

# SEACEN/WORLD BANK REGIONAL ADVANCED WORKSHOP FOR BANKING SUPERVISORS ON AML/CFT

Kuala Lumpur, Malaysia

April 16-20, 2007

## ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

BY

Pierre-Laurent Chatain

The World Bank Group, FPDFI



# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *introduction/general observation*

- Banks are the gatekeepers of financial systems and countries need their vigilance to protect the integrity of the system.
- Without the vigilance of banks, dirty money can slip into the financial system, funding the crime trade and fueling the violence, corruption, and addiction that flow from illicit money.
- Banks that fail to adequately know their customers and screen their transactions for suspicious activities can be exploited by criminals.
- Having in place an effective and **deterrent sanctioning system** is critical to make sure that banks will play their role of gatekeepers.
- FATF has highlighted the importance of establishing an adequate sanctioning system, **whether criminal, civil or administrative**, to deter money laundering and terrorist financing
- Financial institutions that fail to establish appropriate AML/CFT compliance procedures incur legal and financial liability that can impact their bottom lines as well as their reputation.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *Scope of the presentation*

- Several FATF Recommendations and Basel Core Principles refer to sanctions, e.g.:

**Rec.2** : « Criminal liabilities, and where that is not possible, civil or administrative liability, should apply to legal persons (...). Legal persons should be subject to effective, proportionate and dissuasive sanctions. Such measures should be without prejudice to the criminal liability of individuals »

**SR. II** : « Each country should criminalise the financing of terrorism, terrorist acts and terrorist organisations. Countries should ensure that such offences are designated as money laundering predicate offences ».

**SR VI** : Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

**Rec. 17** : « countries should ensure that effective, proportionate and dissuasive sanctions, whether criminal, civil or administrative, are available to deal with natural and legal persons that fail to comply with AML/CFT requirements »

**Rec. 29** : Supervisors should be authorized to impose adequate administrative sanctions for failure to comply with AML/CFT requirements »

**BCP. 22** : « Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements »

- This presentation will only focus on Rec. 17 , 29 and on BCP 22:

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *Main point of discussion*

- I- Usefulness of a sanctioning regime
- II-Preconditions for a suitable sanctioning and remedial arsenal
- III- Scope and types of sanctions to be applied
- IV- Snapshot of sanctions that have been handed down in several jurisdictions
- V- Questions and Discussion

## ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

### *1- Importance of a suitable sanctioning regime:*

- Jurisdictions should necessarily adopt different sanctioning regimes in accordance with their differing legal traditions, constitutional requirements, and systems of governments
- Countries, whether developing or developed, should adopt a minimum set of measures to sanction banks that failed to comply with their AML/CFT obligations
- This set of measures should meet FATF requirements as set out in Recommendations # 17 and 29.

### *1- Importance of a suitable sanctioning regime (Contd):*

- A good AML/CFT legal and regulatory regime is worthless if non compliant financial institutions are not subject to any sanctions and if their misconduct or wrongdoing is not properly and effectively reprimanded
  
- Establishing an effective sanctioning regime is also critical to combat money laundering and terrorist activities by:
  - Deterring banks and other financial institutions who might otherwise be willing to support criminal activities;
  - Dismantling illegal activities by encouraging subject entities to perform enhanced due diligence and monitoring;
  - Promoting a sound and accountable banking system.

### *II- Preconditions for a suitable sanctioning and remedial arsenal*

- First, Jurisdictions should designate an authority (e.g. supervisors or the FIU) empowered to enforce its decision and consequently apply appropriate sanctions where necessary (FATF Methodology, criteria 17.2 and 29.4 and also BCP #23).  
*Example: USA, Spain and France*
- Second, the sanctioning power granted to competent authorities should have a legal basis (see Basel Core Principle #1, see also Basel Core Principle methodology, October 2006, criteria 1(4)).
- Third, sanctions themselves should rest on a strong legal or regulatory basis. Types of sanctions that financial institutions are subject to should also be publicly disclosed.
- Fourth, supervisors should have operational independence to enforce their decisions

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied*

- Scope of sanctions should be as broad as possible:

**Rec 17:** countries should ensure that effective, proportionate and dissuasive sanctions, **whether criminal, civil or administrative**, are available to deal with natural or legal persons that fail to comply with anti-money laundering or terrorist financing requirements.

