982 of Title 18 requires the forfeiture of all property, real and personal, related to the offense (see 18 USC.A. §982 (2000, Suppl. 2003). Conspiracies to violate ss. 1956 or 1957 of Title 18 are also covered by s. 982, although a conspiracy to violate s. 1960 is not. The currency reporting requirements of 31 USC. §§5313, 5316, and 5324 are subject to criminal forfeiture pursuant to 31 USC. §5317. Congress also specifically provided for criminal forfeiture for violations of the bulk cash smuggling statute in the PATRIOT Act (see Pub. L. No. 107-56, §372, 115 Stat. 272, 338–39 (2001) (codified at 31 USC. §5332(b)(2)).

Congress also recently greatly expanded the government's ability to seek the criminal forfeiture of illicit proceeds by enacting s. 16 of CAFRA, which

permits criminal forfeiture whenever a civil forfeiture is authorized (see Pub. L. No. 106-185, §16, 114 Stat. 202, 221 (2000). Before CAFRA, criminal proceeds could only be forfeited if there was a specific statute authorizing such forfeiture for a given crime (*e.g.*, 18 USC. §982).[10]

The procedures that govern these actions are found in certain ss. of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 USC. §§853(c) and (e)–(p)) (see 18 USC.A. §982(b)(1) (2000, Suppl. 2003).

One important difference between criminal forfeiture and civil forfeiture is that criminal forfeiture under s. 982 does not require a nexus between the property and the underlying offense under certain circumstances. The criminal forfeiture statutes allow for the seizure of assets with no relationship to the underlying offense in substitution of the tainted assets, when the original assets: (1) cannot be located upon the exercise of due diligence ; (2) have been transferred or sold to a third party; (3) have been placed beyond the jurisdiction of the court; (4) have been substantially diminished in value; or (5) have been commingled with other property which cannot be divided without difficulty (see, e.g. ibid. §§982(b)(1)–(2) (incorporating 21 USC. §853(p)).[11]

2 Legislation

a Civil asset forfeiture

Section 981 to Title 18 provides, in pertinent part:

(a) (1) The following property, real or personal, is subject to forfeiture to the USA:

(A) Any property, real or personal, involved in a transaction or attempted transaction in violation of s. 1956, 1957 or 1960 of this title, or any property traceable to such property.

(B) Any property, real or personal, within the jurisdiction of the USA, constituting, derived from, or traceable to, any proceeds obtained directly or indirectly from an offense against a foreign nation, or any property used to facilitate such an offense, if the offense –

(i) involves the manufacture, importation, sale, or distribution of a controlled substance (as that term is defined for purposes of the Controlled Substances Act), or any other conduct described in s. 1956(c)(7)(B);

(ii) would be punishable within the jurisdiction of the foreign nation by death or imprisonment for a term exceeding 1 year; and

(iii) would be punishable under the laws of the USA by

imprisonment for a term exceeding 1 year, if the act or activity constituting the offense had occurred within the jurisdiction of the USA.

(C) Any property, real or personal, which constitutes or is derived from proceeds traceable to a violation of s. 215, 471, 472, 473, 474, 476, 477, 478, 479, 480, 481, 485, 486, 487, 488, 501, 502, 510, 542, 545, 656, 657, 842, 844, 1005, 1006, 1007, 1014, 1028, 1029, 1030, 1032, or 1344 of this title or any offense constituting 'specified unlawful activity' (as defined in s. 1956(c)(7) of this title), or a conspiracy to commit such offense.

b Criminal asset forfeiture

Section 982 to Title 18 provides, in pertinent part:

(a) (1) The court, in imposing sentence on a person convicted of an offense in violation of s. 1956, 1957, or 1960 of this title, shall order that the person forfeit to the USA any property, real or personal, involved in such offense, or any property traceable to such property.

3 Requirements for seizure and forfeiture

a Civil asset forfeiture

The procedures for seizing assets are set forth in S. 981(b)(2), which provides, in pertinent part:

(2) Seizures pursuant to this section shall be made pursuant to a warrant obtained in the same manner as provided for a search warrant under the Federal Rules of Criminal Procedure, except that a seizure may be made without a warrant if –

(A) a complaint for forfeiture has been filed in the US district court and the court issued an arrest warrant *in rem* pursuant to the Supplemental Rules for Certain Admiralty and Maritime Claims;

(B) there is probable cause to believe that the property is subject to forfeiture and –

(i) the seizure is made pursuant to a lawful arrest or search; or

(ii) another exception to the Fourth Amendment warrant requirement would apply; or

(C) the property was lawfully seized by a State or local law enforcement agency and transferred to a Federal agency.

In general, the government will file a civil forfeiture complaint; once that complaint is filed, the court clerk will issue a seizure warrant without any showing of probable cause to effect a civil forfeiture under the procedures set forth under 18 USC. §981 (see Ian M. Comisky, *et al.*, *Tax Fraud and Evasion: Money Laundering Asset Forfeiture Sentencing*, ¶ 13.02[1][a], at 13–56 (2002). The US Justice Department has expressed a strong preference for judicial review prior to any federal seizure. Property may also be seized without a warrant pursuant to a lawful arrest or pursuant to an exception to the warrant requirement and if the property is lawfully seized by state officials and transferred to a Federal agency.

Section 981 was recently amended by the PATRIOT Act to greatly expand the power of the US government to seize foreign bank accounts (see H. R. Rep. No. 107-250, at 57–58 (2001). The new measure allows for the seizure of an interbank account of a foreign bank in the USA where funds subject to forfeiture (e.g., the proceeds of a SUA) are deposited into an account at the foreign bank (18 USC. §981(k)(1)(A).

A civil money-laundering forfeiture case under 18 USC. §981 may begin either administratively or judicially, or both. Administrative proceedings are conducted by the seizing agency while judicial proceedings are conducted in a court before a judge. The value and type of seized property and whether or not the forfeiture is contested determine the proceeding used. In general, if the property seized is valued at US$500 000 or less, civil forfeiture proceedings may be used (see 19 USC.A. §1607(a) (2000, Suppl. 2003). There are exceptions; for example, real estate cannot be forfeited under administrative proceedings and monetary instruments can be forfeited using administrative proceedings even if the value exceeds US$500 000 (ibid). Administrative proceedings cannot be used when the action is contested by the filing of a claim.

Civil forfeiture cases follow customs law procedures. Section 981(d) provides that the provisions of the customs laws relating to summary and judicial forfeiture, disposition of proceeds from the sale after forfeiture, remission or mitigation and the compromise of claims apply to money laundering forfeitures (18 USC.A. §981(d) (2000, Suppl. 2003).

CAFRA instituted a significant limitation on the government's forfeiture power. CAFRA added a new s. 983(c) to Title 18, which shifts the burden of proof to the government in civil forfeiture proceedings to prove by a preponderance of the evidence that the property is subject to forfeiture (18 USC.A. 983(c)(1) (2000, Suppl. 2003).

b Criminal asset forfeiture

Section 982 provides the government with various methods to seize and

preserve the defendant's assets pre-conviction (see 18 USC.A. §982(b)(1) (2000, Suppl. 2003) (incorporating 21 USC.A. §853). For example, the criminal forfeiture statute permits the government to obtain pre-indictment restraining orders (see ibid. §982(b)(1)(A) (incorporating 21 USC.A. §§853(e)(1)–(2)). An order may be sought *ex parte*, based on a showing of probable cause to believe that the property is subject to forfeiture (see ibid. S. 982 also incorporates a section of 21 USC. §853, which permits the government to request a seizure warrant 'in the same manner as provided for a search warrant' to preserve property pre-indictment or arrest (ibid. §982(b)(1)(A) (incorporating 21 USC. §853(f)).

The government may also seize property subject to forfeiture not already in its possession after a verdict is entered (see ibid. §982(b)(1)(A) (incorporating 21 USC. §853(g)). In addition, the government may petition the court to appoint a receiver or conservator for the property.

Most courts have held that the government must prove the elements of a criminal forfeiture case by a preponderance of the evidence and not beyond a reasonable doubt (see *USA* vs *Myers,* 21 F.3d 826, 829 (8th Cir. 1994). As the court in *Myers* reasoned, the criminal forfeiture statute is a sentencing sanction and not an element of the underlying offense that would require proof beyond a reasonable doubt.

4 Treatment of third parties

a Civil asset forfeiture

The civil forfeiture statute contains an amended 'innocent owners' defense introduced in CAFRA that is designed to protect those property owners without knowledge of the underlying criminal conduct (see 18 USC.A. §983(d) (2000, Suppl. 2003). This provision, which is contained in the general rules for civil forfeitures, provides that '[a]n innocent owner's interest in property shall not be forfeited under any civil forfeiture statute' (ibid. §983(d)(1). However, the claimant asserting an innocent owner's interest in the property 'shall have the burden of proving that the claimant is an innocent owner by a preponderance of the evidence. One important change to the innocent owner provision that CAFRA introduced is a heightened knowledge standard in cases where the property interest is obtained after the conduct giving rise to the forfeiture has taken place. Under the new standard, an 'innocent owner' means someone who: (1) 'was a bona fide purchaser or seller for value (including a purchaser of goods or services for value)' and (2) 'did not know and was not reasonably without cause to believe that the property was subject to forfeiture' (18 USC.A. 983(d)(3)(A) (2000, Suppl. 2003).

Prior to the enactment of CAFRA, courts were reluctant to deny innocent-owner relief to banks absent a showing of actual knowledge, even when banks failed to comply with normal commercial banking practices.[12] For example, in *USA* vs *One Single Family Residence Located at 6960 Miraflores Ave.*, the Eleventh Circuit reversed the district court's refusal to grant innocent-owner relief following the bank's one-year bridge loan to a customer on a property that had been purchased through a Panamanian shell corporation.[13] Under the heightened knowledge standard introduced by CAFRA, it is not clear whether the bank's conduct in *Miraflores* would pass muster.

5 Asset forfeiture statistics

Official Department of Justice Statistics for fiscal year 2001 show that total forfeited assets related to money laundering offenses totaled US$241 362 783.[14] See 2002 *National Money Laundering Strategy*, p. 11. This represents 37.7 per cent of the US$639 469 124 in assets forfeited in 2001. These revenues, however, have already been negatively affected by procedural and substantive reforms of CAFRA. For example, the Justice Department estimates that receipts from deposits into the Assets Forfeiture Fund were US$67.1 million less in 2001 than in 2000 due primarily to CAFRA and lower interest rates.[15] (Office of the Inspector General, US Dept. of Justice, Audit Report: Assets Forfeiture Fund and Seized Asset Deposit Fund Annual Financial Statement Fiscal Year 2001, No. 02 22, III (June 2002).[16] The value of new seizures is expected to continue to decline through at least 2003 (ibid. para. V).

C Mutual Legal Assistance

Providing legal assistance to foreign countries in money laundering cases is a stated priority for the relevant US enforcement agencies (see 2002 *Money Laundering Strategy*, pp. 25–6, 57–8 and 60–3. The USA provides assistance to foreign countries throughout the life cycle of a money laundering case. US law enforcement officials execute requests from foreign countries for investigative assistance. Law enforcement officers and courts gather evidence in the USA on behalf of foreign countries. US officials and courts extradite accused money launderers to foreign countries. US agencies even share seized and forfeited assets with foreign countries.

1 Primary legal texts for mutual legal assistance

Treaties, international agreements and statutes are the primary sources of US law governing the provision of legal assistance to foreign countries in money laundering cases. Major treaties, international agreements and federal statutory provisions governing US legal assistance in money laundering cases are

listed below. In addition, the provision of legal assistance to foreign countries is subject to constitutional requirements, as discussed below (see generally Michael Abbell and Bruno A. Ristau (1995), 'International Legal Assistance' §12-2-1 (1995) (hereinafter 'International Legal Assistance').

a Treaties and international agreements

a Extradition Treaties

The USA has entered into treaties relating to extradition with: Albania, Antigua and Barbuda, Argentina, Australia, Austria, Bahamas, Barbados, Belgium, Belize, Bolivia, Brazil, Bulgaria, Burma, Canada, Chile, Colombia, Congo, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Denmark, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Fiji, Finland, France, Gambia, Germany, Ghana, Greece, Grenada, Guatemala, Guyana, Haiti, Honduras, Hong Kong, Hungary, Iceland, India, Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kenya, Kiribati, Korea, Latvia, Lesotho, Liberia, Liechtenstein, Lithuania, Luxembourg, Malawi, Malaysia, Malta, Mauritius, Mexico, Monaco, Nauru, Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Romania, St Kitts and Nevis, St Lucia, St Vincent and Grenadines, San Marino, Saudi Arabia, Sierra Leone, Seychelles, Singapore, Slovak Republic, Slovenia, Solomon Islands, South Africa, Spain, Sri Lanka, Suriname, Swaziland, Sweden, Switzerland, Tanzania, Thailand, Togo, Tonga, Trinidad and Tobago, Turkey, Tuvalu, UK, Uruguay, Venezuela, Yugoslavia (Serbia and Montenegro) and Zambia (see 18 USC.S. §3181 (Lexis 2003) (listing extradition treaties in force). (See also List of US Extradition Treaties prepared by UN Crime and Justice Information Network, available at: http://www.uncjin.org/Laws/extradit/usa.pdf (accessed 19 June 2003).

b Mutual legal assistance treaties and international executive agreements relating to mutual Legal Assistance

a MLATs

The USA has entered into treaties relating to mutual legal assistance with: Anguilla, Antigua and Barbuda, Argentina, Australia, Austria, Bahamas, Barbados, Belgium, Brazil, British Virgin Islands, Canada, Cayman Islands, Cyprus, Czech Republic, Dominica, Egypt, Estonia, Greece, Grenada, Hong Kong, Hungary, Israel, Italy, Jamaica, South Korea, Latvia, Lithuania, Luxembourg, Mexico, Montserrat, Morocco, Netherlands, Panama,

Philippines, Poland, Romania, St Kitts and Nevis, St Lucia, St Vincent and Grenadines, Spain, Switzerland, Thailand, Trinidad and Tobago, Turkey, Turks and Caicos Islands, Ukraine, United Kingdom and Uruguay (see US Dept. of State, *Mutual Legal Assistance in Criminal Matters Treaties (MLATs) and Other International Agreements*, *available at* http://travel.state.gov/mlat.html (last visited Jun. 19, 2003); See *also* Frank Tuerkheimer, *Globalization of US Law Enforcement: Does the Constitution Come Along?*, 39 Hous. L. Rev. 307 (2002) (noting expected ratification of MLATs with France, Nigeria and Venezuela).

b International Executive Agreements

The USA has entered into executive agreements relating to mutual legal assistance with: Cayman Islands, British Virgin Islands, Montserrat, Anguilla, Turks and Caicos, Haiti, Nigeria and UK (see *Mutual Legal Assistance in Criminal Matters Treaties (MLATs) and Other International Agreements*, *supra*, at section I.C.1.b.*a*.

c Key federal statutory provisions

a Designation of Attorney General as Interpol National Crime Bureau: 22 USC. §263a

> The Attorney General is authorized to accept and maintain, on behalf of the USA, membership in the International Criminal Police Organization and to designate any departments and agencies which may participate in the US representation with that organization. All dues and expenses to be paid for the membership of the USA shall be paid out of sums authorized and appropriated for the Department of Justice.

b Discretionary Authority to Share Seized and Forfeited Assets with Foreign Countries: 18 USC. §981(I)(1)

> Whenever property is civilly or criminally forfeited . . . the Attorney General or the Secretary of the Treasury, as the case may be, may transfer the forfeited personal property or the proceeds of the sale of any forfeited personal or real property to any foreign country which participated directly or indirectly in the seizure or forfeiture of the property, if such a transfer:
>
> (A) has been agreed to by the Secretary of State;
> (B) is authorized in an international agreement between the USA and the foreign country and
> (C) is made to a country which, if applicable, has been certified under s. 490(a)(1) of the Foreign Assistance Act of 1961.

c Requests for Judicial Assistance Directly to a US Federal Court: 28 USC. §1781(B)(1)

This section does not preclude:

(1) the transmittal of a letter rogatory or request directly from a foreign or international tribunal to the tribunal, officer, or agency in the USA to whom it is addressed and its return in the same manner . . .

d Only Foreign Citizens Can Be Extradited from USA Without a Treaty and Only in Certain Cases: 18 USC. §§3181(a)–(b)

(a) The provisions of this chapter relating to the surrender of persons who have committed crimes in foreign countries shall continue in force only during the existence of any treaty of extradition with such foreign government.
(b) The provisions of this chapter shall be construed to permit, in the exercise of comity, the surrender of persons, other than citizens, nationals, or permanent residents of the USA, who have committed crimes of violence against nationals of the USA in foreign countries without regard to the existence of any treaty of extradition with such foreign government if the Attorney General certifies, in writing, that:

    (1) evidence has been presented by the foreign government that indicates that had the offenses been committed in the USA, they would constitute crimes of violence as defined under section 16 of this title and
    (2) the offenses charged are not of a political nature.

e Extradition Requests Based on Documentary Evidence Alone: 18 USC. §3190

Depositions, warrants, or other papers or copies thereof offered in evidence upon the hearing of any extradition case shall be received and admitted as evidence on such hearing for all the purposes of such hearing if they shall be properly and legally authenticated so as to entitle them to be received for similar purposes by the tribunals of the foreign country from which the accused party shall have escaped and the certificate of the principal diplomatic or consular officer of the US resident in such foreign country shall be proof that the same, so offered, are authenticated in the manner required.

f Discretionary Treaty-Based Extradition: 18 USC. §3196

If the applicable treaty or convention does not obligate the USA to extradite its citizens to a foreign country, the Secretary of State may, nevertheless, order the surrender to that country of a US citizen whose extradition has been requested by that country if the other requirements of that treaty or convention are met.

2 Requirements for mutual legal assistance in money laundering cases

a Investigative assistance

No treaty is required under US law to permit US authorities to assist foreign authorities in the investigation of crimes such as money laundering. The USA has, nonetheless, entered into numerous Mutual Legal Assistance Treaties (MLATs) and executive agreements calling for mutual legal assistance (see 3 'International Legal Assistance', §12-8-1, pp. 231–2. MLATs are advantageous because they often provide for expedited investigative assistance procedures. Some MLATs are limited to assistance from specific US agencies, such as the Securities and Exchange Commission (SEC) or the Customs Service, while others cover specific types of crimes, such as drug trafficking, bribery, or tax evasion. Whether pursuant to MLATs, executive agreements, or voluntarily, the USA provides many forms of investigative assistance to foreign countries, including locating persons in the USA and furnishing public records and financial data (see ibid. §12-7-1 (1)–(6), pp. 210–13.

Several federal agencies accept requests from foreign countries for investigative assistance. The Office of the Attorney General of the US Department of Justice processes most foreign requests for investigative assistance (see 22 USC.A. §263a (2000). Requests for assistance with criminal investigations also are channeled through foreign legal attachés representing various US federal agencies, including the Federal Bureau of Investigation, the Drug Enforcement Administration, the Customs Service and the Secret Service (see 3 'International Legal Assistance', §12-1-2 (2), pp. 19–20. Requests for financial data are directed to FinCEN, which acts as the US FIU. Following the September 11th 2001 terrorist strikes in the USA, the US Congress called upon the President to negotiate to enhance international co-operation in money laundering investigations (see Pub. L. No. 107–56, §330(a), 115 Stat. 272, 320 (2001).

b Extradition of suspects

Extradition of an individual from the USA is the only form of legal assistance that generally requires a treaty under US law (see 18 USC.A. §3181(a) (2000, Suppl. 2003).[17] Under the majority of US extradition treaties, extradition of US citizens is not barred (see 4 'International Legal Assistance', §13-2-2 (18). US law also gives the Secretary of State discretion to surrender a US citizen even if the treaty limits extradition of US citizens (see 18 USC.A. §3196 (2000, Suppl. 2003).

3 Legal assistance system

a Main requirements

a Foreign Requests to Gather and Provide Evidence

US courts assist foreign anti-money laundering efforts by compelling testimony and production of evidence, as well as by authorizing search warrants in the USA. Requests for such judicial assistance traditionally are directed to the US State Department or to the Justice Department's Office of International Affairs (OIA) (see 3 'International Legal Assistance', §12-6-2 (2), at 200. US law also permits federal courts to receive requests for judicial assistance directly, including by letters rogatory, without requiring such requests to come directly from a foreign court or through government channels (see 28 USC.A. §1781(b)(1) (2000, Suppl. 2003). Although US federal courts are the most frequent recipients of requests for these types of assistance, US state courts also provide such assistance (see 3 International Legal Assistance §12-6-3, pp. 207–08, (citing Uniform Interstate and International Procedure Act, 13 U.L.A. 355 (1962)).

b Compulsion of Testimony and Production of Evidence

US federal district courts are authorized by law to compel testimony and production of evidence for use in an ongoing proceeding in a foreign country or in a proceeding that likely will be brought in a foreign country (see 28 USC.A. §1782(a) (2000). No court order is required to take voluntary testimony or evidence voluntarily provided (see ibid. §1782(b). However, if testimony is taken by a foreign agent other than a diplomatic or consular official, the US Attorney General should be notified (see 18 USC.A. §951 (2000).