**Rec 29:** supervisors should be authorized to impose adequate administrative sanctions for failure to comply with AML/CFT requirements

**BCP # 22:** Supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential and compliance requirements (such as AML/CFT obligations) or when there are regulatory violations.



# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

- Scope of sanctions should be as broad as possible (*Contd*):
  - No further indication in the forty FATF recommendations on the definition and exact nature of sanctions that can be imposed by competent authorities;
  - Interesting clues can be found in the 2004 common methodology designed by the FATF to guide the assessment of a country's compliance with the international AML/CFT standards;
  - The methodology contains essential criteria that should be read in conjunction with the text of recommendations #17 and 29 and provides further clarifications on the nature, content and scope of measures.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

- Sanctions should be effective and dissuasive (a).
- Sanctions should be proportionate to the seriousness of a situation (b)
- Range of sanctions should be broad (c)
- Sanctions should be applied to banks as well as to senior management (d)

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

- (a) Sanctions should be effective and dissuasive.

-**Effectiveness** should be understood as a regime where sanctions are actively applied by relevant authorities;

-**Dissuasiveness** is more difficult to define since it refers to a combination of factors comprising effectiveness, proportionality (see below) and nature of sanctions (deterrence).

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

- **(b) Sanctions should be proportionate/commensurate to the seriousness of a situation** (see FATF methodology).
- Similarly, a good and suitable regime is the one which enables a graduated response by supervisors depending on the nature of the problems or the failure (see BCP)

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

### ■ **(c) Range of sanctions should be broad** (see FATF methodology, 2004).

- (i) Written warnings (separate letter or within an audit report);
- (ii) Orders to comply with specific instructions (possibly accompanied with daily fines for noncompliance);
- (iii) Ordering regular reports from the institution on the measures it is taking;
- (iv) Fines for non compliance;
- (v) Imposing conservator ship or a suspension or withdrawal of the license;
- (vi) Imposing criminal penalties where permitted.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

- **(d) Sanctions should be applied to banks as well as to senior management.**

-A bank, as a legal person should not be the only one to be accountable for failure to comply with AML/CFT obligations. Directors and senior management should also be accountable as well for their failures in implementing appropriate preventive AML/CFT measures.

-Supervisors should be vested with the power to impose sanctions to individuals who held management positions within the bank.

-Sanctions should include, but not limited to:

(i) barring individuals from employment within that sector,  
or (ii) replacing or restricting the powers of managers, directors, or controlling owners.

-Discussion: Application of sanctions to other employees?

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *III- Overview of possible sanctions to be applied (contd)*

### ■ ***Example of South Korea***

#### -On bank executives:

- Recommendation of discharge from office
- Suspension from duties
- Notification of reprimand and Cautionary warning

#### -On bank staff:

- Disciplinary dismissal
- Suspension from office
- Reduction of salary
- Reprimand

#### -On institutions:

- Canceling business license
- Business suspension
- Lock-out of business branch
- Cautionary warning
- Demand to publicize a violation of law

## ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

### *IV- Snapshot of sanctions that have been handed down in several jurisdictions*

- The nature of the sanction varies according to each legal and constitutional regime and upon particular circumstances;
- Experiences from countries show that there is no single model when it comes to issue sanctioning measures against defaulting entities;
- Certain jurisdictions use a large panel of measures, ranging from reprimand to the withdrawal of the license while other countries put more emphasis on administrative sanctions rather than on financial fines.



## ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

*IV- Snapshot of sanctions that have been handed down in several jurisdictions*

*(contd)*

- *Examples of civil money penalties*
- *Examples of criminal penalties*
- *Example of other sanctions*
  
- *Discussion: Publication of sanctions?*

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ Example 1: Civil Money Penalties imposed by the **British FSA**

The FSA fined Bank of Scotland plc (BoS) **£1,250,000** for failing to keep proper records of customer identification as required by the FSA's Money Laundering Rules.