Judicial compulsion of testimony or evidence production in response to the request of a foreign country is subject to standard US constitutional protections, particularly the protection from compelled self-incrimination and the right to effective assistance of counsel. The PATRIOT Act may make it easier for foreign countries to obtain testimony and evidence, because it loosens restrictions on sharing sealed grand jury testimony with foreign countries (see, for example, Pub. L. No. 107-56, §203(a)(1), 155 Stat. 272, 279–80 (2001). In ruling on requests to compel testimony or evidence production, US courts consider several factors, such as the existence or likelihood of a *bona fide* criminal proceeding in the foreign jurisdiction, whether the evidence sought falls within the scope of that proceeding and whether the foreign jurisdiction would honor a similar request from the USA.

c Search Warrants

Searches of persons and their property conducted in the USA are subject to probable cause and warrant requirements under the Fourth Amendment of the US Constitution (see 3 'International Legal Assistance', §12-6-1 (1), pp. 192–3. For US law enforcement to obtain a search warrant for the sole purpose of aiding in the investigation and prosecution of a crime in a foreign country, usually the USA must have a MLAT with the requesting country that calls for issuance of warrants upon request (see ibid. p. 193.

d Extradition of Individuals

As mentioned above, US law generally permits extradition of individuals only pursuant to a treaty with the requesting country. The extradition treaty must designate the alleged offense as extraditable (see 18 USC.A. §3181(a) (2000); *Factor* vs *Laubenheimer*, 290 US 276, 287 (1933); *Valentine* vs *USA*, 299 US 5, 8–9 (1936); *USA* vs *Rauscher*, 119 US 407 (1886). The USA has entered into over 100 bilateral extradition treaties, not all of which designate money laundering as an extraditable offense (see section 2.31.a, *supra*). Moreover, the USA has not fully complied with its obligation under the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances to designate narcotics-related money laundering an extraditable offense (see 28 I.L.M. 493 (1989).

US statutory law and many older extradition treaties require the crime for which extradition is sought to have occurred within the jurisdiction of the requesting country, or for the extradition request to assert jurisdiction on another basis (for example, nationality, principal effect of the crime within the requesting country, protection of national currency) (see 18 USC.A. §3184 (2000, Suppl. 2003); 4 'International Legal Assistance', at §13-2-2(6). Due to the international character of many money-laundering schemes, there may be a legitimate question as to where the crime of money laundering occurred if some or all of the underlying acts constituting money laundering were not committed in, or did not have their principal effect upon, the requesting country.[18]

International money laundering cases may also give rise to multiple requests for extradition of the same person. US extradition treaties deal with this issue in a variety of ways, given the evolution of extradition policy and practice over the past century. Older treaties implement various modifications of a 'first-in-time' rule, while more recent treaties grant significant discretion to the USA to weigh the relative strengths of competing applications. Many treaties, indeed, grant absolute discretion to the Secretary of State to determine which request will take priority (see 4 'International Legal Assistance', §132–4(13).

US federal judges and certain federal magistrates have the authority to issue a warrant of apprehension pursuant to a request for extradition from a foreign country (see 18 USC.A. §3184 (2000, Suppl. 2003). After apprehension of the suspect, it is customary for the arresting agent to present the suspect to the nearest available federal judge or magistrate for an extradition hearing (see 4 'International Legal Assistance', §13-3-1(5). A suspect found to be extraditable is then detained, usually in Federal custody, until transferred to the custody of the requesting country pursuant to standard procedures.

b Major exceptions

All US extradition treaties prohibit extradition of suspects in certain cases. Common exceptions are for 'political' offenses and for offenses for which the accused has already been tried in the USA ('double jeopardy'). The political offense exception is a frequent source of controversy because its scope is often poorly defined.

Many US extradition treaties also contain 'dual criminality' exceptions, which prohibit extradition if the offense for which extradition is sought is not a crime under US law. US extradition law does not require dual criminality unless the relevant treaty requires it. US courts interpreting dual criminality provisions have considered both federal and state laws to determine whether an offense is criminalized under US law (see for example *Wright* vs *Henkel*, 190 US 40 (1903); *Hu Yau-Leung* vs *Soscia*, 649 F.2d 914, 918 (2d Cir. 1981), *cert. denied*, 454 US 1971 (1981). US courts must consider whether underlying acts would fall within the 'broad scope' of the same 'generally recognized crime'. The analogous criminal statutes need not be identical (see *Peters* vs *Egnor*, 888 F.2d 713, 719 (10th Cir. 1989).

c Evidentiary standards

Evidentiary standards governing extradition usually are set by the extradition treaty. Most US treaties adopt a standard equivalent to the Fourth Amendment 'probable cause' standard for the issuance of warrants. Where the treaty standard is unclear or unarticulated, US courts have adopted the constitutional probable cause standard (see, for example *Caltagirone* vs *Grant*, 629 F.2d 739 (2d Cir. 1980). The US Federal Rules of Evidence do not apply in extradition hearings; this permits, at the judge's discretion, the introduction of types of evidence, such as hearsay or unauthenticated documents, that would not otherwise be admissible in US courts (see Fed. R. Evid. 1101(d)(3).

d Extradition of laundered funds and sharing of seized assets with foreign countries

The US Government can transfer forfeited assets to a foreign country that participated directly or indirectly in the seizure or forfeiture if: (1) the transfer has been agreed to by the Justice Department and the Treasury Department; (2) the Secretary of State approves the transfer; (3) an international agreement between the USA and the foreign country authorizes the transfer; and (4) the foreign country is certified under the Foreign Assistance Act of 1961, if required (see 18 USC.A. §981(i)(1) (2000, Suppl. 2003). The USA has asset-sharing agreements with many countries, including Canada, the Cayman Islands, Colombia, Ecuador and Mexico. Although not mandated by statute, the amount of forfeited assets shared with a foreign country usually reflects the proportional contribution of the foreign government to the case that gave rise to the forfeiture (see 2002 'National Money Laundering Strategy', p. 61.

Between 1989 and 2002, over US$171 million, or approximately 44 per cent, of assets forfeited to the US federal law enforcement authorities were subject to equitable sharing with foreign countries, although the exact amount of the shared funds attributable to money laundering offenses has not been tracked for statistical purposes (see ibid. In fiscal year 2001, overall forfeitures were about US$639 million. Money laundering forfeitures constituted US$241 million of that total and equitable sharing amounted to about US$3.4 million (see ibid. p. 11, A-7 to A-8).

D Administrative Co-operation

Due to the international character of money laundering, as well as the fact that it requires a predicate crime, investigation and prosecution of a money laundering case often involves the co-operation of multiple law enforcement and regulatory agencies. In response to the PATRIOT Act's mandate to increase communication and co-operation among US financial institutions, law enforcement agencies and financial regulators, FinCEN is emerging as not only an information clearinghouse and source of expert advice, but also a centralized point for US law enforcement to request information from financial institutions in connection with the investigation of terrorist financing and money laundering (see 67 Fed Reg. 9879, 9884 (Mar. 4, 2002) (proposed addition of 31 C.F.R. §103.100, requiring financial institutions to respond to law enforcement requests relayed by FinCEN to search account records without a subpoena).

1 Federal and state law enforcement

Federal and state law enforcement agencies can obtain online access to

FinCEN's 'Gateway' database of information derived from reports made pursuant to the BSA, such as Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs). Over the past several years, financial institutions also notified federal or state law enforcement agencies directly of an SAR filing in about 17 per cent of the cases (see FinCEN, *SAR Activity Review – Trends, Tips and Issues*, Issue 4 at 13–14 (August 2002), hereinafter 'SAR Activity Review').

The US government has identified interagency co-ordination as a major objective in its anti-money laundering strategy (see 2002 'National Money Laundering Strategy', at 29. One of the proposed methods is to focus leadership in the law enforcement task forces that have been established to combat money laundering and terrorism. Pursuant to a 1998 legislative mandate, a component of the US national money laundering strategy is the identification of 'High Risk Money Laundering and Related Financial Crime Areas' (HIFCAs) (see 31 USC.A. §5342 (2000) (defining HIFCAs). The purpose of the HIFCA program is to assemble teams, comprised of federal and local law enforcement officials assisted by FinCEN, to focus on tracing money laundering proceeds and instituting enforcement and forfeiture proceedings within the HIFCA. HIFCAs are designated pursuant to an application and review process, whereby law enforcement representatives from the area propose the establishment of a HIFCA to FinCEN. The determination of whether to so designate the area is made following consultation and review by FinCEN and various offices within the Treasury Department, the Justice Department and the Postal Service.

The US government also has set objectives of creating an interagency task force to identify money laundering targets and prioritize enforcement actions, as well as intensifying SAR review by local US Attorney's offices (see 2002 'National Money Laundering Strategy', pp. 29–32.

2 FinCEN

One of FinCEN's primary roles is as a clearinghouse for information exchange between financial institutions and law enforcement, while also providing law enforcement with expert evidence analyses. FinCEN provides direct case support to approximately 165 federal, state, local and international law enforcement agencies, issuing an average of 6500 analytical case reports annually (see 'Law Enforcement, Direct Case Support', at: http://www.fincen.gov/le_directcasesupp.html (accessed 18 June 18 2003). FinCEN also provides training in anti-money laundering investigation techniques to law enforcement through its 'Platform' program (see 'Law Enforcement, Platform Access Program', at: http://www.fincen.gov/le_plataccessprog.html (accessed 19 June 2003).

As mentioned above, FinCEN maintains an online database of all SARs

and other reports required under US bank secrecy laws, which is available to federal and local law enforcement agencies. FinCEN also attempts to analyze SARs to identify and alert the financial community of trends in suspicious activity and cases that merit referral to federal or local law enforcement agencies. Such analysis, however, is a difficult task, as SAR filings have increased by about 25 per cent recently, averaging about 20 000 per month (see 'SAR Activity Review', p. 5.

3 Financial supervisors

There are numerous federal supervisory bodies that regulate financial institutions and can be in the position to discover money laundering activity through their examination of financial institutions for general regulatory compliance. The Treasury Department examines several types of financial institutions, including compliance with US anti-money laundering laws.[19] Similarly, the Board of Governors of the Federal Reserve System (FSB), Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA), all independent federal supervisory agencies, also include anti-money laundering compliance as a component of their examination of the banks and other depository institutions under their jurisdiction. The Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) also monitor compliance with anti-money laundering regulations by commodities and securities brokers and dealers, respectively.

III SUPERVISORY LAW (REGULATORY)

A Government Attitude Toward and Scope in Practice for Self-regulation

Although supervisory authorities exercise vigilance, US anti-money laundering laws rely fundamentally on self-regulation by financial institutions, despite the recent expansion of governmental powers and institution of mandatory anti-money laundering compliance programs by the PATRIOT Act. The customer due diligence aspects, while suggesting minimum standards, nonetheless leave the ultimate responsibility for establishing procedures to collect customer information up to the individual financial institution. Similarly, while setting forth a basic definition of suspicious activity, the decision as to what constitutes suspicious activity and thus whether to report it, remains with the financial institution. As discussed in greater detail below, while a wider range of financial institutions have recently been put on notice that they will have to implement anti-money laundering programs, many such programs are likely to focus on customer identification procedures, as these

institutions are not likely to be required to report suspicious activity. Such a self-regulatory climate is, perhaps, understandable in light of the millions of transactions processed through the US financial system each day.

B Anti-Money Laundering Legislation and Regulations

1 Scope

a Territorial scope

The BSA primarily follows a territorial approach to the supervision of financial institutions. US jurisdiction arises because of the organization of a financial institution under the laws of the USA, or the presence of a financial institution, its branches, agents, or offices within the territory of the USA. The PATRIOT Act, however, has introduced aspects of extraterritoriality into the BSA, particularly with respect to the treatment of certain correspondent accounts (see *infra* Section II.B.2.a.*b*.3).

a Supervision of Foreign Subsidiaries

Generally speaking, foreign subsidiaries of US financial institutions acting outside the USA (as opposed to foreign branches of US financial institutions) are not subject to the BSA. Foreign branches of insured US financial institutions have been determined not to be subject to certain BSA regulations (see 67 Fed. Reg. 25090, 25093, 9 May 2003). If, however, a foreign subsidiary maintains an agent, agency, branch, or office within the USA, then it would be subject to the BSA, as such a presence within the USA is sufficient to establish US jurisdiction under the BSA (see 31 USC.A. §5312 (2000, Suppl. 2003); 31 C.F.R. §103.11(c) (2002).

b Supervision of US-Incorporated Subsidiaries of Foreign Banks by Foreign Supervisors

On 30 May 2003, the Board of Governors of the Federal Reserve System, which acts as the principal federal functional regulator for foreign banks doing business in the USA, issued a notice of proposed rulemaking (68 Fed. Reg. 32434). The Federal Reserve proposal would amend Regulation K (12 C.F.R. Part 211) to require that US branches, agencies and other offices of foreign banks and Edge and Agreement corporations establish and maintain programs and procedures to comply with the Bank Secrecy Act. Citing the interim final rule issued by the Treasury Department under s. 352 of the PATRIOT Act, which deems a financial institution's adherence to the anti-money laundering

compliance requirements of the federal functional regulator or self-regulatory organization to constitute BSA compliance, the notice of proposed rulemaking describes the action as a 'clarification' of the existing obligations of these financial institutions. (See subsec. b.*a* below for detail on the definition of 'banks' under the BSA.) Comments were due by 30 June; at this juncture, it is not known when the final rules will be issued.

While not affirmatively addressed in the BSA, US law does not prohibit parallel foreign supervision of US-incorporated subsidiaries of foreign banks for purposes of determining compliance with other countries' money laundering requirements, provided that such foreign supervision does not prevent such subsidiaries from complying with their obligations under US anti-money laundering laws.

b Institutions subject to suspicious activity reporting, customer identification program and Anti-Money Laundering Compliance Program Requirements

The BSA, which is the primary US anti-money laundering regulatory statute, identifies numerous types of 'financial institutions' as being potentially subject to suspicious activity reporting, customer due diligence and compliance program requirements (see 31 USC.A. §5312(a)(2) (2000, Suppl. 2003). The BSA, however, delegates the authority to implement such requirements through regulations, including the discretion to exempt certain types of financial institutions, to the Secretary of the Treasury (see 31 USC.A. §5318(a) (2000, Suppl. 2003). Banks (including credit unions), securities broker-dealers, certain money services businesses, mutual funds and casinos and other gaming establishments – currently are subject to the full range of Treasury Department anti-money laundering regulations requiring suspicious activity reporting, customer identification programs and anti-money laundering compliance programs. FinCEN recently proposed the extension of reporting requirements to certain insurance companies, futures commission merchants and introducing brokers (see 67 Fed. Reg. 64067, 17 October 2002, life and annuity insurance companies; 68 Fed. Reg. 25090, 5 May 2003, (futures commission merchants and introducing brokers) (see Appendix 1 for a matrix summarizing BSA requirements for each type of financial institution).

a Banks

Treasury Department regulations define a 'bank' as:

> Each agent, agency, branch or office within the USA of any person doing business in one or more of the capacities listed below:

(1) A commercial bank or trust company organized under the laws of any State or of the USA:
(2) A private bank
(3) A savings and loan association or a building and loan association organized under the laws of any State or of the USA
(4) [A federally insured credit union]
(5) A savings bank, industrial bank or other thrift institution
(6) A credit union organized under the law of any State or of the USA
(7) Any other organization (except a money services business) chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a State
(8) A bank organized under foreign law
(9) Any national banking association or corporation . . . (See 31 C.F.R. §103.11(c) (2002).)

b Brokers and Dealers in Securities and Commodities

Instead of covering all securities and commodities broker-dealers, Treasury regulations apply BSA obligations only to brokers and dealers registered or required to be registered with the SEC and CFTC. As discussed in greater detail below, the PATRIOT Act also required the Treasury Department to expand significantly the customer due diligence and suspicious activity reporting requirements for registered securities and commodities broker-dealers.

c 'Money Services Businesses' (MSBs)

'Money services businesses' engage in one or more of the following businesses:

(1) Currency dealer or exchanger [whose business exceeds US$1000 in transactions per day].
(2) Check casher [whose business exceeds US$1000 in transactions per day].
(3) Issuer of traveler's checks, money orders, or stored value [whose business exceeds US$1000 in transactions per day].
(4) Seller or redeemer of traveler's checks, money orders, or stored value [whose business exceeds US$1000 in transactions per day].
(5) Money transmitter.
    i. In general. Money transmitter:
        (A) Any person, whether or not licensed or required to be licensed, who engages as a business in accepting currency, or funds denominated in currency and transmits the currency or funds, or the value of the currency or funds, by any means through a financial agency or institution, a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both, or an electronic funds transfer network; or
        (B) Any other person engaged as a business in the transfer of funds.
    ii. Facts and circumstances: Limitation. Whether a person 'engages as a

> business' in the activities described in [the preceding] paragraph . . . is a matter of facts and circumstances. Generally, the acceptance and transmission of funds as an integral part of the execution and settlement of a transaction other than the funds transmission itself (for example, in connection with a bona fide sale of securities or other property), will not cause a person to be a money transmitter . . .
>
> (7) US Postal Service . . . except with respect to the sale of postage or philatelic products. (31 C.F.R. §103.11(uu) (2002).)

Currently, all MSBs except for check cashers and issuers, sellers and redeemers of stored value are subject to SAR requirements (see 31 C.F.R. §103.20(a)(1), (a)(5)(2002).

MSBs, which are not otherwise under the supervision of a federal agency, are required to register with the Treasury Department (see 31 C.F.R. §103.41 (2002). The operations of unregistered MSBs, particularly informal international money transmission services, such as *hawala* services,[20] have been targeted by the Treasury Department as being highly susceptible to use in financing terrorism (see for example, Richard Cowden, *Treasury Underscores Aggressive Stance in Targeting Hawalas, Other Money Services*, 147 D.E.R. (BNA) A-12 (31 July 2002).

d Gambling Casinos and Other Gaming Establishments

Casinos and gambling establishments with US$1 million or more in annual gaming revenue are subject to US anti-money laundering customer due diligence regulations, if located in the USA, its territories and insular possessions (for example, Puerto Rico, US Virgin Islands, the US Pacific island territories), or on Native American Indian reservations. So-called card clubs and gaming clubs, which are 'members-only' gambling establishments, also are covered.

Until recently, casinos and card clubs were not required to report suspicious activity to the Treasury Department.[21] Treasury issued a final rule expanding SAR reporting to cover casinos and card clubs, effective as of 25 March 2003, as part of its implementation of the PATRIOT Act (see 67 Fed. Reg. 60722 (26 September 2002) (to be codified at 31 C.F.R. §§103.11, 103.21 and 103.64).

e Proposed Expansion of SAR Requirements

FinCEN has proposed regulations extending SAR reporting requirements to certain insurance companies. An insurance company is defined in the proposed regulations as a business (but not its agents or brokers) engaged in:

(A) The issuing, underwriting, or reinsuring of a life insurance policy
(B) The issuing, granting, purchasing, or disposing of any annuity contract or
(C) The issuing, underwriting, or reinsuring of any insurance product with investment features similar to those of a life insurance policy or an annuity contract, or which can be used to store value and transfer that value to another person (67 Fed. Reg. 64067, 64074, 17 October 2002).

FinCEN also has proposed to expand SAR requirements to mutual funds, (see 68 Fed. Reg. 2716 (21 January 2003). This requirement would apply to open-ended investment companies, as defined by the Investment Companies Act of 1940, 15 USC. 80a-2 (see ibid. p. 2721. FinCEN also has proposed to apply SAR requirements to certain futures commission merchants and introducing brokers in commodities who are registered as such with the CFTC (see 68 Fed. Reg. 23653, 23660, 5 May 2003).

c Financial institutions subject to customer identification program and anti-money laundering Compliance Program Requirements

The BSA, as amended by the PATRIOT Act, imposes Customer Identification Program (CIP) and anti-money laundering compliance program requirements for financial institutions in addition to those discussed in the previous section (see Appendix 1 for a matrix summarizing the BSA requirements that apply to each type of financial institution. The Treasury Department, in co-operation with other relevant supervisory agencies, has issued regulations instituting CIP requirements (based on 'Know Your Customer' (KYC) requirements) for futures commission merchants and introducing brokers in commodities (see 68 Fed. Reg. 25149 (9 May 2003) (SAR reporting for such entities also has been proposed, as discussed in the preceding section).

d Financial institutions subject only to anti-money laundering compliance program Requirements

Furthermore, the Treasury Department recently issued regulations requiring regulated financial institutions, money services businesses, mutual funds, credit card systems, certain insurance companies and certain unregistered investment companies (such as hedge funds, real estate investment trusts and commodity pool operators) to put in place anti-money laundering compliance programs, also extending this requirement to credit card system operators, which were previously not subject to any BSA regulations.[22] While there are few explicit requirements for the anti-money laundering programs, the mere existence of an obligation to establish a program is, nonetheless, novel, as is its applicability to credit card operators, life and annuity insurance companies, mutual funds and unregistered investment companies.[23]

Although the BSA authorizes imposition of reporting, due diligence and compliance program requirements on various types of financial institutions, certain financial institutions are currently exempted from such requirements, including:

- Dealers in precious metals, stones, or jewels
- Pawnbrokers
- Loan or finance companies
- Travel agencies
- Telegraph companies
- Sellers of vehicles, including automobiles, airplanes and boats
- Persons involved in real estate closings and settlements
- Commodity trading advisors.

The Treasury Department also has proposed adding a new type of business, investment advisers, not previously listed in the statute, pursuant to discretionary authority granted to the Treasury Department to extend coverage of the BSA to other businesses that may present money laundering risks (see 68 Fed. Reg. 23646 (5 May 2003) (covering certain investment advisers with US$30 million or more under management, but not required to register under SEC rules.)

Treasury Department regulations have deferred indefinitely the obligation to institute an anti-money laundering compliance program for such financial institutions (see 67 Fed. Reg. 67547 (6 November 2002) (removing the requirement that all listed financial institutions institute a compliance program by 24 October 2002, as previously set forth at 31 C.F.R. §103.170(b)(1)). As noted in its amendment to the regulations, however, the Treasury Department is considering whether to apply the requirement to some or all of these financial institutions (see ibid. at 67548. The Treasury has issued notices proposing to subject commodity trading advisors and unregistered investment advisors to anti-money laundering compliance program requirements (see 68 Fed. Reg. 23640, 5 May 2003) (commodity trading advisors); 68 Fed. Reg. 23646, 5 May 2003) (investment advisors). FinCEN also has issued advance notices of proposed rulemaking seeking public comment about whether to subject travel agents, vehicle sellers and persons involved in real estate closings to anti-money laundering compliance program requirements (see 68 Fed. Reg. 8568, 24 February 2003) (vehicle sellers); 68 Fed. Reg. 8571, 24 February 3003) (travel agents); 68 Fed. Reg.17569, 10 April 2003) (persons involved in real estate closings).

Unlike in the European Union, attorneys, notaries and other unregulated fiduciaries involved in financial transactions in the USA currently are not subject to either suspicious activity reporting or customer due diligence

requirements under US anti-money laundering laws. This position has been the subject of heated debate in recent years, pitting the Justice Department and Treasury Department against the American Bar Association, which has resisted the imposition of such requirements on attorneys because of conflicts they would create with the attorney-client privilege. However, the notice of proposed rulemaking for persons involved in real estate closings, 68 Fed. Fed. 17569 (10 April 2003), identifies lawyers as one possible category of persons to whom anti-money laundering compliance rules should be applied in this context. As international standards for compliance by professionals such as lawyers are further developed, it is likely this issue will be revisited by US authorities.

2 Regulatory obligations of financial institutions

a Customer identification programs and due diligence

In force since 1970, the BSA embodies various KYC principles (see 31 USC.A. §§5311 *et seq*. (2000, Suppl. 2003). KYC principles have been adopted over time by financial institutions in response to the examination requirements of their various supervisory agencies, which, generally speaking, impose a duty on regulated financial institutions to take reasonable efforts to be reasonably certain of the identity of their customers and the beneficial owners of accounts.[24]

The PATRIOT Act reaffirmed and expanded KYC principles under the rubric of 'customer identification programs', making more specific recommendations about the information to be collected and procedures to be adopted, expanding the type of financial institutions subject to such requirements and adding a limited number of mandatory elements, such as screening prospective customers against US government lists of known terrorists.

The BSA, as amended by the PATRIOT Act, directs financial institutions to maintain certain records concerning customers, including the customer's name and tax identification or social security number. These records ensure that the financial institution can identify and provide basic information about its customers. More fundamentally, they create an obligation for financial institutions to learn about their customers, in order to recognize unusual transactions that could be related to money laundering.

In issuing regulations implementing the PATRIOT Act revisions for banks, savings associations and credit unions, the Treasury Department stated,

> Section 326 of the [PATRIOT] Act provides that the regulations must contain certain requirements. At a minimum, the regulations must require financial institutions to implement reasonable procedures for (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2)

> maintaining records of the information used to verify the person's identity, including name, address and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency (68 Fed. Reg. 25090, 25090 (9 May 2003).

a Account Opening Procedures and Customer Acceptance Policy

1 Treasury department mandated customer identification programs

Recent regulations proposed by the Treasury Department in co-operation with other supervisory agencies impose a duty on banks, savings associations, credit unions, credit card companies, mutual funds, investment companies, securities brokers and dealers, commodities merchants and introducing brokers to implement customer identification programs (CIPs) that go beyond previous KYC requirements, including the screening of customers against government lists of known terrorists and terrorist organizations. The regulations impose minimum standards, but also exhort financial institutions to design CIP programs that:

> [I]nclude risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The procedures must enable the [financial institution] to form a reasonable belief that it knows the true identity of each customer. These procedures must be based on the [financial institution's] assessment of the relevant risks, including those presented by the various types of accounts maintained by the [financial institution], the various methods of opening accounts provided by the [financial institution] and the various types of identifying information available and the bank's size, location and customer base (68 Fed. Reg. 25090, 25109 (9 May 2003) (banks, savings associations, credit unions, private banks); requirements are similar for other financial institutions (see 68 Fed. Reg. 25113, 25130 (9 May 2003) (broker-dealers); 68 Fed. Reg. 25131, 25147 (9 May 2003) (mutual funds); 68 Fed. Reg. 25149, 25160 (9 May 2003) (futures commission merchants and introducing brokers).

While not required by law, Treasury regulations strongly encourage covered financial institutions to obtain the following minimum information prior to opening an account or adding a signatory:

1. Name
2. For individuals, date of birth
3. i. For individuals, residence or business street address, Army Post Office, Fleet Post Office, or the residential or business street address of next of kin or another contact individual.
   ii. For persons other than individuals, such as corporations, partnerships and trusts: a principal place of business, local office, or other physical location.

4 i. For US persons, a US taxpayer identification number (e.g. social security number, individual taxpayer identification number, or employer identification number); or

ii. For non-US persons, one or more of the following: US taxpayer identification number; passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. (See ibid. p. 25109 (to be codified at 31 C.F.R. §103.121(b)(2)(i) for banks; requirements are similar for other financial institutions).

Financial institutions subject to CIP requirements also must have 'risk-based' procedures in place to verify the information provided for a new account, both through documentary and non-documentary procedures. While specific procedures are not mandated, financial institutions must, practically speaking, institute sufficiently detailed procedures to withstand Treasury Department scrutiny.[25]

Suggested verification documents include: '(1) For individuals: unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and (2) For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument' (ibid (to be codified at 31 C.F.R. §103.121(b)(2)(ii)(A) for banks; requirements are similar for other financial institutions).

Financial institutions subject to CIP requirements also must have procedures in place for conducting verification when such documentary evidence is not available, the bank is not familiar with the documents presented, an account is opened without obtaining documents, an account is not opened in a face-to-face transaction (such as through electronic banking), or the type of account increases the risk that the bank will not be able to verify the true identity of the customer through documents (see ibid. The CIP program also 'must include procedures for responding to circumstances in which the [financial institution] cannot form a reasonable belief that it knows the true identity of a customer' (see ibid. at 25110 (to be codified at 31 C.F.R. §103.121(b)(2)(B)(iii) for banks; requirements are similar for other financial institutions). Again, the Treasury regulations do not prescribe when financial institutions must take certain actions, but do require that the procedures describe when the financial institution should refuse to open an account, limit customer use of the account while verification procedures are proceeding, close the account, or file an SAR.

2 Customer identification requirements of other supervisory agencies and Self-Regulating Organizations

The SEC,[26] National Association of Securities Dealers (NASD),[27] and New York Stock Exchange (NYSE)[28] rules also require brokers and dealers to collect certain information regarding their customers. In response to the PATRIOT Act, NYSE also issued new Exchange Rule 445 requiring all member broker-dealers to implement anti-money laundering compliance programs and BSA customer due diligence requirements.[29]

3 Industry practices

All banks are required by law and regulation to have an effective BSA compliance program.[30] In response to the PATRIOT Act, the banking and securities industries, through associations and self-regulating organizations (SROs), have renewed their longstanding efforts to review and recommend industry 'best practices' that exceed the minimum compliance obligations of the BSA, as amended by the PATRIOT Act. The American Bankers Association (ABA), for example, recommends that banks solicit additional information from customers, such as an individual account holder's occupation and additional details regarding the nature of business operations for commercial accounts. It also recommends specific verification procedures for such information.[31] Similarly, the NASD has developed new compliance program templates for its members, suggesting specific additional information to be collected and specific methods of verification.[32] The Securities Industry Association (SIA) also has issued guidance for anti-money laundering compliance by brokers and dealers in securities.[33] The degree to which the US government relies on private industry to develop compliance programs cannot be understated, using the possibility of penalty mitigation under the Federal Sentencing Guidelines based on an effective internal compliance program to encourage financial institutions to develop programs that err on the side of caution and exceed the minimum requirements of the law.

4 Beneficial owner identification and notification

Other than the special rules proposed for private banking accounts, discussed in greater detail below, the BSA does not impose a separate legal obligation on financial institutions to ascertain the identity of the beneficial owner of an account, other than the standard requirement to implement sufficient procedures to be reasonably certain of the identity of their customers. The US regulatory approach to this issue is, in essence, risk-based, relying on the desire of financial institutions to avoid enforcement actions or after-the-fact identification with illicit transactions to motivate them to engage in voluntary information gathering. As discussed above, because of their desire to engage in good business practices, as well as to avoid costly and embarrassing enforcement

proceedings, many US financial institutions often take a very conservative approach and require that information about the identity of beneficial owners be collected in connection with account opening procedures and the addition of signatories. US law does not require financial institutions to notify the beneficial owner that such information is being collected from an agent or intermediary.

5 Delegation of identification procedures to third parties

US law does not prohibit delegation of identification procedures to third parties. In the event that identification procedures are delegated, however, US law does not exempt a financial institution from its ultimate responsibility to be reasonably certain of the identity of its own customers.

b Enhanced Due Diligence in Special Cases

1 Private banking accounts

Section 312 of the PATRIOT Act introduced new requirements for financial institutions, enhancing the level of due diligence required for certain types of accounts and customers. One such requirement is for financial institutions to conduct enhanced due diligence of private banking accounts held by or maintained for non-US persons, including foreign individuals visiting the USA, or a representative of a non-US person. The Treasury Department has proposed regulations implementing this requirement, but has not issued final regulations as of this writing (see 67 Fed. Reg. 37736 (30 May 2002), 67 Fed. Reg. 48348 (23 July 2002).[34] US financial institutions now are required to ascertain the identity of the nominal and beneficial owners of and source of funds deposited into, all private banking accounts held by non-US persons, in order to guard against money laundering and report any suspicious transactions (see 67 Fed. Reg. 37736, 37744 (30 May 2002).

A 'private banking account' is defined by the PATRIOT Act as (1) having a minimum aggregate deposit of US$1 000 000 or more, (2) is established on behalf of one or more individuals with a direct or beneficial interest in the account and (3) is assigned to, maintained, or managed by an officer, employee or agent of a financial institution acting as liaison between the financial institution and the direct or beneficial owner of the account (see 31 USC.A. §5318(i)(4)(B) (2000, Suppl. 2003).

2 Politically exposed persons (PEPs)

Similarly, the PATRIOT Act requires that private bank accounts held by senior foreign political figures, members of their families and their close associates require 'enhanced scrutiny' (see 31 USC.A. §5318(i)(3)(B) (2000, Suppl. 2003). US financial institutions will be required to scrutinize private banking

accounts held by such persons in a manner reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption (see 67 Fed. Reg. 37736, 37744 (May 30, 2002); 67 Fed. Reg. 48348, 48351–52 (July 23, 2002) (to be codified at 31 C.F.R. §103.181–182). While the current regulations apply only to banks, credit unions, savings associations and securities brokers and dealers, they will likely become applicable to a broader range of financial institutions (see ibid. at 48351. Enhanced scrutiny with respect to the accounts of such PEPs was encouraged by the Treasury Department in guidance issued in early 2001, but is now codified by the PATRIOT Act.

3 Correspondent accounts

Following congressional hearings held in 2000, correspondent banking accounts were identified as a conduit for laundered funds.[35] It is thus not surprising that S. 312 of the PATRIOT Act also requires financial institutions to establish procedures to conduct enhanced due diligence for certain correspondent accounts maintained on behalf of a foreign bank. The enhanced due diligence standard applies to accounts owned by foreign banks operating under an offshore banking license or a license issued by a jurisdiction designated as a non-co-operating jurisdiction in international anti-money laundering efforts by the Treasury Department or by an intergovernmental anti-money laundering organization in which the USA participates, such as FATF.

The enhanced procedures include taking reasonable steps to ascertain the identity of each of the owners of the foreign bank, to conduct enhanced scrutiny of the account to guard against money laundering and to ascertain whether the foreign bank provides correspondent accounts to other foreign banks and if so, to identify such foreign banks (see 31 USC.A. §5318, Subtitle I (2000, Suppl. 2003); 67 Fed. Reg. 60562 (26 September 2002).

Section 313 of the PATRIOT Act prohibits banks (as defined in the BSA) and SEC-registered brokers and dealers from establishing, maintaining, administering, or managing correspondent accounts with foreign banks that do not have a physical presence in any country ('shell banks') (see 31 USC.A. §5318(j) (2000, Suppl. 2003). In addition to the ban, the legislation requires such institutions to take reasonable steps to ensure that any correspondent accounts of a foreign bank maintained in the USA are not being used by that foreign bank to indirectly provide banking services to a shell bank.

In order to implement this ban, the Treasury Department issued regulations requiring banks to maintain records identifying the owners of each foreign bank that maintains a correspondent account, as well as the name and address of a US person authorized to receive service of legal process for

records regarding the account (see 66 Fed. Reg. 67459, 67466 (28 December 28 2001); 67 Fed. Reg. 60562 (26 September 2002). Treasury also issued certification forms, which provide 'safe harbor' protection if used by US banks (see 66 Fed. Reg. 67469, 67476. Covered financial institutions were required to close all correspondent accounts for which the foreign accountholder had not provided the certification by 31 March 2003 (see 67 Fed. Reg. 78383 (24 December 2002).

c Customer Screening Requirements: Anti-Terrorism

Section 326 of the PATRIOT Act introduced a new requirement to screen all new customers against US government lists of known terrorists and terrorist organizations and to follow all procedures of the relevant agencies when a customer appears on such a list (for example, asset blocking procedures) (see 31 USC.A. §5318(l)(2)(C) (2000, Suppl. 2003); 68 Fed. Reg. 25090, 25110 (9 May 2003) (to be codified at 31 C.F.R. §103.121(b)(4) for banks; requirements are substantially similar for certain other financial institutions). While many major US banks have conducted such screens on customers in the past in order to ensure compliance with US economic sanctions regulations, this new requirement represents a noticeable shift from a voluntary to a mandatory compliance scheme.

The US Treasury Department's Office of Foreign Assets Control (OFAC) administers the financial aspects of US economic sanctions programs against embargoed countries and individuals, including designated terrorists and terrorist organizations. There is a separate set of regulations for each targeted country or group of individuals and each set of regulations contains its own definitions of prohibited activity and the persons or property subject to the sanctions.[36]

The USA currently maintains comprehensive trade and investment sanctions against Cuba, Iran, Libya and Sudan, as well as limited sanctions against Burma (Myanmar). The USA also blocks the US assets of numerous individuals, including the Taliban, members of the former Iraqi regime, members of the Mugabe regime in Zimbabwe, war criminals from the former Yugoslavia, terrorists, foreign terrorist groups and narcotics traffickers. In order to enforce US economic sanctions against such individuals and groups, OFAC maintains a list of 'Specially Designated' embargoed country nationals, terrorists and narcotics traffickers, which includes hundreds of individuals and companies (many of them in friendly countries and some in the USA), that are subject to asset blocking and trade prohibitions, depending on their designation. US persons and companies are prohibited from engaging in or participating in a broad range of transactions involving 'property' in which an embargoed government or individual has any 'interest'.

d Ongoing Monitoring of Clients

The BSA does not require ongoing monitoring or periodic updating of client information by subject institutions but rather focuses on obtaining and verifying information in connection with account opening procedures or the addition of authorized signatories. Despite the lack of a requirement for ongoing monitoring, FinCEN advisories nonetheless frequently advise financial institutions to exercise enhanced scrutiny with respect to transactions involving and customers from jurisdictions deemed to be non-co-operative or to be centers of money laundering activity. Within the financial community, industry groups and published best practices frequently recommend adopting policies and procedures to periodically update and/or verify customer account information in general, both for general business reasons, as well as for anti-money laundering reasons. Furthermore, as discussed in the following section, financial institutions that are subject to suspicious activity reporting requirements are required to maintain an ongoing awareness of the activity in their customers' accounts in order to fulfill their reporting requirements.

b Notification of unusual or suspicious activities

a Legal Requirements

1 Suspicious activity reports (SARs)
The BSA requires certain financial institutions to file a SAR with FinCEN when they identify a suspicious financial transaction or pattern of suspicious behavior (see 31 USC.A. §5318 *et seq.* (2000, Suppl. 2003); 31 C.F.R. §§103.18–20 (2002). Under the original BSA, only banks and certain money services businesses were required to file SARs. Section 356 of the PATRIOT Act expanded SAR reporting requirements to include SEC registered brokers and dealers (see Pub. L. No. 107–56, §356(a), 115 Stat. 272, 324 (2001). Section 356 also gave the Treasury Department, in consultation with the Commodity Futures Trading Commission, the authority to issue regulations requiring futures commission merchants, commodity trading advisors and commodity pool operators to file SARs (see ibid. §356(b), 115 Stat. at 324. FinCEN also has expanded suspicious activity reporting to include casinos (see 67 Fed. Reg. 60722 (26 September 2002).[37]

Under the BSA, a suspicious financial transaction is one where a financial institution 'knows, suspects, or has reason to suspect' that:

(i) The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, loca-

tion, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

(ii) The transaction is designed to evade any requirements of [the Bank Secrecy Act or its implementing regulations]; or

(iii) The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction. (31 C.F.R. §103.18(a)(2) (2002) (for banks). Regulations covering all other types of financial institution subject to SAR requirements also include any transaction that

(iv) 'Involves use of the [financial institution] to facilitate criminal activity'.[38] (It is likely that FinCEN also will add this category to the standard for banks.)

Covered financial institutions except for MSBs must report suspicious activity only if the transaction (or transactions in the aggregate) totals US$5000 or more.[39] In most cases, MSBs must report suspicious activity if the transaction (or aggregate transactions) totals US$2000 or more.[40] As will be discussed in greater detail below, the 'reason to suspect' standard requires that financial institutions spot 'red flags' and perform due diligence in an attempt to negate or address such red flags.

Except at the request of FinCEN, a supervisory agency, or law enforcement agency, financial institutions generally are prohibited from (1) informing anyone involved in the transaction that a SAR has been filed, (2) responding to a subpoena or other request to produce a SAR, or (3) providing any information that would disclose that a SAR has been prepared or filed (see 31 USC.A. 5218(g)(2) (2000, Suppl. 2003); See also 31 C.F.R. §103.18(e) (2002). Section 314(b) of the PATRIOT Act (codified at 31 USC. §5311 Note), however, authorized financial institutions to share information regarding individuals and organizations 'engaged in or reasonably suspected of engaging in terrorist acts or money laundering'. The Treasury Department has issued regulations implementing this authorization, permitting financial institutions subject to SAR reporting requirements to disclose such information to other covered financial institutions or to FinCEN (see 67 Fed. Reg. 60579 (26 September 2002) (to be codified at 31 C.F.R. §103.100). While the PATRIOT Act also authorizes information sharing by covered financial institutions with federal law enforcement agencies, the Treasury Department has not yet issued implementing regulations defining the circumstances under which such information sharing can occur.

The BSA contains a safe harbor provision for mandatory reporting. The liability of financial institutions and their directors, officers, employees and agents is limited by statute with respect to disclosures contained in SARs required to be filed by law, or for failure to disclose the fact that a SAR was

prepared or filed (see for example, 31 USC.A. §5218(g)(3) (2000, Suppl. 2003); 31 C.F.R. §103.18(e) (2002). A financial institution that files a SAR that is not required by law (for example, if the institution is not subject to mandatory filing) may not be protected by the BSA safe harbor provisions and may be exposed to liability under other privacy laws.[41] A bank also is not protected if it files an SAR that contains knowingly false and malicious allegations (see *Bank of Eureka Springs* vs *Evans*, Ark.S.Ct., No. 02–623 (5 June 2003).

b Guidelines and 'Red Flags'

FinCEN issues several types of guidelines, including alerts and advisories regarding the need to apply enhanced scrutiny to transactions involving jurisdictions that FinCEN deems deficient in enacting or enforcing anti-money laundering activities, or are known hubs of money laundering activity. Such advisories instruct covered financial institutions to apply enhanced scrutiny to transactions involving such countries. FinCEN also issues periodic summaries of recent reports of suspicious activities as a means of educating covered financial institutions about common patterns of suspicious activity. It also makes publications by international anti-money laundering organizations, such as FATF, available on its website to alert financial institutions to worldwide patterns in money laundering activities. Various industry groups, such as the American Bankers Association, also provide guidelines and lists of red flags to their members and develop 'best practices' standards for anti-money laundering procedures.

c Notification Procedures

All covered financial institutions are required to file a standardized SAR form[42] no later than 30 days after the initial detection of facts that may constitute the basis for filing a report (see, for example 31 C.F.R. §103.18(b)(2) (2002). Banks, however, may delay filing for another 30 days if no suspect was identified at the time of the initial detection of the facts, in order to identify a suspect. Under no circumstances, however, should filing be delayed more than 60 days after the initial detection of the suspicious transaction (see ibid. §103.18(b)(3).

MSBs also are required to contact appropriate law enforcement agencies by telephone '[i]n situations involving violations that require immediate attention, such as ongoing money laundering schemes . . .', see ibid. §103.20(b)(3).

Banks and broker-dealers are not required to file a SAR to report an attempted or completed robbery or burglary, or for lost, missing, counterfeit, or stolen securities, provided that a report is made to an appropriate law enforcement authority (see, for example ibid. §103.18 (c).

Treasury regulations also do not require broker-dealers to file a SAR when a violation of SEC rules, or the rules of other SROs (for example NASD, NYSE), is detected, provided such violations are reported to the relevant entities (see 31 C.F.R. §103.19(c)(1)(ii)). Only one SAR need be filed in transactions involving multiple brokers or dealers. Although each broker or dealer retains a legal obligation to report, Treasury regulations require the assignment of SAR filing to only one of the entities involved under such circumstances (see ibid. at §103.19(a)(3)).

If conduct continues for which a SAR already has been filed, FinCEN has provided guidance that organizations should report continuing suspicious activity with a SAR filing at least every 90 days, even if a law enforcement agency has declined to investigate or there is knowledge that an investigation has begun.[43]

Covered financial institutions also must keep records of any SAR filed, as well as the original or business record equivalent of any supporting documentation, for five years from the date of filing of the SAR. All such documentation must be made available to FinCEN and other law enforcement agencies upon request (see, for example 31 C.F.R. §103.18(d) (2002).

d Subject of Obligation

The obligation to file SARs is borne by the financial institution. Individual employees are not personally liable for filing or failing to file reports, unless their participation in a violation is willful, or if they knowingly make a false statement on a report.

e Penalties

Violations of BSA customer due diligence and reporting requirements can result in both civil and criminal penalties. Any person who willfully violates BSA customer identification and reporting requirements can be criminally fined up to US$250 000, imprisoned for not more than five years, or both. Penalties can be doubled where the violation is committed in conjunction with other crimes or as part of a pattern of BSA violations (see ibid. §103.59(a)–(c). A knowingly false statement or representation on a SAR is punishable by a fine of up to US$10 000, imprisonment for up to five years, or both (see ibid. §103.59(d). In the first enforcement action of its kind, a community bank pled guilty in Federal court to criminal charges that it failed to maintain an anti-money-laundering program and failed to file SARs with respect to US$123 million in suspicious money transfers (see *US* vs *Broadway National Bank*, S.D.N.Y. Case No. 02-Cr.-1507 (2002).

US financial institutions that violate BSA regulatory requirements can be

assessed civil penalties of not more than the greater of (a) the amount involved in the transaction (not to exceed US$100 000) or (b) US$25 000 for willful violations of BSA customer identification and reporting requirements. Individual employees who willfully engage in such violations may also be subject to such penalties (see ibid. §103.58(d)–(f). Civil penalties up to US$500 per violation can be assessed for negligent violations (see ibid. §103.59(h). Record-keeping violations can carry penalties of up to US$1 000 per violation (see ibid. §103.59(c).

According to its website, FinCEN has concluded 20 civil penalty proceedings for regulatory violations since 1999, involving failure to file suspicious activity reports or currency transaction reports, as well as record-keeping violations.[44] Two penalties were assessed against individuals (pursuant to a fraudulent check-cashing scheme) and the other 18 were against financial institutions; nine casinos, four money services businesses, four banks and one credit union. Penalties ranged from as low as US$2 500 (for recurrent late filing of CTRs by an exchange bureau) up to the largest civil penalty to date of US$20 000 000, imposed against a federally chartered savings bank for failing to file SARs involving multiple suspicious transactions.

f Obligations to Freeze Assets

1 Legal obligations

Certain laws, such as the US economic sanctions regulations administered by OFAC, obligate financial institutions to take action to block assets. If, for example, a US financial institution becomes aware that it is in possession of assets belonging to a designated foreign terrorist organization, or certain foreign narcotics traffickers listed on OFAC's SDN List, it can no longer engage in any transactions involving such assets and must report the asset blocking to OFAC (see, for example 31 C.F.R. §598.202 (2002) (blocking order for designated narcotics trafficker 'Kingpins'). Practices for establishing and dealing with such blocked accounts under the OFAC regulations are widespread in the banking industry, but may not be as prevalent throughout other types of financial institutions, such as securities brokers. When dealing with assets related to actual or suspected money laundering that does not involve one of the entities or individuals on the SDN List, however, financial institutions generally are not required to freeze assets in the absence of an order from a duly authorized enforcement agency or court.

2 FinCEN not empowered to order assets freeze

FinCEN is not independently authorized to order a financial institution to freeze assets. FinCEN functions mainly as an information clearinghouse and does not carry out its own criminal investigations. Orders to freeze assets

related to money laundering generally are obtained by the investigating law enforcement agencies or the Justice Department.

3 Court ordered assets freeze

As discussed in greater detail above in section I.B., in the US legal system, a court-ordered seizure of assets generally results from a request by a law enforcement agency pursuant to statutory authority to seize and forfeit assets. US courts are not empowered to issue such an order on their own initiative.

g Practical Experience with Notification

SARs currently are being filed both electronically and on paper. Filings are processed into computer records by the IRS in its Detroit computer facility. 203 508 SARs were filed in 2001 (see FinCEN, *SAR Activity Review*, Issue 4, p. 5 (August 2002). While SARs, on average, are available within ten business days of receipt by the IRS, reducing this delay has been cited by FinCEN as an issue of concern and it has initiated the establishment of a secure, fully-computerized filing system (see Secretary of the Treasury, 'Report to Congress in Accordance with §357 of the US PATRIOT Act', pp. 14–18 (26 April 2002).

c Other regulatory obligations

In addition to the above-mentioned CIP and SAR requirements, US financial institutions are also required to submit reports involving certain currency and monetary instrument transactions and transactions involving foreign financial institutions, which are also used by regulators to identify money laundering and other illegal activities (see generally 31 C.F.R. §§103.22–26 (2002).

3 Institutions of the anti-money laundering system

a Role of supervisory agencies in compliance monitoring

The Treasury Department is currently the primary Federal agency responsible for monitoring compliance with US anti-money laundering laws, with responsibility distributed among several Treasury bureaux, including the Office of the Comptroller of the Currency (OCC), which supervises national banks and the Office of Thrift Supervision (OTS), which supervises savings and loan institutions. Other independent federal supervisory agencies, such as the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and National Credit Union Administration include anti-money laundering compliance as a component of their supervision of depository institutions.

The CFTC and SEC also monitor compliance with anti-money laundering regulations by commodities and securities brokers and dealers, respectively. SROs, such as the NASD and NYSE, also monitor their members' compliance with their anti-money laundering rules through auditing and examination. Financial institutions can also report regulatory violations directly to supervisory agencies when filing a SAR with FinCEN, although such direct notifications occur in connection with less than 2 per cent of SAR filings (see FinCEN, 'SAR Activity Review', Issue 4, pp. 13–14 (August 2002).

b FinCEN's role in compliance monitoring

a Organization

Founded in 1990, FinCEN is a relatively small bureau of the Treasury Department (currently less than 250 full-time staff and seconded law enforcement personnel). While it has primary responsibility for coordinating information flow and formulating standards for US anti-money laundering regulatory programs, FinCEN relies to a large degree on outside contractors and other Treasury Department bureaux for support in monitoring BSA compliance. The Internal Revenue Service (IRS), which is also a bureau of the Treasury Department, performs routine BSA compliance audits and processes SARs and currency reports submitted by financial institutions (see Secretary of the Treasury, 'Report to Congress in Accordance with §357 of the US PATRIOT Act', p. 12 (26 April 2002). OCC and OTS also incorporate BSA compliance audits in their examinations of depository institutions.

b Powers

1 Regulatory enforcement

FinCEN is authorized to bring administrative enforcement actions seeking civil penalties for violations of reporting, record-keeping and other BSA regulatory requirements. As is true throughout the Federal government, bringing a criminal enforcement action for BSA violations requires the co-operation and assent of the Justice Department.

2 Information sharing

FinCEN's primary law enforcement functions are to make information received from financial institutions through SARs and other reports available to law enforcement agencies, as well as to provide analyses to law enforcement agencies of suspicious activities identified by such agencies. Section 314 of the PATRIOT Act's mandate to enhance information sharing among financial institutions and law enforcement agencies is still in the process of imple-

mentation, but it appears that FinCEN will be granted the formal authority to require financial institutions to search their records for account information relating to specified individuals, entities, or organizations identified to FinCEN by law enforcement agencies (see 67 Fed. Reg. 60579, 60585–86 (26 September 2002) (to be codified at 31 C.F.R. §103.100), requiring financial institutions to respond to requests from FinCEN to search account records. These regulations codify the informal information request procedures developed following the September 11, 2001, terrorist attacks, with which financial institutions have been co-operating voluntarily (see 67 Fed. Reg. 9879 (4 March 2002) (notice of proposed rulemaking).

Furthermore, use within the Treasury Department of the information derived from BSA reports is not limited to FinCEN. Indeed, according to FinCEN, the IRS is the most frequent user of information contained in BSA reports, as it is often useful in detecting tax evasion and tax fraud (see Secretary of the Treasury, 'Report to Congress in Accordance with §357 of the US PATRIOT Act, p. 12 (26 April 2002).

3 Limitations

FinCEN is not empowered to order financial institutions to freeze assets or take other actions with respect to accounts, but rather works in conjunction with federal or state law enforcement agencies to obtain the appropriate court orders to take such actions.

c Law enforcement agencies

a Information Sharing Regarding Compliance Violations

FinCEN makes information filed through BSA reports available online through its 'Gateway Program' and in response to requests from law enforcement agencies. Inasmuch as FinCEN and the financial regulators are the agencies primarily concerned with enforcing regulatory compliance, there is no real need to share information regarding regulatory compliance violations with law enforcement in the absence of evidence of criminal violations.

NOTES

1. The authors gratefully acknowledge the assistance of their colleagues David Hamill and Mark Rochon in the preparation of this chapter.
2. Copyright 2003 Miller and Chevalier Chartered. All rights reserved. This chapter was current through June 2003.
3. Federal supervisory agencies for banks include the Office of the Comptroller of the Currency in the Treasury Department (which supervises national banks), the Board of Governors of the Federal Reserve System (which supervises state member banks and finan-

cial holding companies) and the Federal Deposit Insurance Corporation (which supervises state non-member banks). Savings and loan associations, thrift institutions and credit unions have separate federal supervisory bodies. Because the USA is a federal system, federal supervisory agencies do not supervise all entities listed as 'financial institutions' under the BSA, such as banks that are not depository institutions, banks chartered at only the state level and insurance companies.

4. For the most recent statement of the authority delegated to FinCEN, see 67 Fed. Reg. 64697 (21 October 2002).
5. The wire fraud statute provides, in pertinent part: 'Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representation, or promises, transmits or causes to be transmitted by means of wire . . . communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both'. (18 USC.A. §1343 (2000, Suppl. 2003).
6. In general, proof that the goods or services were purchased with the intent to carry out the specified unlawful activity has been held sufficient to demonstrate promotion (see *USA* vs *Jackson*, 935 F.2d 832, 841 (7th Cir. 1991).
7. To establish knowledge that the transaction was designed to conceal the proceeds of a specified illegal activity, the government need not prove that the defendant shared the criminal's desire to conceal the funds, only that the defendant knew of the design for concealment (see, for example *USA* vs *Campbell*, 977 F.2d 854 (4th Cir. 1992) (under-the-table funds and nominee names for mortgage on house).
8. See 2002 'National Money Laundering Strategy', p. 1. As the Report notes, '[t]he 2002 National Money Laundering Strategy breaks important new ground and, for the first time, describes a co-ordinated, government-wide strategy to combat terrorist financing. We will apply the lessons we have learned from the federal government's efforts against money laundering to attack the scourge of terrorism and to deny terrorist groups the ability to finance their cold-blooded murder', ibid.
9. See *Pub. L.* No. 107–56, §372, 115 Stat. 272, 338–9 (2001).
10. Criminal forfeitures pursuant to this provision are subject to the procedures set forth in 21 USC. §853.
11. The US government may not seek substitute assets in certain cases involving intermediaries who simply handled money but did not retain the property (see 18 USC.A. 981(b)(2) (2000, Suppl. 2003).
12. Section 983(d) includes lienholders such as banks and mortgage companies as owners eligible for innocent-owner relief (see 18 USC.A. §983(d)(6)(A)(2000, Suppl. 2003).
13. See *USA* vs *One Single Family Residence Located at 6960 Miraflores Ave*., 731 F. Suppl. 1563, 1571 (S.D. Fl. 1990).
14. Similar statistics for previous years were unavailable. Officials in the Treasury Department's Executive Office of Asset Forfeiture informed the authors that the forfeiture statistics for money laundering offenses in 2001 were produced specifically for the 2002 Money Laundering Strategy and involved an intensive case-by-case review of all federal forfeitures to segregate which funds were specifically linked to money laundering offenses.
15. This figure represents forfeitures related to all crimes where forfeiture is authorized by law and is not limited to money laundering forfeitures.
16. Available at: http://www.usdoj.gov/jmd/afp/01programaudit/auditreport72002.htm.
17. US extradition law was amended in 1996 to allow the extradition of individuals pursuant to comity and without a treaty, if the suspect has committed certain violent crimes against a US national in the requesting country.
18. While the Justice Department and State Department historically have taken a restrictive approach, requiring the acts underlying the crime to have taken place within the requesting country's territory, some US courts have permitted extradition when the suspect was not physically present in the requesting country but the crime's principal impact was in the requesting country.
19. Supervisory responsibility is distributed among several Treasury bureaux. The Office of the

Comptroller of the Currency (OCC) supervises national banks. The Office of Thrift Supervision (OTS) supervises savings and loan institutions. As sister bureaux within Treasury, these agencies are well situated to notify and work closely with FinCEN if they discover potential money laundering activity in the course of an examination.

20. *Hawala* is a traditional system of long-distance money exchange in the Middle East, Africa and South Asia. It permits international transfers of cash between agents within the *hawala* system without the need for international bank transfers through ongoing account maintenance between the agents.
21. Casinos located in Nevada, a major gaming state, have been required to file SARs with FinCEN since 1 October 1997, pursuant to Nevada gaming regulations. A proposal by FinCEN in 1998 to extend SAR reporting was vigorously opposed by the gaming industry and was not adopted by Treasury (see 63 Fed. Reg. 27230 (18 May 1998).
22. See 67 Fed. Reg. 21110 (Apr. 29, 2002) (financial institutions); 67 Fed. Reg. 21114 (29 April 2002) (money services businesses); 67 Fed. Reg. 21117 (29 April 2002) (mutual funds); 67 Fed. Reg. 21121 (29 April 2002) (credit card systems); 67 Fed. Reg. 60617 (26 September 2002) (unregistered investment companies); 67 Fed. Reg. 60625 (26 September 2002) (insurance companies).
23. Previously, the only required BSA compliance programs were for currency transaction reporting.
24. OCC proposed regulations to impose mandatory KYC procedures on national banks in late 1998, but withdrew the proposal in the face of massive industry opposition. The regulations would have required banks to implement KYC systems determining (1) a customer's identity, (2) a customer's source of funds and (3) a customer's normal and expected transactions involving the bank, as well as monitoring and identifying inconsistent transactions and reporting them through the SAR process (see 63 Fed. Reg. 67524, 67529 (7 December 1998) (proposal); 64 Fed. Reg. 15137 (30 March 1999) (withdrawal).
25. National banks, thrifts and savings and loan institutions have an additional incentive to have sufficient BSA compliance programs in place, as BSA compliance is a component of general examination procedures by relevant supervisory agencies on both the federal and state level.
26. SEC Rule 17a–3(a)(9) requires registrants to obtain information regarding beneficial ownership of cash and margin accounts.
27. NASD Rule 2310 requires brokers and dealers to make efforts to obtain certain information regarding investment objectives, tax status and the like from their customers. NASD Rule 3110 requires brokers to obtain identifying information, including taxpayer identification numbers, information regarding employment and authorized signatures for both individual and organizational accounts.
28. NYSE Rule 405 requires members to exercise due diligence to learn the 'essential facts' relating to customers, orders and cash or margin accounts.
29. See NYSE, Release No. 34-45798 (new Rule 445); NYSE, Information Memo 02–21 (6 May 2002) (approval of new rule 445); NYSE, Information Memo 02–34 (1 August 2002) (clarification to new Rule 445). Both memos at http://www.nyse.com under the 'Regulation' tab.
30. For national banks, the minimum requirement is that the board of directors of each national bank must adopt a written compliance program (12 C.F.R. §21.21(b) (2002).
31. See, for example American Banking Association, *Industry Resource Guide – Identification and Verification of Accountholders* (January 2002), available at: http://www.aba.com/aba/pdf/InsResourceGuide.pdf) (last visited 19 June 2003).
32. See NASD, *Small Firm Template, Anti-Money Laundering (AML) Program: Compliance and Supervisory Procedures*, available at http://www.nasdr.com/pdf-text/aml_template.doc (accessed 19 June 2003).
33. See SIA Anti-Money Laundering Committee, *Preliminary Guidance for Deterring Money Laundering* Activity, available at: http://www.sia.com/moneyLaundering/pdf/AMLguidance.pdf (accessed 19 June 2003).
34. Treasury's interim announcements, however, advise financial institutions to use the proposed regulations as a compliance guideline (see 67 Fed. Reg. 48348, 48350–1 (23 July 2002).

35. See Minority Staff of Permanent Subcomm. on Investigations, 107th Congress, *Report on Correspondent Banking: A Gateway for Money Laundering* 1 (Comm. Print 2001).
36. For additional information regarding the scope and extent of US economic sanctions, see Lucinda Low and William M. McGlone, 'Avoiding Problems Under the Foreign Corrupt Practices Act, US Antiboycott Laws, OFAC Sanctions, Export Controls and the Economic Espionage Act', 12–20, publication forthcoming in American Bar Association, *Structuring and Documenting International Business Transactions*.
37. Until recently, the only SAR reporting requirement was for Nevada casinos, which must file SARs with FinCEN in accordance with Nevada Gaming Commission Regulation 6A, Part 100.
38. See 31 C.F.R. §103.19(a)(2) (broker-dealers); 68 Fed. Reg. 6613, 6617 (10 February 2003) (MSBs); 67 Fed. Reg. 60722 (Sept. 26, 2002) (casinos); 67 Fed. Reg. 64067, 64074 (17 October 2002) (proposed rule for insurance companies).
39. See 31 C.F.R. §§103.18(a)(2) (banks); 103.19(a)(2) (broker-dealers); 67 Fed. Reg. 60722, 60729 (26 September 2002) (casinos); 67 Fed. Reg. 64067, 64074 (17 October 2002) (proposed rule for insurance companies); 68 Fed. Reg. 2716, 2721 (21 January 2003) (mutual funds).
40. See 31 C.F.R. §103.20(a)(2). In cases where suspicious transactions are identified from a review of clearance records of money orders or traveler's checks, the threshold is US$5000.
41. Health insurers, for example, may be covered by BSA as insurance companies; filing of voluntary SARs also must comply with privacy regulations issued pursuant to the Health Insurance Portability and Accountability Act (HIPAA) (see 45 C.F.R., Parts 160 and 164 (2002). For additional detail See Miller and Chevalier Chartered, *ERISA and Benefits Alert*, Vol. 4, No. 4 (12 April 2002).
42. Forms for banks (SAR), brokers and dealers (SAR-BD), casinos (SARC), insurance companies (SAR-IC), mutual funds (SAR-SF) and MSBs (SAR-MSB) differ slightly. All are referred to herein simply as 'SAR'.
43. See FinCEN, 'SAR Activity Review – Trends, Tips and Issues' 27 (October 2000), at: http://www.fincen.gov/sarreviewissue3.pdf.
44. See 'Regulatory Enforcement Actions', at: http://www.fincen.gov/reg_enforcement.html (last visited 19 June 2003).

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APPENDIX: REGULATORY OBLIGATIONS OF US FINANCIAL INSTITUTIONS AS OF 19 JUNE 2003

Institution	SAR	Customer Identification Program	Anti-money Laundering Program
Banks	Yes	Yes	Yes
Credit unions	Yes	Yes	Yes
Registered broker-dealers	Yes	Yes	Yes
Money services businesses	Yes (some types; proposed for others)	Yes (some types; less information than banks)	Yes
Casinos	Yes	Yes (less information than banks)	Yes
Mutual funds/unregistered Investment Companies	Yes	Yes	Yes
Futures commission merchants introducing brokers	Proposed	Yes	Yes
Private banks (w/o federal functional regulator)	Yes	Yes	No*
Credit card system operators	No	Yes	Yes
Insurance companies (life and annuity)	Proposed	No	Proposed
Commodity pool operators	No	No	Yes
Commodity trading advisors	No	No	Proposed
Unregistered investment advisers	No	No	Proposed
Other insurance companies (property/casualty, health)	No	No	No*
Dealers in precious metals, stones, or jewels	No	No	No*
Pawnbrokers	No	No	No*
Loan or finance companies	No	No	No*
Travel agencies	No	No	No*
Telegraph companies	No	No	No*
Sellers of vehicles	No	No	No*
Persons involved in real estate closings and settlements	No	No	No*

Note: *The Treasury is currently in the process of determining whether these financial institutions will be subject to anti-money laundering compliance program requirements

PART III

8. Synthesis: Comparing international standards and their implementation

Mark Pieth and Gemma Aiolfi

I ANTI-MONEY LAUNDERING AS A MULTIFUNCTIONAL CONCEPT

A Measuring Effectiveness

Returning once again to the chapter on international standards,[1] a key issue in the discourse on AML seems to have been lost: Are AML-rules really effective? After 15–20 years of setting standards it seems very hard to pose such a simple – and yet 'subversive' – question. How could it become such a taboo?

To answer the question about effectiveness would require a clear definition of the goals of AML. Superficially the assumption must be that AML is about catching criminals and disrupting their support network. While reducing the ability of criminal operators to obscure the origin of ill-gotten gains and to put them to new use, is certainly one of the *raisons d'être* of AML, it might not be the only one.

Remaining for a moment with the officially declared goal – that is combating crime – even here effectiveness is difficult to assess, not least because AML has been a constantly moving target. Starting off as a specific measure to track down drug-traffickers, then later used to combat other forms of organized criminals active on all sorts of illegal markets, it soon moved into the area of serious crime as such, encompassing as predicates economic and corporate crime, especially the abuse of public power or to use a popular expression 'graft'. More recently, the concept has been enlarged to encompass tax fraud in some jurisdictions. Finally, several countries have diluted the notion of predicate offence yet further in order to tag 'money laundering' on to all sorts of offences (stopping short perhaps of mere misdemeanours).[2]

Furthermore, even if the effectiveness of AML measures were restricted to their narrowest traditional meaning relating to drugs and organized crime, efficacy in police and justice terms cannot easily be proven. Of course figures on convictions and confiscation are available for most developed financial centres.[3] They are, however, relatively low compared with the amount of

suspicious transaction reports (STRs) and – nearly 20 years into the development of these rules – it cannot be credibly argued that AML has helped phase out any of the current forms of macro-crime, be it 'organized', 'corporate' or 'state' crime or terrorism. The efforts will make laundering procedures more complicated and costly, thereby possibly creating additional opportunities for more sophisticated operators. Additionally, one could say that it imposes a kind of 'law-enforcement levy' on these activities. It will be a moot point whether the 'taxation rate' is 3 or 10 per cent, since there is no clear indication of the overall volume of illegal transactions.

B Financial Stability

In our opinion, we would however, maintain that the assessment of the efficiency of AML-rules is being discouraged for more fundamental reasons. A closer analysis of the criminal provisions implementing the 1988 Vienna Convention[4] or the Council of Europe Convention 141[5] indicates that the texts are not only making the introduction of ill-gotten gains into the electronic financial circuit a criminal offence, they are, above all, criminalizing the interruption of the paper trail. This is in line with early discussions in the Financial Action Task Force on Money Laundering (FATF) prior to the adoption of the 'Forty Recommendations', when several delegations, including in particular the USA, emphasized the need to control cash transactions routinely, to develop rules to monitor wire transfers[6] and to collect regular and meaningful aggregate data on money flows between financial centres world-wide. In the introductory chapter of this book,[7] we therefore suggested that AML is just as much about creating instruments of global control over money flows in an attempt to abolish national currency controls, and to react to the failing national overview over capital movements. The logic of creating such tools of global governance has been spelled out far more explicitly recently by the Financial Stability Forum and the IMF[8] as well as those organizations focusing on OFCs as risk factors to international financial stability.[9]

As a major consequence of the multi-functionality of AML concepts it has become accepted practice to discuss effectiveness from a restricted, relative perspective.

C Preventing Regulatory Arbitrage

Are the major financial centres and are the competitors in the industry living up to the common (formal) standards defined internationally? Instead of measuring the impact on organized and other forms of crime, the public discourse on AML is about compliance with legal and regulatory requirements. Within companies it is about preventing reputational risk. In the public

domain it is about securing a level playing field for the financial industry and impeding regulatory arbitrage amongst financial centres.[10] It would not be difficult to show that the international peer-review mechanisms, especially the procedures developed by the FATF for members[11] and for non-members[12] are restricting themselves to measuring formal compliance. To give two examples: The mere figures on suspicious transaction reports (STRs) to financial intelligence units (FIUs) are treated as an indicator of success, entirely independent of the number of criminal investigations, convictions or confiscated funds they actually generate. Furthermore, both with respect to members (Argentina) or non-members (Noumea on the one hand for example, and Israel on the other) the verdict of the evaluation depends far more on the current political constellation than the actual merits of the system in place. The emphasis is whether the country has enacted laws and not necessarily on whether the FIU and other institutions envisaged in the laws are actually in operation.

As a consequence, 'effectiveness' has been reformulated in relative terms of 'Customer Due Diligence' (CDD) and comparable standards of risk management.

For instance when in a correspondent banking relationship financial institutions are required to establish the regulatory standard and the compliance level of their respondent banks,[13] the focus is, by necessity, on the formal implementation of rules by supervisors and financial institutions. Banks are in need of simple, abstract and operational risk indicators, allowing them to categorize their business partners and to define stereotyped procedures for specific risk levels.

D Methodology of the Synthesis

In the light of recent developments the relative effectiveness of standards developed by international organizations will be examined, looking in addition at national regulators and financial institutions alike. The focus here is on the implementation of the standards.

However, the synthesis will go beyond a mere comparative description of legal institutions. Making use of a methodology derived from the 'functional' method of comparison of law[14] and attempting to understand law in its context as well as addressing the interaction of rules and practice, it seeks to understand the underlying logic of AML-rules established in the four countries examined.

In a first part of this analysis the extensive country reports, written by observers from within the systems, giving a – critical – account of the countries' approaches in their own right, will be summarized from an outside perspective (section II). These 'vertical reviews' are followed up by a more subjective interpretation of the current differences in approach from country to

country (section III). Since a strong tendency towards convergence can be observed, the final part of the analysis will focus on the cross-cutting issues in a 'horizontal' manner (section IV).

II COUNTRY SUMMARIES

A Singapore

1 General development

Whereas the other financial centres have developed over lengthy periods of time and many of their features which are sometimes contradictory, can be explained as being a result of their historical context, Singapore cannot be categorized in this way. It has evolved as a financial centre as a result of dedicated policies and legislation specifically aimed at creating a leading financial centre within a very short timeframe.

Following its independence from Malaysia, Singapore has struggled to broaden its economic base. Whereas the conditions for setting up a thriving financial centre have been favourable, especially because the economically active Chinese minorities in Malaysia and Indonesia have been looking for a safe harbour for their earnings, whilst being acutely aware of the ethnic and political sensitivity of their position, the delicate relationship of Singapore with its neighbouring countries has also had its impact on the way Singapore evolved as a financial centre and has defined its AML-concept.

The Government has taken an active role in developing the financial centre beyond its supporting role to the local industry. With the creation of the Monetary Authority of Singapore (MAS), chaired by the Minister of Finance, the Central Bank, somewhat atypically, has become the main regulating body for the financial services industry and has governed the financial sector with a firm hand.

Only relatively recently the Singaporean authorities have realized that to be competitive as one of the leading financial centres in Southeast Asia it needed to follow the general trend towards deregulation. It has done so in a continuous manner, also to give its domestic banks a chance. The MAS has pursued a variety of strategies to achieve its goals and in 1999 it declared it would:

1 embark on a five-year liberalization period
2 improve corporate governance practices
3 increase the foreign shareholding limit of local banks.

Worth adding here are the reforms unveiled in 1998 that were designed to increase the competitiveness of Singapore as a financial centre. These reforms

include closer working relationships with the other Government agencies, the institution of a new supervisory framework based on three items:

1 Maintaining high prudential and supervisory standards
2 Shifting the emphasis from regulation to supervision
3 Implementing a risk-based approach to bank supervision.

Developments in the area of asset management are also an interesting example of the dedicated approach the Singaporean Government is taking to develop its financial sector, the stated aim here being to make Singapore the '*premier asset management hub in Asia*'. The efforts to boost the asset management industry have been pursued by committing some S$35 bn, that were previously managed by the MAS and the Government of Singapore Investment Corporation to external asset managers. Giving this sort of seed money has contributed to the development of local know-how and expertise in fund management.

The operating environment for fund managers was further improved through streamlining of regulations and the offer of tax incentives (fund management companies which have been granted 'Enhanced Fund Manager' status will enjoy tax exemption on the free income received from managing at least S$5 bn of foreign investors' funds). As a result of these actions the number of asset management entities has grown from around 80 in 1994 to around 215 companies.

2 Emergence of the AML concept

It must be acknowledged that Singapore had to develop its financial market under difficult circumstances. Many of the local clients are doing business under conditions of high corruption and questionable public governance. From this perspective, it may not at all be a coincidence that until 1999 the AML concept of Singapore was narrowly focused on drug-money laundering and that it lacked a formal obligation to notify suspicious transactions. Informal mechanisms to mediate between conflicting interests have not, however, prevented Singapore from being heavily criticized by the FATF in its 1999 review.

In an effort to change the situation swiftly, Singapore has conducted a complete overhaul of its AML-system: Three new legal texts upgraded the criminalization of money laundering and the ability to confiscate ill-gotten gains (the Corruption, Drug Trafficking and Serious Offences Act, CDSA 1999), the regulatory approach to money laundering (six sectoral MAS Guidelines on Prevention of Money Laundering of 22 February 2000) and the ability to accord mutual legal assistance (Mutual Legal Assistance in Criminal Matters Act, MACMA 2000). Since these legislative and regulatory changes are comparatively recent, it is difficult to assess their impact as yet.

3 Criminal law

a Criminalizing money laundering

The rules criminalizing money laundering were originally contained in the Drug Trafficking Act (DTA) 1993. In 1999 they were amended to extend drastically the list of predicate offences (currently 182 additional non-drug related serious offences). The list of predicate offences does not, however, contain fiscal crime.

The construction largely follows the UK approach, creating five basic offences: First, assisting in the retention of the benefits of crime; second, concealing or transferring; third, acquiring proceeds; fourthly, failure to disclose knowledge or suspicion; and finally, the offence of 'tipping off'. Beyond the UK standards the prosecution does not have to prove that the defendant had actual knowledge that the proceeds derived from crime. An objective knowledge standard lets 'reasonable grounds to believe' suffice.

A body corporate is deemed to be liable under the CDSA for the conduct of its employees or agents acting within the scope of their actual or apparent authority.

b Seizure and confiscation

The public prosecutor can apply for a confiscation order against a defendant who is convicted of drug trafficking or another serious offence with respect to benefits of the offence if the court is satisfied that they are thus derived. There is a rebuttable presumption that the defendant derived benefits from the offence if they appear disproportionate to his own sources of income and cannot be explained to the satisfaction of the court.

The approach to confiscation chosen by Singapore does not insist on the confiscation of the physical assets tainted by the crime, it adopts a value confiscation on the basis of an assessment by the court backed up with default sanctions, including long-term imprisonment.

True to the common law tradition provisory seizure and freezing of assets has to be ordered by a judge. For restraint and charging orders the court needs to be satisfied that there is reasonable cause to believe that benefits have been derived from a predicate offence by the defendant.

It is an open question whether this standard is flexible enough to enable efficient action to block assets pending judicial review. The UK has recently felt it necessary to depart from its traditional requirements and to make provisory measures possible at a very early stage of the procedure.

c Mutual legal assistance

Mutual legal assistance remains one of the weaknesses of the Singaporean

AML system: Even under the new law (MACMA 2000), enacted after harsh criticism from the FATF, coercive measures require a treaty base. MACMA provides the framework within which mutual legal assistance treaties will be negotiated. So far, however, only one such treaty has been concluded (with the USA).

d The effect of bank secrecy on AML

Singapore, like some other places, has a strong bank secrecy law. The 'general rule' states that 'customer identification shall not, in any way, be disclosed by a bank in Singapore or any of its officers to any other persons except as explicitly provided in the banking act'. This confidentiality applies to customer identification, which means any information relating to an account of the customer of the bank, including deposit information. Furthermore, Singapore is one of the only financial centres in which 'numbered accounts' can still afford anonymity to the client.

However, there have been some amendments to the bank secrecy law in 2001, so that it may be relaxed in certain situations. Unfortunately though, some uncertainties still remain. For example, it appears that a bank can disclose customer information in relation to a specified list of laws. It seems rather curious that the CDSA is not on this list. On the other hand the serious crimes law provides the party disclosing information with protection to the extent that the disclosure will not be a breach of any obligation of confidentiality imposed either by law, contract or rules of professional conduct.

e Practical application

Due to the lack of published statistics and the reluctance of authorities to grant access to data[15] it is very difficult to assess the effectiveness of the application of criminal law rules to money laundering in Singapore.

To date there are no reported cases of convictions under the five offences of the CDSA. However, the Country Report refers to four case-histories primarily addressing fraud cases in which apparently an incidental conviction for money laundering occurred.[16]

4 Regulatory law

a CDD rules

The MAS Notice 626 issued in 2000 together with the Association of Bankers' Guidelines 2001 contain detailed and comprehensive rules on CDD. Failure to abide by the MAS rules could result in the loss of the operating licence.

Referring to the FATF ‘Forty Recommendations’ and the Basel Committee Statement of Principles of 1988, the MAS Guidelines oblige banks to implement compliance programmes in the areas of:

- KYC
- Compliance with laws
- Co-operation with law enforcement agencies
- Suspicious transaction reporting
- Staff training
- Record keeping and the retention of documents.

The scope of coverage of financial institutions is wide, since MAS acts as a single regulator. However, Singapore had to admit in its self-evaluation to the FATF for 2001/02 that it was only in partial compliance with Recommendation 19 of the FATF, detailing the NBFIs to be included. Deficits in the coverage of intermediaries, such as fiduciaries and lawyers remain.

The KYC rules are comprehensive and detailed, including special rules for the identification of corporate vehicles and trusts. As to the identification of beneficial owners, Notice 626 does mention the issue in relation to ongoing relationships (4.3), not, however, when detailing the obligations for the opening of accounts (4.1). If doubts remain whether the rules on the identification of the beneficial owners of trusts are as clear as they could be, the reference in the ABS Guidelines to the Wolfsberg AML Principles on verification procedures in private banking could diffuse part of the problem.

As far as increased diligence is concerned, the Singaporean rules still lack reference to PEPs and correspondent banking. Again the banks explicit endorsement of the Wolfsberg Principles could go some way to solve this problem, however, the issues are too pressing to be left to such indirect treatment.

The rules on record keeping require that ‘response can be provided within a reasonable time to any inquiry from the relevant authorities on, *inter alia*, the beneficial owner of the funds deposited with the banks’. If this implies that financial institutions need to be able to extract expediently upon request not only information on the clients but also on beneficial owners from their entire client base, this would meet the requirements of an efficient record-keeping system. The question whether the rule really obliges banks to have computerized access to the data on beneficial owners remains to be answered.

b Suspicious transaction reporting (STR) to Financial Intelligence Unit (FIU)

CDSA 1999 has made the reporting of suspicious transactions mandatory for

all persons (including non-financial institutions) and has included all predicate offences as reporting cases.

Furthermore, under the MAS Guidelines banks are obliged to 'clarify the economic background and purpose of any transaction or business relationship if its form or amount appears unusual in relation to the customer . . . or if the economic purpose of legality of the transaction is not immediately clear'. Increased diligence is a necessary stepping stone towards notification of suspicion.

The standard set by this law obliges banks to make an STR when they know or have reasonable grounds to suspect that any property represents the proceeds of drug-trafficking or other criminal conduct. This would be the case if the transaction in question is inconsistent with the customer's known transaction profile or does not make sense economically.

MAS provides a standard form for the reporting of suspicious transactions and explicitly states that in cases of urgency notification should be made by telephone. There is, however, no mandatory blocking rule. Failure to report is an offence under CDSA.

The Suspicious Transaction Reporting Office (STRO), a unit within the Commercial Affairs Department received 189 STRs under the old system in 1999 and around 500 per year under the new system in 2000 and 2001. For 2002 this figure rose to around 1000. It is so far not possible to relate these figures to cases investigated for money laundering by police and justice authorities.

5 Conclusion

Singapore is making great efforts to become a prime centre for financial services in South East Asia and beyond. On the one hand the authorities are determined to allow a controlled liberalization of the financial markets (they are currently opening Singapore to foreign banks), on the other hand they are making efforts to upgrade the AML-laws and regulations. They are emphasizing a change of approach from 'regulation to supervision' in order to align themselves with the newly emerging trend towards a risk-based approach. The primary goal of the supervisory authority in its work on money laundering is, however, the preservation of the Singaporean banking community's reputation.[17] How this policy will work out in practice cannot yet be determined for lack of evidence. That both the authorities and the local banks are still very shy to share information even about the way in which they implement the rules with the public, does raise some serious questions. Finally, the AML-concepts have a few flaws even in the abstract when compared to the world standard.

B Switzerland

1 General development

With only 7 million inhabitants Switzerland is one of the world's most active financial centres. Some 5.7 per cent (120 000 employees) of the working population in 2000 generated 11–14 per cent[18] of Switzerland's GDP. Swiss banking, especially the Geneva based private banks have a long history,[19] however, Switzerland has only relatively recently become a global player with 'Swiss banking' as the famous, if slightly ambiguous brand. According to estimates, Swiss banking institutions world-wide control roughly one third of cross-border banking world-wide.[20] The success of Swiss banking is closely related to 'bank secrecy'; even if this is not the only asset, it is perceived as a major competitive advantage by foreign competitors. Beyond mere customer confidentiality (a key element of all serious banking) Swiss bank secrecy and related legislation precludes mutual legal assistance and administrative co-operation in fiscal matters (as far as simple tax evasion, as opposed to tax fraud is concerned).[21]

It is no coincidence that Switzerland, as the country of 'bank secrecy', has also become the protagonist of customer due diligence. In 1977,[22] a time when money laundering had not yet become an international concern, all major Swiss banks were pushed to conclude a gentleman's agreement (the CDB[23]) by the Swiss National Bank (SNB) after a large banking scandal in Chiasso. The CDB contains very detailed rules on KYC and identification of beneficial owners (including corporate vehicles and introducers) as well as obliging banks to abstain from actively furthering tax evasion. This type of regulation has become quite typical for the emergence of AML rules in Switzerland. Crises or scandal provokes authorities or self-regulatory bodies to step in, in order to safeguard the reputation of the entire financial centre. Since the place is small and decision-chains short, the reaction can be immediate. This crisis-born legislative history may be regarded as a general pattern. The following examples go to illustrate the theory:

- The Chiasso scandal 1977 led to the CDB 1977ff. (on CDD, especially KYC).
- The 'Pizza Connection' case and the difficulties of courts to react adequately to drug-money laundering led to the first draft of the criminal offences on money laundering.
- The Magharian/Kopp scandal in 1988 led to a fast track parliamentary procedure for the criminal provisions (Art. 305bis and ^{ter}, enforced 1 August 1990).
- The Marcos case (and many other MLA cases involving so-called 'potentates', like the Shah of Persia, Duvalier, etc.) led to a fundamental

revision of the AML legislation and a drastic shortening of procedures in 1996/97.

- Widespread lack of adequate compliance with CDD rules which became apparent with the Abacha scandal, gave the Federal Banking Commission (FBC) a hook on which to develop its most recent draft regulation on CDD, introducing a far reaching version of the risk-based approach.[24]

2 Criminal law

a Money laundering

Criminal legislation on money laundering evolved in three stages in Switzerland. An early draft written under the impression of large drug-money laundering cases was shelved for years and then suddenly activated in 1998/99 as a reaction to yet further, new scandals. The approach of Art. 305bis was from the outset wide, the definition of the crime incorporated all serious offences as predicates. From the beginning, the possible contribution of the Swiss banking resort to money laundering was seen in the layering and integration stage. The law has not been amended since. Additions have been achieved indirectly by elevating for instance the new crime of transnational bribery to the level of a 'felony', the threshold for predicate offences. So far, however, tax offences do not constitute predicate offences, since neither tax evasion nor tax fraud are ranked as felonies. In addition to intentional money laundering, the law of 1990 included an offence of lack of due diligence in identifying clients and beneficial owners (Art. 305ter CC), adding a criminal sanction to the already existing civil and administrative sanctions for supervised financial institutions. In the still unsupervised area of NBFIs, this offence substituted regulatory law, which was only to be drafted in 1997.

b Confiscation

Since money laundering is technically defined as an act able to impede confiscation of ill-gotten gains, a review of confiscation laws became inevitable. Together with rules criminalizing the participation in criminal organizations (Art. 260ter CC) and the right to notify suspicious transactions to law enforcement agencies (Art. 305ter s. 2 CC) the new confiscation law (Art. 58–60 CC) came into effect in 1994. It also introduced a totally different train of rules next to money laundering: Funds under the control of a criminal organization could independently from their source and their destination become forfeitable under Art. 59 s. 3, introducing a rebuttable presumption of control by organized crime for those who have been convicted as helpers of a criminal organization.

Finally, the so-called 'efficiency'-legislation (1999/2000) shifted part of the jurisdictional competence from the cantonal to the federal level.[25]

c Mutual legal assistance

Following up on a series of extremely slow and complex procedures in mutual legal assistance, (especially relating to PEPs and the repatriation of their funds) comprehensive reform of the MLA legislation reduced the amount of appeals drastically. The new law, termed 'lex Marcos' by the media entered into force in 1997.

d Statistics

Considering statistics of investigations and convictions, domestically run cases for money laundering need to be distinguished from MLA procedures. Between 1990 and 1998 the Federal Office of Statistics reported 241 convictions for money laundering.[26] Many of these cases are assumed to be connected to domestic drug investigations. Figures on MLA procedures are hard to come by. It is not possible to indicate how many of the about 2500 MLA requests per year relate to money laundering. Data on seizure and confiscation remains incomplete. Nevertheless every year, several hundred million Swiss francs have been repatriated and currently, in two cases sums of over SFr. 1 bn have been seized and are awaiting final decisions.

3 Regulatory law

a Towards the single regulator?

Due to its history, regulatory law on AML is complex. There is to date, no single regulator, even if projects suggest to transform the Federal Banking Commission (FBC) into a macro-supervisor, including insurance supervision and supervision of intermediaries.[27] AML legislation distinguishes three schemes: One for regulated entities, one for unregulated intermediaries participating in an SRO and one for intermediaries directly under the supervision of the AML Control Authority in the Ministry of Finance.

b CDD

The substantive rules are similar for the entire financial services industries: Extensive CDD and KYC provisions go into detail, whereby some of the state regulations (like the AML regulation by the FBC of 1992, revised 1998 and again in 2003, implementing the BCBS standard of 2001) integrate industry

standards, like the CDB of 1998 and give them an official status. Within the first segment, legal regulations for banks, brokers, dealers, insurance companies and casinos are responsible for the regulation of their respective area of competence. In this sector a kind of 'overkill' has established itself, since most units are also organized in SROs. They are subjected to sanctions of criminal, administrative and private law.[28] Concurrently, there is no double jeopardy rule.

Whereas supervision is strict in the core sector of financial services, the incorporation of NBFIs into the AML-systems has been far more arduous: The laws (Art. 305ter CC of 1990 and Art. 2 AML legislation of 1997), both contain an extensive formula to include NBFIs and notably also comprise the legal profession, as far as they supply services outside their traditional domain of legal advice and litigation. Whereas the EU fought for a long time over the definition of the scope when revising its Directive, the Swiss legislators rapidly included NBFIs, however, the implementation of up to 6000 entities proved to be far more difficult than anticipated and the AML Control Authority was initially severely understaffed. Only since 2001 have matters started to change and the complex SRO system is beginning to establish itself in practice.

c FIU

The FIUs (MROS) work has to be understood in the context of the rather atypical STR-model introduced in Switzerland by the AML-legislation of 1997. Beyond the older right to notify (Art. 305ter s. 2 CC), Art. 9 AML legislation introduced the obligation to notify cases of 'founded suspicion'. Omission to notify is an offence. These concepts demand intensive in-house vetting of unusual cases. The number of notifications is relatively low, however, in over 80 per cent of the cases, criminal investigations are opened.[29] Financial operators are obliged to block routinely funds relating to notifications for at least five days, to allow the FIU to decide on further steps. The financial institutions are put in a somewhat awkward position, since they would risk prosecution if they tipped off the client. Notification is, however, not required where a financial institution does not enter into business relations with a potential client.

4 Overview

The Swiss system hinges on serious identification of clients, which constitutes a correlate to strong bank secrecy. CDD-rules have a long history and are embedded in banking practice, however, their acceptance with NBFIs has caused far more difficulties and is only just coming about in practice.

Criminal law generates rather high numbers of cases statistically, of which many relate to domestic drug cases. International cases mostly lead to AML requests, where substantial sums are blocked and repatriated.

The particular notification systems produce relatively few but qualified cases, mostly passed on to law enforcement agencies. The primary interest of the Swiss AML system is to avert bad risks by tackling them early in the account opening phase. Notification of negotiations that are abandoned with suspicious clients is not (yet) mandatory.

C United Kingdom

1 General development

London is one of the three major financial centres of the world. The financial sector employs about a million people and accounts for roughly 5 per cent of the GDP. There are more foreign banks in London than in any other financial centre and London is the largest financial centre for cross-border bank lending, accounting for some 20 per cent of this business. Given its sophistication and importance as a market place, it may be expected that there would be a corresponding level in regulatory and legislative terms.

The UK has traditionally played a crucial role in the development of AML-policies in international fora, such as the UN, the FATF and later as a host to the secretariat of the Egmont Group. Originally the UK Government under Prime Minister Thatcher formed an alliance with the US administration of President Reagan and the French Government of President Mitterrand to drive the issue of money laundering within the framework of the G7. The UK's contribution was vital for the creation of FATF in 1988/89. It is, however, less clear whether this policy was reflected in domestic politics: At the time the financial centre was essentially self-regulated. Whilst the Bank of England did obtain some statutory powers to issue directives in 1979, these powers were never used and the Bank relied on informal means of persuasion.[30] After 1986 the newly established 'Securities and Investment Board' was to regulate with the help of Self Regulating Organizations (SROs). Only after the Labour Party took over was the philosophy changed towards centralized regulation with a remaining element of co-operation with the industry. This new supervisory structure only became fully operational with the creation of the Financial Services Authority (fully in force since December 2001).

Interviews with prominent members of the banking community revealed that at the end of the 1980s awareness amongst practitioners did not mirror the thrust of the Government in international policy development.[31] However, the publication of the Bank of England Guidance Note on money laundering in 1990 did help change this attitude.

2 The emphasis on police work

From the early days of AML, there was a strong emphasis on police and intelligence work in the UK's approach. NCIS, the UK's FIU created in 1992,

rapidly attracted large amounts of suspicious transaction reports.[32] Its role beyond the management of the information flow is to analyse the data and provide strategic and tactical intelligence on serious and organized crime. As with other countries, the ability to digest the vast amount of information very much depends on the resources available.

3 Criminal law

a Money laundering offences

The offences of money laundering were originally developed in the Drug Trafficking Offences Act (DTOA) of 1986 and eventually expanded to cover terrorism related money laundering in the PTA 1989. The CJA 1993 extended the UK's AML-provisions and introduced new offences in an attempt to bolster money laundering deterrence. Since most domestic tax offences are indictable they would qualify as predicates. Whether offences against foreign tax laws are included, is at present unclear.[33] After a series of further legislative modifications in the 1990s the Proceeds of Crime Act 2002 (PCA), which came into effect in 2003, 'consolidates, updates and expands all earlier anti-money laundering legislation'.[34]

There are five money laundering offences in England and Wales. These offences can be committed by natural and legal persons and cover the concealment of criminal property, its acquisition, if assistance is given or arrangement is made to facilitate another person's retention, the use or control of criminal property, then the failure to disclose, which applies only to the regulated sector and is subject to an objective test, and finally, the offence of tipping-off.

The PCA has not changed the mental element with regard to AML offences. The standard of knowledge is still subjective. What this means is that without an admission of guilt, it is difficult to prove that the defendant knew or suspected that another had benefited from a crime.

The requirement to report a suspicious transaction was initially only in relation to drugs and terrorist offences. The Proceeds of Crime Act has changed that. It has been said that the prime purpose of the UK's money laundering legislation is not to outlaw money laundering but rather to ensure that suspicious transactions are reported to the authority. It seeks to achieve this through a carrot and stick approach, the stick being the threat of criminal liability for failing to report and the carrot being a defence to criminal liability by reason of the report. Under the new law, STR will apply to the laundering of the proceeds of all crimes. In addition a new objective test will set the standard for reporting. In practice, it seems likely that this will mean that the courts will look at whether an institution has followed the Joint Money Laundering Steering Group's rules.

This new development extends the offence of failing to report from actual knowledge or suspicion to include what the reasonable banker would have thought about the transaction in question. The legislator refrained from re-organizing and simplifying the list of offences. The PCA 2002 basically replicates the approach put forward in the Vienna Convention 1988, based largely on US law. To some commentators it may seem repetitive or even redundant. From the point of view of an international observer this is immaterial as long as the UK system in itself seems consistent and effective.

Here questions have been raised, however, since the amount of investigations (357 in the period of 1987–1998, 100 in 1999[35]) and of convictions (136 in the period of 1987–1998[36]) seems very low compared to the relatively large figures on STRs.

b Seizure and confiscation

The main difficulty of the seizure, confiscation (and forfeiture[37]) legislation up until the PCA has been that provisory measures to immobilise assets, which might be forfeited, depended not only on a judicial decision, but were only available when the suspect was about to be charged. Under the PCA 2002 seizure of assets will be ordered at the beginning of the criminal investigation.

A second reason for the low figures of confiscation in practice[38] was attributable to the high standard of proof required. The PCA 2002 seeks a radical solution to this problem by introducing 'civil forfeiture' which empowers the Asset Recovery Agency to sue to recover the proceeds of crime in the High Court. It is also possible to go for an interim receiving order to freeze a suspect's assets, and, at a subsequent full hearing, application can be made for a recovery order. The civil rules of evidence and procedure apply. The burden of proof rests with the director of the Asset Recovery Agency namely on a balance of probabilities. This, of course, raises questions as regards procedural justice: If the Government is unable to gather enough evidence to charge someone with a crime and obtain a conviction beyond a reasonable doubt, the same Government through the Asset Recovery Agency may opt for the easier path and obtain an economic punishment in a civil court, where less onerous balance of probabilities is required.

In criminal asset recovery, the court would assume, where a convicted defendant has a 'criminal lifestyle', that all his assets are derived from crime unless the contrary can be proved by him.

c Mutual legal assistance

Even after the enactment of PCA 2002 mutual legal assistance (MLA) remains a delicate issue in UK law. Now that the freezing of suspected assets should

be easier, one major problem has been addressed. The criticism of the slow response relating especially to the burdensome and complex judicial review procedures still applies.[39]

Continental European lawyers question the need for a treaty in order to repatriate confiscated assets as well as the evidence test required by UK law. From the perspective of international law it is certainly up to the UK how it wants to define its MLA-rules. It is, however, the responsibility of each state to meet the internationally agreed requirements. The UK will need to address the widely articulated international criticism of its slow process.

4 Regulatory law

a Scope and approach

The regulatory structure has recently undergone fundamental change. The establishment of a single regulator with clear objectives and powers is mirrored in the wide scope of the AML-regulations (the 1993, the 2001 and 2003 Money Laundering Regulations) now covering most NBFIs.

Even though the UK has decidedly moved away from self-regulation towards strong centralized state supervision, a crucial role has been reserved for industry co-operation. Industry guidance on the FSA regulations is to be found in the Joint Money Laundering Steering Group's Rules. These rules were approved by the British Government in July 2002, and they will be used by the FSA to see that the regulated business is meeting its obligations with respect to KYC, monitoring, reporting of suspicious transactions etc. Financial firms must adopt a risk-based approach both to determine what is reasonable to obtain sufficient evidence of identity and also with respect to due diligence procedures.

b Customer due diligence (CDD)

A closer analysis of both the existing and planned CDD rules underlines that the UK AML-system is undergoing fundamental changes:

a Know Your Customer (KYC)

So far the rules on customer identification have remained very sketchy:

- The customer needed to be identified 'as soon as reasonably possible'.
- In substance the company had to obtain 'sufficient evidence of the identity of the client'.
- If the Regulations and Guidance Notes did give details of how to identify

clients, domestic problems remained because UK citizens cannot be obliged to carry an ID.

- Furthermore, the 'Joint Statement of Principles' of 16 July 2002 of six major UK banks on the 're-identification' of existing customers confirms indirectly that client relations formed before 1 April 1984 did 'not require' state of the art identification as defined in the Regulation and the international standards.
- If the six banks decided to set higher standards for themselves, they admitted that the system had existed for years (and partly continues to do so with the rest of the financial institutions) with a *considerable degree of unidentified risk*.
- There are rules requesting the identification of beneficial owners and the identification of natural persons ultimately controlling corporate instruments and trusts. However, here again the devil is in the detail. As long as there is no obligation to maintain a computerized or otherwise easily accessible register of beneficial owners, effective law enforcement on macro-crime remains uncertain (efficient documentation rules). Furthermore there are substantial differences of opinion on the scope of 'beneficial ownership'. Common law countries usually focus on the trustee whereas the actual beneficiaries of the trust (as far as identifiable) are not necessarily identified.
- Finally, on 'introducers and agents from an EU country' it has been current practice to accept assurance that they have identified their client and kept records.[40]

The system continues to be scrutinized in the aftermath of 9/11 and following up on the CDD-rules of the BCBS 2001, the new Recommendations by the FATF and the Wolfsberg Principles.[41] It is understood that the so-called 'risk-based approach' has led many of the more scrupulous institutions to re-organize fundamentally their CDD-concept, especially by introducing automatized systems to filter the customer base regularly, according to certain risk criteria, but so far the standard has not yet been established throughout the banking industry in the UK, let alone the NBFIs at risk.

5 Conclusion

The very active role of the UK in international fora, where standards are set, contrasts with traditionally low regulatory requirements at home. Furthermore, there is a marked discrepancy between the intensive efforts to collect STRs by NCIS and the small number of criminal investigations brought. The CDD-rules are, however, currently undergoing fundamental change. The mandatory identification standards have remained sketchy, even if some proactive companies have gone beyond. With the advent of the single statutory regulator and

the PCA 2002 stricter rules in both regulatory and criminal law are being introduced. Additionally there is a convergence of standards set by the industry itself, the Group of Six, which will also have an impact on other companies.

D United States

1 General development

The US banking system comprises 8315 commercial banks holding assets worth US$6.2 trillion. Less than 7 per cent of these banks are foreign-owned yet they hold 22.5 per cent of domestic assets held by commercial banks in the USA. The financial services industries contributed approximately 8.3 per cent of GDP in 2000. Specifically in private banking the USA is believed to account for 26 per cent of the high-net worth individual's market, of which up to a third is of foreign origin. The largest two stock exchanges worldwide are domiciled in the USA (NYSE and NASDAQ).[42]

2 The emergence of AML-laws

Money laundering as a concept is not as new as is frequently believed. Already the 'President's Commission on Organized Crime' in 1984 defined money laundering as 'the process by which one conceals the existence, illegal source, or illegal application of income, and then disguises that income to make it appear legitimate'.[43]

Obligations to keep records and to report certain domestic and international transactions involving currency (Cash Transaction Reports, CTR) go back to the Bank Secrecy Act (BSA) 1970. The federal criminal offences of money laundering, however, were created as a consequence of increasing fears of endemic drug trafficking. In the context of the 'War on Drugs' proclaimed by President Reagan, the 1986 Money Laundering Control Act (MLCA) was adopted. The introduction of Suspicious Activity Reporting (SAR) to FinCen, the US FIU created in 1990, however, is more recent (1992) and is a consequence of the emerging world standard as defined by the FATF 1990. Even though the USA have certainly been amongst the pioneers in developing rules against money laundering, some of the most fundamental changes have only come about very recently, with the 'Patriot Act' 2001 in the aftermath of the terrorist attacks of 9/11.

In a nutshell, the AML-system in the USA can be characterized by very rigorous criminal law threatening long prison sentences and drastic forfeiture as well as imposing stringent reporting requirements on the one hand, and a still rather uncharted and complex regulatory system, with an uneven coverage, relying extensively on self-regulation, on the other.

3 Criminal law

a Money laundering offences

The complex structure of the basic offences in 18 USC §§1956 and 1957 introduced by the Money Laundering Control Act (MLCA) 1986 are easily identified as a blueprint of the criminalization provision of the 1988 UN Convention on Drugs.

§1956 distinguishes between three separate provisions, one domestic, one on international money laundering and a separate rule criminalizing the laundering provoked by a Government sting operation.

The provisions basically share a common list of predicate offences referred to as 'specified unlawful activities' (SUA). This list covers hundreds of US federal felonies, including violations of the Inland Revenue Code. Tax offences against a foreign state may indirectly serve as a predicate offence.[44] The object of the crime is defined differently in domestic money laundering (proceeds of SUA) and international money laundering (monetary instruments or funds without reference to their origin!). The criminal act is defined by a list of different transactions. It is this part of the legislation that is frequently considered redundant, especially by foreign observers. Essential weight in defining illegal behaviour is placed on the subjective elements. Liability requires either intending to promote the carrying on of SUA or knowing that the transaction is designed to conceal etc. or avoid STR. The main difference between domestic and international money laundering is that the mere intent to promote the carrying on of SUA is sufficient to trigger responsibility in international transactions – even if the defendant has no knowledge of the illicit origin of the funds.

§1957 adds yet another variation to the list of criminalized activities, the knowing engagement in a monetary transaction. Even if there are fine differences between the provisions, there is a considerable amount of overlap.

Ancillary offences further criminalize violations to the BSA, namely the 'failure to file CTRs', 'structuring transactions to evade reporting requirements' and the amended operation of 'illegal money transmitting businesses' (targeting *Hawala* banking) as well as the new offence of 'bulk cash smuggling'.

Conviction statistics indicate that over the last few years a stable figure of around 1000 defendants were sentenced to prison each year for money laundering. This statistic evidently does not take sanctions against legal persons into account.

b Seizure and forfeiture

a By Executive Order

With Executive Order 13224 of 25 September 2001 President Bush blocked all

property and interests in property of originally 27 individuals and entities suspected of terrorist involvement (to which others were added later on). The scope of the order covered all property interests of these persons in the USA and within the control of US persons, including overseas branches. Additionally, the Order exerts pressure on foreign financial institutions, threatening to block their property if they are found to assist terrorism in any way.[45] The Executive Order is remarkable both for its extraterritorial approach and the strict liability it introduces.

b Civil Forfeiture

The Civil Asset Forfeiture Reform Act (CAFRA) 2000 has dramatically expanded the list of crimes subject to civil forfeiture to include all SUAs. Civil forfeiture is a procedure '*in rem*' with a different evidential standard to criminal forfeiture. Innocent owners may claim relief, however, the rules have been toughened up recently: After CAFRA the claimant bears the burden of proof.

c Criminal Forfeiture

Criminal forfeiture is directed at the defendant and follows the general rules of evidence in criminal matters. Unlike civil forfeiture however, it does not require a nexus between the property and the underlying offence: The property forfeited may serve as a substitute to products of the offence transferred out of the reach by any means.

d Seizure and Freezing of Assets

Similar to UK law, a court order requiring similar prerequisites to those of a search warrant is necessary for a restraining order under US law.

e Data

Statistics on civil and criminal forfeiture for 2001 indicate that US$241 million have been forfeited in connection with money laundering offences including both civil and criminal forfeiture, a figure relatively small compared to the economic significance of the US economic centre and the dimensions of the problem.

c Mutual legal assistance (MLA)

Even though the USA has concluded bilateral MLA and extradition treaties with many countries to assist foreign states in investigations on money laundering, a

treaty does not seem to be required and judges may be directly approached with requests for assistance. Like other common law countries, the USA does require 'probable cause', at least for extradition. The extradition of laundered funds is treated as an issue of sharing of seized assets. It remains open whether – beyond the cases where countries co-operated in the seizure of defrauded, embezzled or stolen goods – funds are actually restituted to the victim abroad integrally, even if the victim is a foreign state.

4 Regulatory law

a The scope of regulatory rules

The basic obligations to maintain CDD, to file SARs and to develop a compliance programme apply unevenly to different sectors of the financial industry.

Even though the BSA had allowed the Treasury to go much further, the Secretary of the Treasury had until very recently only subjected the four core types of financial institutions to the full AML rules (banks, securities broker-dealers, money services businesses and certain gaming establishments).[46]

A further group of three types of institutions is only subject to CDD-rules.[47]

A long list of NBFIs[48] are exempted from AML-rules, even though the USA has already been harshly criticized for it in the 1997 FATF evaluation.[49] As long as these evaluation texts are not published though, they do not seem to generate the necessary peer pressure on larger member states. The Treasury has very recently expanded CDD and reporting requirements to some of the NBFIs in its regulations implementing the Patriot Act (with a view to entering into force in March 2003).

However, attorneys, notaries and unregulated fiduciaries are still not subject to the AML reporting and CDD rules.[50] It would rather stretch the general meaning of the words 'self-regulation' or 'risk-based approach' to apply them to this type of regulation.

b Customer due diligence (CDD)

As with other countries, one needs to distinguish what financial institutions do on a voluntary basis and what is required by law. Many conscientious firms go beyond the mandatory minimum.

Until 2001 the statutory obligations on KYC had merely requested companies to make '*reasonable efforts to be reasonably certain of the identity of their customers*'. The Patriot Act and the new regulation by the Treasury Department impose more specified duties on an extended group of financial professions to implement customer identification programmes (CIPs). Beyond a basic minimum the regulation remains purely exhortative.[51] The focus is

very much on account opening procedures, an explicit requirement for on-going monitoring is not foreseen. It may, however, be deducted from the risk-based approach. Overall, the decision how to proceed if a financial institution 'cannot form a reasonable belief that it knows the true identity of a customer' is left open.[52]

The issue of material identification ('CDD' in a narrower sense, including, for instance, the gathering of information on occupation, nature of business etc.) beyond formal identification has so far only been addressed in ABA Recommendations. Their legal value does not so far seem to go beyond private best practice suggestions.[53]

Overall the system is very much focused on retail banking and restricts itself to a mere minimum of mandatory rules. It is therefore doubtful that the requested 'screening of customers against Government lists of known terrorists and terrorist organizations' will be very effective.

This impression is corroborated by the lack of a general rule obliging financial institutions to determine beneficial ownership. This rather remarkable divergence from the internationally agreed standards has been criticized by international organizations.[54] An explanation would have to take the overall thrust of the US AML system into account, which from the outset has been directed against drug money, especially cash and the first stage of money laundering, the so-called 'placement' as opposed to the 'layering' and the 'integration' stages.[55]

Only after 9/11 was the administration able to override industry concerns and introduce elementary requirements on the identification of beneficial owners and on determining the source of funds, though still restricted to private banking. However, even those rules only apply to funds held for non-US-persons.[56] Apart from falling beneath international standard, this restriction to foreign persons raises serious questions about the effectiveness in determining money launderers and terrorists: As long as terrorists are US citizens or use US stooges, they will easily elude detection. It is remarkable that the discriminatory treatment of US and non-US persons seemed politically more essential than maximizing effectiveness even after 9/11.

In a closely related area, however, the Patriot Act and its implementing regulations go way beyond previous standards: in correspondent banking. Because the 'Bank of New York' and other scandals demonstrated frequent abuses of correspondent banking relationships as a way to infiltrate the US financial industries, this issue was singled out for strict Government regulation. Enhanced due diligence standards apply to accounts owned by foreign banks operating under an off-shore banking licence or a licence issued by a jurisdiction designated as non-co-operating in international AML-efforts by the Treasury Department or by an inter-governmental AML-organization such as the FATF.[57] Relations to foreign shell banks are to be phased out. In general,

banks must ascertain the ownership, the reputation and the adequate supervision of respondent banks. The issue has since been picked up by international standard setters[58] and by the industry itself.[59]

One other area has been singled out for 'increased diligence': 'politically exposed persons' (PEPs). US financial institutions will be required to scrutinize private bank accounts held by such persons. This regulation so far only applies to the four main regulated categories of financial institutions, its scope will, however, be extended shortly.

c SARs to FinCEN

a Reporting Requirements

1 The scope of SAR requirements

The Patriot Act has expanded the scope of reporting requirements to include SEC registered brokers and dealers. The extension of other professions is being contemplated. Some of the professions under obligation to identify clients now are still not required to report suspicion, and unlike in the EU and other countries, attorneys, notaries and unregulated fiduciaries are not at all subject to AML-legislation and therefore not required to file SARs.[60]

2 Reporting of suspicious activities

For those professions covered, reporting requirements are rather broad, focusing on 'activities' rather than on mere transactions. However, the definition of suspicious activity is left to the individual institutions to be translated into operational terms.[61] The procedural rules on notification clearly anticipate that up to 95 per cent of SARs will be made in the aftermath of transactions, without need of urgent intervention. Banks are given a 30-day-period to report from the initial detection of the facts; and they may delay filing for another 30 days if no suspect was identified at the time, in order for one to be identified. Similar leeway for bureaucratic processes is left on the Government side, allowing 10 days for IT treatment. There is no obligation of automatic blocking of the funds. Only in the remaining 5 per cent of cases is immediate action by telephone etc. required.[62]

b The Role of SARS

It appears that the system is basically aimed at gathering data and looking out for recurring patterns and conspicuous client behaviour. Similar to the UK approach it is primarily focused on retail banking and mass-notification of unusual, rather than genuinely suspicious activities. In 2001, roughly 204 000 SARs were filed; this figure rose to nearly 274 000 in 2002. Again the number

of criminal investigations, let alone convictions, is much lower.[63] Inferences on the effectiveness of the system cannot be drawn directly from these figures. But they help to give an understanding of the diverging approaches.[64]

5 Overview

The US AML-system relies on deterrence through tough criminal laws and stiff 'civil and criminal' forfeiture rules. The criminal justice system is nourished by extensive reporting of suspicious activities. In comparison – especially with European systems – the regulatory standards remain astonishingly undefined. Many types of financial institutions within the scope of international standards are left outside CDD, reporting or compliance obligations.

CDD-rules rely heavily on self-regulation, official guidance is given only in special areas (for example, correspondent banking and PEPs). In particular the identification of beneficial owners is not yet current standard. The new rules contained in the Patriot Act 2001 still differentiate between US and non-US persons.

Overall the US AML-system remains still preoccupied with cash generated by illegal drug-trafficking and the first stage of money laundering, the 'placement' phase. To this was added the issue of terrorist financing. Again, however, the emphasis is on structuring of small transactions, on cash smuggling etc. The US regulatory system does not really address the considerable vulnerability of its financial centre to abuses for large-scale 'layering' and 'integration' purposes.

III SEARCHING FOR REASONS OF DIFFERENCE

Rather than attempting to evaluate the country performance against a set international standard, this section intends to suggest a few reasons for the considerable discrepancies between country-approaches to AML. They are in our view very much based on domestic agendas and attitudes to the problem of money laundering. The next section will then discuss the current efforts towards a common standard (IV).

A Singapore: 'Using the Right Words'

Singapore's overriding interest is clearly to develop the economic significance of its financial centre: It wants to become the first destination in asset management in SE-Asia. It has realized that it needs to liberalize its restrictive licensing policies for financial institutions and to open up to foreign banks. It is currently also relaxing its traditionally authoritarian approach to banking regulation and substituting it for a more flexible form of supervision ('supervision

instead of regulation'). Singapore is especially exposed to the difficulties arising from the ambiguities all financial centres are facing between deregulation linked to globalization and renewed standard setting in the regulatory field relating to the combating of international crime.

Until recently Singapore's AML rules were clearly insufficient. Singapore was only ready to adopt the world-wide standards to contain laundering of drug money (according to the 1988 UN-standard) even though it had been a member of the FATF since the early 1990s. After a scathing critique by FATF it decided, however, to completely overhaul its legislation. This step is certainly not without risk to Singapore since many of its customers are exposed to a very difficult business environment, especially regarding corruption and extortion. Nevertheless, the scope of predicate offences, in its criminal provisions, was drastically enlarged and the forfeiture rules were extended accordingly. The single regulator (MAS) enacted far more detailed rules on KYC in conformity with the FATF and the BSP standards. The role of the FIU (STRO) was upgraded and the notification of suspicious transactions made mandatory. A series of deficits still remained, however: First, the AML-outfit cannot become really efficient before MLA-treaties have been concluded with the main financial centres. Second, the scope of regulatory standards against money laundering remains limited, it still falls short of FATF Rec. 19, it does not (yet) cover attorneys and fiduciaries. In substance, questions remain as to the thorough identification of beneficial owners, especially of trusts.

Overall, Singapore is now using the right words; whether the new laws are going to be efficient cannot yet be evaluated. There are no statistics available for investigations and convictions in the past and the new laws are still too recent to say anything definite about their application.

It seems that Singapore has understood that a sound AML-structure is an entry ticket to the club of the serious financial centres. However, the refusal of banks and authorities alike to answer questions about the concrete implementation of the new laws indicates that the hitherto prevailing 'culture of secrecy' has not yet fully been overcome: both, the authorities and the industry above all want the country to 'look good and make money'. Therefore they are using the 'right words', but are they really convinced of the need for change?

B Switzerland 'Reputation First'

Switzerland in common with Singapore has a financial services industry that plays a far more important role than the size of the population or even the productive industry would suggest. Even though there is a long tradition in private banking (especially in Geneva), 'Swiss banking' has only taken on its meaning as a 'world wide label' in relatively recent times. Certainly the enactment of bank secrecy laws in the 1930s has helped to generate the reputation

this financial centre enjoys. It has also created some of the problems, since it has attracted all sorts of clients, including in particular PEPs. Swiss AML legislation and regulation has very much been crisis driven in the past: not only the proactive rules, but also the enactment of criminal law against money laundering (1990, 1994) and the revised mutual legal assistance rules (1997) are a consequence of scandals and consequent efforts in risk management, conducted in close co-operation between authorities and the industry. Also the most recent version of the regulation on money laundering of the Swiss Banking Commission (2003) is intertwined with industry rules (notably the CDB 2003, which has been accorded official status). This introduced a far reaching version of the 'risk based approach'. It draws its legitimacy from deficits in practice namely as manifested in the Abacha case.

Both the rules in criminal and regulatory law, have come about over the last 15 years in a rather unplanned and piecemeal manner. The result is a complex normative patchwork. Nevertheless, after several stages of (domestically heavily criticized) upgrading, the criminal law organized crime offences, forfeiture rules and mutual legal assistance provisions) generate a comparatively high number of investigations and convictions as well as confiscation decisions. Domestic cases however, if they are not opened in support of an AML request, are frequently mere prolongations of local (drug) cases. AML practice on the other hand is extensive and figures of forfeited funds high.[65] There is an evolving practice of repatriation of assets (Marcos, Abacha and others).

The main thrust of the Swiss AML-system, however, clearly lies in the development of CDD and especially KYC-rules. It is no coincidence that these originally industry-driven rules primarily focus on the needs of private banking, even if they are declared generally applicable throughout all sectors of the industry. Serious KYC rules, including identification of beneficial owners in all variations are a correlate to strict bank secrecy. Bank secrecy can only continue to be maintained if the system can efficiently identify high risks and co-operate with authorities and criminal investigations. This explains also why the industry has developed its own sanctioning programme[66] in addition to those of a supervisory and criminal nature.

The system is oriented towards risks posed by high-net worth clients, it focuses especially on private banking and particularly on the latter stages of laundering: the use of the Swiss banking sector for 'layering' and 'integration' purposes. It therefore does not specifically address drug money laundering, the criminal and regulatory laws were tailored to pick up all serious predicate crime. However, there is a marked aversion to include fiscal offences: mutual legal assistance in foreign fiscal matters is only given in cases of tax fraud[67] and foreign tax offences (including fraud) are not predicate offences to money laundering (since tax fraud is not considered a felony in Swiss law). The question

therefore may arise whether tax evasion could serve as an excuse for money laundering. According to existing laws this could be possible as long as the laundering technique remains very basic, however as soon as so-called structures are involved (IBCs created at OFCs, lawyers as organizers and certainly if there is a hint of incorrect book-keeping or forgery) the financial institution risks becoming an accessory to fraud, which should normally set the alarm bell off.

The rules on notification of suspicious transactions add to the understanding of the Swiss approach to AML: following a model adopted originally also by France and Germany (now under review), Swiss law obliges notification only in cases of fact based suspicion. Omission to notify under these circumstances is an offence. On the basis of less defined doubts, financial institutions have a right to notify. They are under all circumstances obliged, however, to clarify all cases of unusual transactions in-house and to keep records of this procedure. In cases of mandatory notification they are obliged automatically to block funds for five working days in order to give the FIU time to decide how to proceed. Here the prohibition of tipping-off kicks in. The consequences of notifying suspicion are very serious and notifications have, in the past, led to prosecutions in up to 80 per cent of cases. However, financial institutions are not required to enter into business relations with potential clients, nor to report negotiations that are abandoned with undesirable persons.

In essence Switzerland is the country with probably the strictest CDD-rules world-wide now, and it is above all interested in keeping risky clients away from its financial institutions, reminding us of a somewhat irreverent popular saying: 'Holy St. Florian, prevent our houses from catching fire, and set fire to others, if you have to'.

C UK: 'A Very Active International Player'

The most striking features of the UK's AML-system, seen from afar, are two seemingly contradictory tendencies:

First, the UK was since the mid-eighties one of the driving forces internationally to bring about the Vienna Convention against drug trafficking and its AML-rules as well as to create the FATF. The UK also hosts the secretariat of the Egmont Group. On the other hand, CDD and especially KYC-rules have developed late. Especially in those early days of international activism, domestically self-regulation was taken very seriously and interventions by supervisors were virtually unheard of.

KYC-rules were only very gradually upgraded and they still allowed for potential risks to go undetected, since they never requested a serious search for possible 'skeletons' in the cupboard (client relationships opened pre 1994). If the banking industry is in 2002 suggesting a 're-confirmation' of identity,

using a 'risk based approach' this is to be seen in the context of a rapidly changing regulatory environment at home and abroad (see section IV). Additionally, deficits compared to world wide best practice have been recognized regarding the identification of beneficiaries (especially in trusts) and in keeping of (computerized) data on such beneficial owners, and to be made available for law enforcement in cases of request.

On the other hand, the UK is one of the countries generating a comparatively high number of notifications to its FIU (NCIS). The second contrast to be noted is, however, the discrepancy between high notification figures and very low figures of investigations and convictions. It could be that the rules of criminal procedure (especially the rules on seizure and blocking prior to the PCA 2002) have made it difficult to bring cases. It is more likely, however, that the system is not really meant to generate a high ratio of criminal cases: Rather the 'early warning system' as in the case of the US deliberately treats 95 per cent of notifications as non-urgent and uses them as a 'stockpile' of data for further use if later notification or otherwise generated intelligence should suggest a suspicious pattern. Only 5 per cent of notifications would – in the eyes of authorities – warrant direct action.

It is suggested that the main orientation of the UK AML-systems is to generate police data. It could, indirectly, have a preventive effect. The system is clearly focused on 'retail banking' and risks close to the predicate offences, especially domestic drug trafficking and cash related transactions: It is most likely to pick up information about dubious retail-clients involved in placement of drug (or otherwise illegally obtained) funds.

The question that needs to be asked is whether it is adequately addressing the considerable risks involved in running one of the world's most active financial centres. Could it be – to put it bluntly – that this AML-system (as it has been run in the past; for the future cf. below, section IV) particularly geared towards picking up everyday risks in high street banking and to leave the city of London alone? Perhaps this is the attitude the FSA, with its new emphasis of a risk-based approach and with the help of the PCA 2002, is attempting to move away from?

D USA: 'Casting the Net'

The summary of the current AML system in the USA has shown that people convicted of money laundering face very serious criminal sanctions and that the money laundering offences relate to a long list of predicates. Confiscation, using the two-pronged approach of civil and criminal forfeiture is an additional threat. The Patriot Act has further strengthened the criminal-law oriented approach.

In regulatory law the pattern is far more complex: Developing CDD rules

has traditionally been left largely to the industry, many parts of which have not been subject to the AML rules at all, even in areas where the BSA would have given the Secretary of the Treasury the authority to act. Some sectors have been covered unevenly by having to identify their client, but not necessarily notify suspicion etc. Only since 9/11 has it been possible to upgrade substantially the obligations (introducing CIPS and to extend the coverage).

Leading financial institutions have made great efforts to introduce computerized screening systems in retail banking and to adopt comprehensive CDD rules in private banking. Nevertheless, the legal situation still lags far behind this best practice achieved by some firms, and only gradually are groups of companies agreeing on standards in the USA. Overall, the regulatory approach remains eclectic, with remarkable gaps, especially in the area of intermediaries (fiduciaries, legal profession). And the substantive CDD rules are timid in comparison with their foreign equivalents: They suggest KYC practices and remain reluctant to enforce them. According to the 'risk-based approach' the main responsibility stays with the industry. Still, by law, beneficial owners need only to be identified in private banking in relation to accounts held or maintained for non-US persons. This bias against foreigners (and foreign institutions) reflected in the Patriot Act does raise questions as to its efficiency: Is the US legislator sure that there are no US persons engaging in terrorism or helping terrorists or drug traffickers?

Equally, ongoing monitoring of clients is left by law to the industry according to the 'risk-based approach'. Only in some specific areas (notably PEPs and correspondent banking) have concrete rules been developed on increased diligence.

In contrast to the rather 'laissez faire' attitude on the regulatory side, the BSA has traditionally required a routine reporting of cash transactions. Lack of compliance with the rules has been an offence and several forms of circumvention (be it structuring, cash smuggling or the running of illegal transmitting businesses) are now criminalized. This focus on routine transactions finds a parallel in the requirement to include complete information on both parties of a wire transfer.

Beyond routine cash reporting the USA has developed extensive suspicious transaction monitoring (SARs to FinCen). Rather similar to the situation in the UK the immense amount of data (in 2002: 273,823 notifications) does not necessarily immediately generate a high number of criminal investigations: Except in very urgent cases the financial institutions may take their time to notify (up to 60 days in all) and the authorities basically make the notified data electronically available to other law enforcement agencies. Again, recurring incidents or other intelligence may allow a pattern to be generated as a basis for investigation. There is no requirement of automatic blocking of funds, it may, however, be ordered by the authorities.

It may be assumed that this system is primarily interested in funds from domestic illicit drug sales, therefore the emphasis on cash and the SAR-system picks up information primarily from the retail-sector. These procedures are now increasingly being computerized, also to prevent criminal liability for not notifying in time: For the US authorities money laundering has primarily been the manipulation of cash stemming from drug-trafficking. This perspective has – throughout the developments of the last decade – not fundamentally changed. Of course the issue of financing terrorism has been added, the systems are now upgraded to catch typical patterns of known terrorists and to check the client base against specific lists of names.

Overall the US AML system is able to frighten the weak-hearted criminal and is geared towards collecting massive amounts of data on routine cash and electronic transactions for potential use in the future. It is (in its current legal form) – only in a very limited way – really able to ensure thorough identification of clients and beneficiaries throughout the financial industry. And, maybe this has always remained a secondary interest, easily sacrificed in the face of public opposition.

IV A CASE FOR CONVERGENCE

If the interpretations given for the past development of domestic AML systems have seemed rather stark in their contrast for everybody's liking, the final section intends to add some counterbalance to the image painted so far. There is currently a comprehensive change and convergence in all jurisdictions discussed towards a common standard, especially in customer due diligence, driven mainly by regulators and financial institutions domiciled in the main financial centres.[68] National bodies are actively engaging in modelling the new paradigm.[69]

The final section will give an overview over this emerging common denominator, starting this time with the regulatory side, since it is here where the development becomes most clearly visible.

A Regulatory Law

1 A changing concept of supervisory law

The financial markets have been much affected by globalization and the ensuing liberalization. National supervisors have been caught somewhat off-guard and are only now beginning to conceptualize models of collective supervision. In some countries with a tradition of strict regulation it became apparent that the approach was ineffective (because it focused too much on the domestic situation) and inappropriate (because it threatened to curb the development of

the financial industries). Other financial centres traditionally left regulation largely to the industry itself. A series of scandals as well as political change, resulted in a new tendency towards more intensive state regulation. Part of this trend is also the leaning towards a single regulator for the entire financial sector.[70] These two developments may seem contradictory, they both, however, testify to the emergence of a new common paradigm of supervision. Globalization also implies global risks,[71] therefore the emergence of a common set of regulatory standards is necessary: Rather than closely regulating all eventualities, the emerging standard creates a framework regulation coupled with industry co-operation.[72] The model is based on the theoretic concept of 'governance-at-a-distance'.[73] Universally, regulators are talking of introducing a 'risk-based approach', substituting the earlier 'rule-based approach' towards AML.[74] It is an open issue whether they really mean the same when endorsing the new rhetoric unanimously.

2 Towards a risk-based approach to CDD

A risk-based approach implies the sharing of the responsibilities between supervisors and members of the industry, possibly mediated by groupings of the industry,[75] or more formally structured co-operation bodies[76] sometimes even endowed with regulatory powers.[77]

a The role of regulators

In the early days of AML, regulators had developed detailed rules to be followed by financial institutions. Increasingly it was realized that following the letter of the rules did not mean that they also accepted the rationale. The new 'risk-based approach' shifts part of the responsibility for detecting risks back to the industry. This does, however, at the current stage of development of AML rules, no longer mean that regulation is more or less left to the industry:

Regulators usually define the relevant risks[78]; beyond financial risks a broad array of operational risks are now to be controlled. Amongst them particularly prominent are legal (which are almost always also reputational) risks. They call to attention money laundering following serious crime, especially drug trafficking, then risk of abuse by PEPs and lastly, financing of terrorism.

Typically regulators request financial institutions to categorize their clients according to the risks they pose and the type of services they request. They ask institutions to define the necessary measures to be taken for each category and to collect the information from their clients to determine whether their activities leave a pre-defined customer profile (see section b. below).

Some regulators have gone as far as to indicate risk factors to be considered when defining risk categories.[79] The lists typically comprise:

- geographic factors
- for natural persons place of origin, place of business activities (and the possible exposure of such places to intensive corruption and money laundering)
- for legal persons the place of incorporation (OFC-awareness)
- personal factors: PEPs
- business related factors: particularly exposed sectors like the defence industry etc.
- product-related factors: the traditional 'red flag list' published regularly since 1990 by regulators (e.g., back-to-back loans)

Furthermore, the fundamental legislative and regulatory standards of advanced financial centres contain rules both on account opening and on ongoing monitoring. Account opening procedures address the minimum standard on KYC, including identification of beneficial owners and essential cases of increased diligence as well as the notification of suspicious transactions (or activities).

In specific areas – especially when dealing with PEPs or correspondent accounts – regulators call for increased diligence. Here they do not leave the decision on categorization to the financial institution. Nevertheless, defining the exact measures to be taken remains a task for the industry.

b The role of the industry

The industry's responsibilities dove-tail into the regulatory standards. For the industry the 'risk-based approach' has definite advantages. Even if it requires a high degree of attention and corresponding investments, it allows the firms to differentiate radically between low-risk client segments, in which it will be sufficient to go through formal identification procedures and higher risk segments where they would concentrate their diligence efforts. Nevertheless, more and more firms are introducing computerized filter-systems to identify higher risk clients and to monitor ongoing client behaviour against their own behavioural pattern in the past. Atypical transactions or requests would raise alerts and would require personal attention by trained compliance personnel.

Closer attention will be given to specific high-risk segments. This does not mean, however, that PEPs are excluded from the accounts, however, they will be monitored more attentively. On a routine basis a higher standard is required in private banking with high-net worth clients.

The main difficulty in the construction of these risk categories and their implementation in automatic filter systems remains the vagueness of the overall criteria: what is a high risk country? To mention only one example, the official AML bodies, be they international organizations or regulators, will refrain

from giving operational advice, since they are not only bound to 'political correctness' but it would also contradict the concept itself, where decisions are delegated to the industry otherwise it would be a rule. To date, the FATF considers any FATF country as belonging to the 'regulated world', even though it is evident that risk wise there will be huge differences.[80]

3 FIUs and STRs

Looking at the construction models of FIUs and suspicious transactions reporting and monitoring, the survey has shown substantially diverging approaches. 'Early warning systems', working on the basis of a low threshold of suspicion, typically generate vast numbers of reports. Their value rarely is to immediately trigger criminal investigation, more likely they are stored as information to be used to determine patterns of suspicious activities. On the other hand, a system that requires reporting of 'founded suspicion' requests more investigative work of the financial institution in-house, these notifications will more frequently lead to criminal investigations.

There is no *unité de doctrine* on which system would be preferable. Rather, the 'early warning system' is more suited to an AML-systems focusing on retail banking, whereas the 'founded suspicion' model will be of more value where 'private banking' is at the centre of the AML structure.

B Criminal Law

Criminalization in all its forms (harmonizing the definition of the offence, the rules on confiscation, forfeiture as well as on mutual legal assistance) have – as with other issues[81] – been the point of entry into the world-wide harmonization of AML-standards. The 1988 UN Convention against Illicit Trafficking in Narcotic Drugs[82] is primarily a criminalization convention, as opposed to earlier treaties on drug trafficking, focusing on administrative control. Criminalization seems to be the easiest path towards harmonization, since every country in the world has a criminal law and at first sight criminal law seems to have similar preventive effects world-wide. In comparison, harmonizing prudential law is – as the complex efforts of the Basel Committee on Banking Supervision (BCBS) prove – far more arduous. The financial industries' systems of supervision diverge substantially across the world. Furthermore, a plethora of detailed rules would be required in order to make a real difference. Finally, criminalizing seems to be the cheaper option than implementing complex supervisory structures in the entire financial industry world-wide. Criminalization basically lashes out at the few black sheep who do not conform and leaves the others to develop their own risk management.

Of course it has become evident over the years that criminalization is no

substitute for harmonizing regulatory standards for AML. Rather, international fora are attempting in the meantime to do both. Furthermore, criminalization is only a simple, cheap option as long as one remains on the rather superficial level of comparing abstract texts. As long as one does not really want to discuss the concrete workings of criminal justice in the individual country, there is no serious effort in comparison of law: A functional analysis and comparison would have to discuss case law as well as the volume and the type of cases generated by these specific domestic laws. Much of this is, however, determined by the procedural and professional rules enforced in the country, take rules of evidence and of prosecutorial discretion, an area which international organizations and other harmonizing agents very rarely want to get involved in. It is no coincidence that international treaties typically contain provisions reserving established fundamental principles of domestic law, thereby safeguarding their established approach to criminal procedure.

This explains why international institutions like the UN or the FATF are satisfied with an abstract analysis of the elements of the crime – on the objective side especially focusing on the scope of predicate offences,[83] on the subjective side on the question of objective versus subjective knowledge standards.[84] A detailed analysis of case law and the number of cases generated is not an issue for mutual evaluation.[85]

In general neither the relatively small number of money laundering cases,[86] of money laundering-related confiscation cases nor of confiscated assets is discussed by the harmonizing agencies.

The international discussion on the effectiveness of mutual legal assistance has in turn generated a series of criteria, now addressed above all in regional instruments[87]: The ability to rapidly freeze suspicious funds, the level of evidence required in MLA and the overall duration of the proceedings of MLA up to the final decision (which is primarily considered as a function of the amount of appeals available). It has become clear that effective MLA is a joint task both of the requesting and the requested state. The table below indicates the relative responsibilities. It is further understood that effectiveness cannot be the only goal: Since MLA needs to be accorded also in states with a very different legal system from that of the requested country, at least one full judicial review in the requested state should secure that the rule of law is observed and that human rights are respected.

It follows from an overview over the recent efforts to harmonize criminal law on money laundering that the bodies charged with standard setting are primarily interested in achieving formal equivalence of texts, effective law enforcements and justice are not really an issue with them.

Table 8.1 Relative responsibilities of countries in MLA (esp. in sharing of information on clients in the financial services industry)

	Requested country	Requesting country
Rapid reaction	Rapid blocking and seizure	Standard of request (clear description of facts, meet legal requirements of requested state)
	Speedy follow-up to contain possible damage to innocent parties	Seriousness of request
Evidence standards	Refrain from requesting too high an evidence threshold	Follow-up and readiness to supplement information
Duration of procedure	One full series of appeal procedure sufficient	Follow-up to request: efficient domestic procedure

V CONCLUSION

The seemingly contradictory policy of re-regulation of financial intermediaries juxtaposed with markets that have undergone extensive liberalization in a world where financial centres serve the needs of globalization, can in fact be rationalized. In order to control the abuse of financial centres by trans-national criminal operators, preventive and punitive measures are clearly necessary. Moreover, the stability of financial markets has to be secured from the damage that could result through systemic misuse. This latter aim has meant that international bodies such as the Basel Committee, the FSF and the FATF amongst others, are continually developing details for a harmonized approach aimed at preventing 'money laundering'.

The standards that are implemented at the national level in response to these international principles and recommendations, are evaluated and peer pressure is strong internationally, even if the agreed criteria essentially aim at formal compliance with the letter of the standard rather than at genuine effectiveness of the measures. The tragic events of 9/11 have not changed the approach, but have served to extend the applicability of the standards and heightened the pressure to conform at the national level – while the international approaches still lack coherence despite a seemingly united stance towards the problem.[88]

Although national systems all address the same elements associated with the problems of money laundering, they diverge considerably in their emphasis. It may be suggested that the substantive mix of AML rules – even if their historic evolution is different in each of the countries examined – reflects a

tacit, but at the same time, defined agenda. The various systems are in need of interpretation.

It emerged that the two large financial centres (USA and UK) placed far more emphasis on an 'early warning system' with the recording of everyday transactions and the reporting of unusual or suspicious circumstances within the context of retail banking. Having collected information, its primary use was not so much to initiate criminal proceedings, but more to build up a databank of intelligence for future strategic and tactical use by the police or similar authorities. In both countries the emphasis on criminalization of money laundering was far stronger than on the preventive approach of customer identification. In fact, the lack of effective in-depth identification of customers and beneficial owners (especially where corporate vehicles and trusts are used) and the reluctance to have this data available for law enforcement (documentation obligation) could support the contention that the effect of these systems is comparable to 'bank secrecy'. Instead of protecting information on clients, neither system really wants to know or establish these details at all. Broadly speaking, the anti-money laundering concepts in the UK and the USA are to date, more attuned to the risks posed by domestic drug markets, cash and suspicious 'placement' in high street banks than the illegal world-wide financial circuit which would mean the additional burden of equipping their systems against the latter phases of money laundering.

Both in Singapore and Switzerland, the AML-systems are far less oriented towards data collection for intelligence and law enforcement purposes. In Switzerland the system relies on in-house vetting of clients. STRs are fewer than in the UK and USA (even in relative terms), but in Switzerland at least, they lead in most cases to the opening of a criminal investigation. The main emphasis is placed on CDD and KYC, and considerable efforts are made in screening clients in the account opening phase. There is no obligation to date to engage with undesirable clients, and there is also no obligation to notify account openings that are abandoned in the formative stage by the financial intermediary. The main emphasis by these countries is to keep risks away from these small and exposed financial centres. Extensive KYC has a direct correlation to strong banking secrecy. Whereas the Swiss approach is a product of continuous reaction to crises, the tactic in Singapore is a recent and deliberate move to make the financial centre compatible and attractive for international business.

Meanwhile, looking beyond this state of affairs at the domestic level, regulators (especially with the BCBS) and exponents of the industry (Wolfsberg Group, Group of Six, ABA, SBA etc.) are striving towards harmonizing the approaches. The latter operate within their specific industry segments whilst the regulators are primarily addressing themselves to their member states. In certain subject areas both the private sector and the international organizations

define concrete rules (such as for PEPs and correspondent banking), and overall they now increasingly adopt the 'risk-based approach' delegating it to the micro-level of the private sector to define risk categories and the appropriate internal measures. This may result in a grey area between where the rule based approach leaves off, and the margin for defining risk commences. The harmonization of risk strategies also requires further development of a common vocabulary and agreed definitions so that effective standards that really contribute to a level playing field are developed. As for the experiment of the risk based approach and the relationship it creates with the financial services industry, so far it is an untested one. This combination of partnership, delegation and empowerment between government and industry may turn out to be a creative and solution oriented approach or it may be grist for the lawyers mill should shortfalls in risk coverage occur.

However, as a consequence of applying the risk-based approach, all major banks are introducing computer-based filtering mechanisms for retail clients and more individualized mechanisms for private banking. It may be expected that some systems which have over performed in comparative terms may be able to reduce their efforts (such as Swiss banks on identification of beneficial owners in retail banking), whilst others will have to catch up (US banks on KYC in private banking). And although the differences amongst the larger players are rapidly disappearing, smaller institutions and especially NBFIs have still to find their way in the changing regulatory landscape.

NOTES

1. Cf. above, Chapter 1.
2. Cf. above, Chapter 1, Ch. IV.A.1.
3. Cf. for instance Kilchling, 2002.
4. Cf. Chapter 1, FN 10.
5. Cf. Chapter 1, FN 37.
6. An issue finally picked up in the aftermath of 9/11 by the FATF, cf. 29/30 October 2001, FATF Special Recommendations lit. G.
7. Cf. Chapter 1, II.C.3.
8. Cf.Chapter 1, FN 92–4.
9. Cf. Chapter 1, FN 98: OECDs 'Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes', Paris 2001.
10. UK: Group of the Six: Cf. Chapter 6, UK Country Report, Supervisory Law, section VI.A.4.a (Accounts predating the 1993 Regulations).
11. Cf. Chapter 1, section V.
12. Ibid.
13. For US Patriot Act: Cf. Part 2, US Country Report, 3.22.a.2.C (Correspondent Accounts); The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking, 21. 10. 2002 (www.wolfsberg-principles.com).
14. Gemma Aiolfi/Mark Pieth (2002), p. 351 *et seq.*
15. Cf. Chapter 2, Singapore Country Report, section II (Introduction).
16. Cf. Chapter 2, Singapore Country Report, section V.J.

17. MAS Notice 626, 1.1.
18. Depending on whether pension funds are included; cf. Chapter 2, Switzerland Country Report, Combating Money Laundering, section I.A.
19. Cf. Chapter 4, Switzerland Country Report, Combating Money Laundering, section I.B.
20. Cf. Chapter 4, Switzerland Country Report, Combating Money Laundering, section I.A.
21. For definitions of these terms cf. Chapter 4, Switzerland Country Report, Combating Money Laundering, section III.A.2.c.
22. Cf. Chapter 4, Switzerland Country Report, Combating Money Laundering, section I.B.
23. Cf. Chapter 4, Switzerland Country Report, Customer Due Diligence, section I.
24. Cf. Chapter 4, Switzerland Country Report, Customer Due Diligence, section III.D.
25. For details cf. Chapter 4, Switzerland Country Report, Combating Money Laundering, section II.B.5.
26. Cf. Pieth/Estermann (2002), p. 381.
27. Chapter 4, Switzerland Country Report, Combating Money Laundering, section IV.B.
28. Therefore, certain banks face three procedures for lack of due diligence in the Abacha case. Apart from the criminal and the prudential procedure, a private fine of up to SFr. 750 000 has been imposed on individual banks by a tribunal introduced by the Banker's Association.
29. For 2001, 417 notifications, over 80 per cent led to criminal investigations.
30. Chapter 6, UK Country Report, II.A (Self-regulation).
31. Interviews conducted within the context of research on governance funded by the British ESRC and Swiss National Fund.
32. Whereas the figures oscillated around 15 000 in the late 1990s they moved up to 18 500 in 2000, jumped up to over 30 000 in 2001 and are expected to increase yet further, towards 70 000, in 2002, following the terrorist attacks of 9/11.
33. Cf. Chapter 6, UK Country Report, Criminal Law V.A.1.c (Fiscal Offences).
34. Cf. Chapter 6, UK Country Report, Criminal Law V.A.1 (Primary Legislation).
35. Chapter 6, UK Country Report, Criminal Law V.A.3 (Statistics and Convictions).
36. Ibid.
37. For this distinction cf. Chapter 6, UK Country Report, Criminal Law V.B.2.
38. Cf. Chapter 6, UK Country Report, Criminal Law V.B.7.
39. Cf. the strong words of London's Lord Mayor cited in Chapter 6, UK Country Report, Criminal Law V.C.3: 'Mr Oliver received a number of complaints that Britain is 'one of the slowest countries to respond to requests for assistance in gaining evidence against money laundering and other financial crimes' (*Financial Times* 8 August 2002).
40. Chapter 6, UK Country Report, Supervisory Law VIII.A.5 (Identity-Client accounts opened by professional intermediaries); for trusts in particular cf Supervisory Law, pp. 325–7. (Identity-Trusts, fiduciaries and nominees).
41. For BCBS, FATF and Wolfsberg Principles cf. Part 1, VII.A.
42. Cf. Chapter 6, UK Country Report, sections II.A.-D and IV.C.
43. Cf. President's Commission on Organized Crime, 'The Cash Connection: Organized Crime, Financial Institutions and Money Laundering', Washington DC 1984, p. 7.
44. Cf. Chapter 7, US Country Report, p. 353 for information on using a method referred to as 'bootstrapping'.
45. Cf.Chapter 7, US Country Report, p. 363 for Executive Order 13224 on terrorist financing.
46. Cf. Chapter 7, US Country Report, pp. 381–5.
47. Cf. Chapter 7, US Country Report, p. 385.
48. Cf. Chapter 7, US Country Report, p. 386.
49. FATF 1997, Second Mutual Evaluation Report on the USA of 21 March 1997.
50. Cf. Chapter 7, US Country Report, pp. 386–7.
51. Cf. Chapter 7, US Country Report, pp. 388–9.
52. Ibid.
53. Cf. Chapter 7, US Country Report, p. 389.
54. See the critique of the FATF in its 1997 report, cf. above, FN 49.
55. Cf. internal report by US Customs to the Subgroup Statistics and Methods of the FATF 1989.
56. Cf. Chapter 7, US Country Report, p. 381.
57. Cf. Chapter 7, US Country Report, p. 391.

58. BCBS, FATF: cf. Chapter 1, FN 163/164.
59. Wolfsberg: cf. Chapter 1, FN 165.
60. Cf. Chapter 7, US Country Report, pp. 386–7.
61. Cf. Chapter 7, US Country Report, p. 396.
62. Cf. Chapter 7, US Country Report, ibid.
63. Cf. Chapter 7, US Country Report, p. 398.
64. Cf. below IV. A. 3.
65. Pieth/Estermann (2002), p. 371 *et seq*.
66. Cf. recent private fines of up to SFr. 750 000 imposed on the basis of the CDB on member banks of the Swiss Banking Association, for lack of diligence in KYC (Abacha); cf. Neue Zürcher Zeitung, 28 November 2002, p. 23.
67. Chapter 4, Switzerland Country Report, Combating Money Laundering, section II.C.1.a.
68. BCBS CCD 2001, FATF 40/ 2003, Wolfsberg 2000 & 2002, cf. Chapter 1, section VII.A.
69. For a risk-based approach see: Chapter 3, Singapore Country Report, III.B and D; Chapter 4, Switzerland Country Report, Combating Money Laundering, Introduction and III.D.3.a, Chapter 6, UK Country Report, Institutions of the AML system-II. and Supervisory Law-VIII. Chapter 7, US Country Report, p. 387 ff.
70. Cf. the development in the UK and in Singapore, but also plans for the development in Switzerland.
71. Basel Committee on Banking Supervision; Chapter 1, section VII.A.
72. Cf. UK approach.
73. Capus, N. (2002), 'Self-regulation in combating money laundering', in *Auslandrundschau der Zeitschrift für die gesamte Strafrechtswissenschaft*, Berlin.
74. Cf. above Chapter 1, section VII.
75. Domestically: Chapter 6, UK: Group of Six; Switzerland :CDB; US: ABA, New York Clearing House.
76. UK: Steering Group, UK Country Report, section IV.E.2.
77. UK: Financial Services and Markets Act 2000, cf. Chapter 6, UK Country Report, section II.A; Switzerland: Swiss Banking Commission Regulation 91/98 referring to the CDB.
78. Cf. BCBS 2001, cf. Chapter 1, VII.A.
79. Cf. Draft Regulation Swiss Banking Commission, Chapter 4, Switzerland Country Report, Combating Money Laundering.
80. This problem is accentuated by accepting countries like Argentina and Russia as member-states, for example, FATF, *Annual Report* 2002/3, para. 61 ff.
81. Cf. the work on corruption.
82. 'United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances', adopted 19 December 1988.
83. Enlarged by the FATF in 1996 and 2003.
84. Cf. the discussion in the FATF Consultation Paper 2002 §131 *et seq*.; and now FATF 40/2003, Rec. 2a.
85. At least so far not for the FATF. The OECD Working Group on Bribery has in its so-called 'Phase 2'-evaluations developed a new kind of monitoring, focusing on application rather than mere implementation, cf. Pieth, 2000, p. 56 *et seq*.
86. Kilchling, 2002, p. 440
87. Council of Europe: European Convention on Extradition (1957); European Convention on Mutual Assistance in Criminal Matters (1959); Additional Protocol to the European Convention on Extradition (1975); European Union: EU Convention on Mutual Assistance in Criminal Matters between the Member States of the European Union (2000).
88. Cf. FATF Annual Report 2002/3, para. 22 ff., annex B, Guidance Notes for the Special Recommendations on Terrorist Financing and the Self-Assessment Questionnaire.

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