The FSA's investigation confirmed weaknesses in BoS record keeping systems and controls across its retail, corporate and business banking divisions.

According to FSA, in over half of the sample of accounts tested in late 2002, BoS had failed to retain either a copy of the customer identification evidence or a record of where this evidence could be obtained.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ Example 2: Civil Money Penalties rendered in the US

In 2004, the Financial Crimes Enforcement Network (FinCEN) and the Board of Governors of the Federal Reserve System imposed a **\$10 million** civil money penalty against AmSouth Bank of Birmingham (Alabama) for its violations of the Bank Secrecy Act.

FinCEN and the Federal Reserve Board based their assessment on the failure of the banking organization to establish an adequate anti-money-laundering program and the failure to file accurate, complete, and timely Suspicious Activity Reports (SARs).

The agencies found systemic defects in bank's program with respect to internal controls, employee training, and independent review that resulted in failures to identify, analyze and report suspicious activity occurring at the bank.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

- Example 3: Civil Money Penalties imposed by the French Banking Commission

CALYON bank, received a sentence of **€1 million** for:

- (i) failing to require identification of customers when entering into business relations,
- (ii) failing to establish on-going due diligence and
- (iii) for omitting to instruct its branches and subsidiaries overseas on the necessity to collect information related to complex and unusual operations or operations without economical justification.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ *Example 1 of criminal penalties rendered in the US*

The first criminal prosecution against a bank for money laundering was brought in 2002 in the case of the Broadway National Bank.

The BNB was given a sentence of a \$4 million criminal fine for:

(i) failing to maintain a legally-required anti-money laundering program,

(ii) failing to make legally-required reports to the authorities regarding approximately \$123 million in suspicious bulk cash and structured cash deposits and,

(iii) aiding and assisting customers to structure approximately \$76 million in transactions to evade currency reporting requirements.

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ *Example 2 of criminal penalties rendered in the US*

In May 2004, the U.S. Federal Reserve fined Riggs Bank \$25 million for:

(I) failing to implement effective programs against money laundering and

(II) failing for not reporting suspicious transactions executed on behalf of former Chilean Dictator Gen. Augusto Pinochet.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ *Example of other sanctions:*

In addition to the civil and criminal penalties described above, competent authorities may take further measures when the breach is particularly serious.

Authorities can for instance combined fines with administrative and or other disciplinary measures.

The withdraw of the license and consequently the termination of the activity of a financial institution is the most severe disciplinary sanction that a competent body may impose: *Example in France:* ETNA Finance securities and 3 LTD Companies (Money changers).

In the face of serious offenses, the supervisor must have direct access to the prosecutor and bring the case to the justice, notwithstanding the possibility to rule, as supervisor, specific administrative and/or civil sanctions.

## *IV- Snapshot of sanctions that have been handed down in several jurisdictions (contd)*

### ■ *Example of combined sanctions in France*

(a) In 2006, the Banque Privée Européenne (European Private Bank) was fined **€100,000** in addition to a reprimand for failing to (i) report suspicious transactions to the FIU, and (ii) perform on-going surveillance.

(b) This was also the case for BLC Bank France SA which was fined **€200,000** in conjunction with a reprimand for breaching national requirements on internal control, customer identification and suspicious transaction reporting.

In both cases, the decision was publicly disclosed, which is particularly deterrent.



# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

## Publication of sanction?

### ■ Pros and cons:

- +sanctions appear to be more deterrent if they are publicly disclosed;
- +publication of sanctions can be seen as an additional instrument that competent authority may use as a leverage;
- disclosing names can negatively impact the image and reputation of a bank or the banking industry as a whole and thus generate unpredictable consequences;
- disclosing names of non-compliant banks can also compromise public confidence in the banking system as a whole.

# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

■ Thank you !

[pchatain@worldbank.org](mailto:pchatain@worldbank.org)



# ESTABLISHING AN EFFECTIVE SANCTIONING REGIME

QUESTIONS:

