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Money laundering, Tax havens and Transparency: Any role for the Board of Directors of Banks?

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Abstract:

Among other characteristics, money laundering notably occurs across national borders and primarily through banks, and mainly because banks, which are both legitimate and 'ubiquitous' financial services institutions, engage primarily in financial intermediation. We ask, are the levers of control over banks' involvement in money laundering and other financial crimes, more effective when pulled from the outside by government agencies or is there a less arm's-length role for banks' board of directors, by way of appropriately nuanced corporate governance? To answer this question, we first attempt to understand money laundering, its antecedents, its support mechanisms, and then how it may be tamed; with emphasis on the potential productive role of banks' boards. At a general and/or high level, we recommend that the intervention of banks' boards must focus (i.e., insist) on: (i) the primacy of transparency and upholding of both real and perceived reputational capital of the bank, and (ii) ascertaining that their banks' relations with corresponding banks distributed across several national borders or association with banks domiciled in notorious tax havens, are demonstrably above board.

1. Introduction

Among other characteristics, money laundering notably occurs across national borders and primarily through banks, and mainly because banks, which are both legitimate and 'ubiquitous' financial services institutions, engage primarily in financial intermediation (Barry-Johnston 2005, Chaikin 2006, 2011 & 2017, Tsingou 2010, Zucman 2015, and others). Therefore, as the natural logical choice of launderers of 'soiled funds', a key question implicit in this chapter is: could effective corporate governance in financial institutions, particularly banks, possibly mitigate or stop this corrupt use of formal financial services institutions and markets?

The idea of money laundering dates back many years and is linked to banking and investment transactions, which are carried out in presumed "safe" environments. It mainly manifests in individuals and firms hiding their earnings and ill-gotten funds from authorities as to: avoid being found out; circumvent paying taxes and/or the capturing of their pertinent data. Over time, from 2000-BC in China to September 11, 2001 in the US, there has been back and forth between illicit funds flow under varying activities and counter efforts to discourage them largely because of the huge economic sequences of the underlying illegal activities. This seemingly iterative process has since culminated in today's set of anti-money laundering laws and initiatives, such as FIU, FICA, AUSRAC, FATF, Patriot Act, and so on (Morris-Cotterill, 2001; El Qorchi, 2002; Unger, 2013; Zucman, 2015; and others).

Clearly, for these mitigating and/or preventive initiatives to be effective, the levers for implementation must be in the grasp of government to a reasonable extent. The formal legitimate platforms co-opted into these illegal, if not, nefarious activities are financial services institutions, chief of which are banks[1]. Therefore, an additional key question here is: are the levers of control over banks' involvement in money laundering and other financial crimes more effective when pulled from outside by government or is there a less arm's-length role for banks' board of directors (by way of appropriately nuanced corporate governance articulation)?

To see our way through to how banks' board of directors can assist, we need a good understanding of what the "animal" (money laundering) is like, how the animal comes to be, and what efforts governments have made thus far to tame the animal, as it were. The next sections, therefore, address these necessary background issues. Then follows thoughts on how board of directors of banks can contribute productively in better taming and curbing the money laundering menace.

[1] Money laundering may not be nefarious but the activities or actions it sponsors, such as terrorism, human trafficking, arms dealing, etc., are clearly and increasingly becoming nefarious.

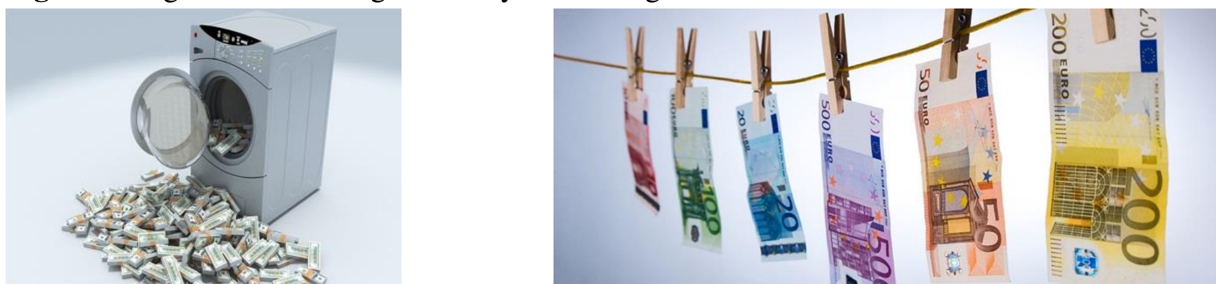
2. Money Laundering

2.1. Origins and underlying theories of money laundering.

Money laundering is the act of modifying proceeds from corrupt activities and crime (dirty money) into supposedly clean money (genuine resources). Money earned illegally from crimes and illegal or corrupt activities such as insider trading, extortion, illegal gambling, drug dealing and human trafficking, tax evasion, fraud, bribery, misappropriation of public funds, even armed robbery, is "dirty" and needs to be "cleaned" to seem legal and legitimate (Van Fossen 2003). The notion of money laundering has even expanded to include a variety of businesses and financial crimes, ranging from misuse of financial institutions/markets to financing of terrorism.

Arguments persist on the origin of the term “money laundering”. Some believe money laundering originated from ownership of laundromats in the US in the 1920s, when some mafias attempted to legalize proceeds from illegal activities by using those proceeds to acquire legitimate businesses (Schneider 2008, Aluko and Bagheri 2012, McCarthy 2010). Some believe the term was first used in the 1970s, during the Watergate scandal, when some illegal activities – ‘dirty tricks’ (connected to cash/‘black fund’ used by a presidential re-election committee) contributed to the resignation of President Richard Nixon[2]. As the verb “launder” means to wash or clean, the term “money laundering” simply adopts the figurative meaning of wash/clean to explain the act of legalizing dirty money (as pictorially illustrated in Figure 1).

Figure 1: Figurative meaning of money laundering



Different definitions of money laundering have emerged from different countries, jurisdictions, organizations and authors. Thus, no consensus original definition of money laundering exists. What seems clear is that most definitions in the extant literature are based on a seemingly universal definition put forth by the UN convention on Drugs and an EU-directive, which relates money laundering to the legalization of illegitimate/forbidden/unlawful proceeds from criminal activities. This definition has been

[2] http://www.word-detective.com/2012/02/money-laundering/.

adopted or modified and incorporated into national laws of member countries (Schneider & Windischbauer 2008, Schneider 2008). For example, the Financial Action Task Force (FATF), an intergovernmental body, defines money laundering as alteration of criminal earnings to disguise their illegitimate origin (Aluko & Bagheri 2012, Chaikin 2017)..

FATF went on to develop a theory of the process of money laundering (Gilmore 2004). Though money laundering can sometimes take a highly complex form, the FATF theory conceptualizes money laundering as involving a three-stage process: placement, layering, and integration of funds. And these three predominant stages of the money laundering, can sometimes entail layers of arcane activities within one or two of these identifiable stages (Reuter and Edwin 2004).

2.1.1. Placement

Placement is the first identifiable stage of the laundering chain of activities, where the launderer moves the funds earned from illegal activities to a safe place that is less suspicious to law enforcement agencies. In most cases, the funds are deposited in bank accounts or lodged in other financial institutions or retail economy; consequently, such funds become mingled into the financial system. According to the Australian Transaction Reports and Analysis Centre (AUSTRAC, 2014)[3], methods of placement range from opening false bank accounts to placing cash deposits in multiple banks. The logic of using banks as a placement depot is that if illicit cash is deposited in a bank, the likelihood of tracing the criminal source of the cash is greatly minimized; thus, banks are the most attractive repository for placement of soiled money (Chaikin 2017).

According to the Economist of 2014[4], in over 200 countries, trillions of dollars are transacted each year by no less than 11000 financial institutions via the Worldwide Interbank Financial Telecommunication (SWIFT) apparatus. Thus, there is a high probability that banks misuse SWIFT facilities for placement, by shifting illegally generated funds to offshore jurisdictions (SWIFT, 2016)[5].

2.1.2. Layering

The second stage involves movement of the illicit fund through a series of deliberately intricate transactions, designed to make it more difficult to trace its original source. Indirectly, banks facilitate layering of illicit funds by allowing customers to operate multiple accounts with multiple banks, and across countries (AUSTRAC, 2014). Further, advancement in financial production technologies and existence of offshore financial hubs and corporation form of business has facilitated funds movement

[3] http://www.austrac.gov.au/typologies-and-case-studies-report-2014. Retrieved December, 2017.
[4] https://www.economist.com/news/international/21633830-blocking-rogue-states-access-worlds-financial-messaging-network-potent-measure. Retrieved December, 2017.
[5] https://www.swift.com/about-us/swift-fin-traffic-figures. Retrieved December, 2017.

across countries. Another means of clouding the original source of illicit monies is through the use/misuse of financial derivatives (Schneider and Windischbauer 2008).

2.1.3. Integration

At the integration stage, the process of money laundering is viewed to have come to completion. The illegal fund would have been integrated into the formal economy, such that there is no more differentiation between funds earned through legal and illegal means. Hereafter, the launderer can move his funds within a country, around the globe, or invest them in any legitimate business with little fear of detection. If the illicit fund had been moved offshore during the placement/layering stage, the launderer can now decide whether to move the fund back to home jurisdiction or allow it to remain offshore. And if the former is decided, the fund is moved back in a way that seems it had been legally earned abroad.

The banking sector also plays an important and quite involving role at this stage just as in the first two stages. The integrated fund could be invested in property (backed by bank loans) or equity market via brokerage or wealth management firms.

2.2. Sources of 'soiled money' needing laundering

Often the literature takes 'as a given' that laundered monies simply appear "soiled" from nowhere, as it were, needing to be cleaned, without reflecting on their origins and why they need to be laundered. This is quite a significant omission that has bearing on the efficacy of measures put in place to combat the symptom of the problem (money laundering) instead of the sources of the soiled money (corrupt activities) and the antecedents of corruption. Understanding these linkages would enable governments and civil society to evolve mitigating measures at early stages (sources) of the problem. This, in turn, would attenuate the quantity of soiled monies needing to be laundered, and thus, make AML measures undoubtedly more efficacious.

All else equal, corrupt activities are more likely in countries characterized by ethnic and/or racial fractionalization (Alesina & Ferrara 2000, Triesman 2000, Burgess et al. 2011, Delavallade 2012, Franck & Rainer 2012, Esteban et al. 2012, Feske & Zurimendi, 2017 and others). E.g., collective vigilance against looting and abuse of shared-wealth are more probable in societies where groups have a feeling of "it's them against us" than in societies where people have a generally healthy sense of belonging (Alesina & Ferrara 2000, 2004; Gyimah-Brempong 2002, Alesina et al. 2003). In the same vein, where there is a high distributional problem (income inequality) whether it be on the basis of social class, income, race, gender, or whatever, there is more likely a sense of "it's our turn to take our share of the national cake" than where members of a society have an overall sense of belonging (social cohesion) (Alesina, 1992,

Mustapha 2006, Franck & Rainer 2012, Dev et al. 2016, Alesina et al., 2016, Mthanti & Ojah 2017, and others).

Weak institutional infrastructures, especially legal and political ones, have been shown to wreck control of corruption (Greif 1993, Gyimah-Brempong 2002, Djankov et al 2003, Mauro 2004, Delavallade 2012, and others). The extent to which the populace of a country is educated affects both the degree of inequality based on significantly divergent incomes attributable to education gaps, and ability to hold leaders accountable and/or organize effective civil society bodies (e.g., Van Rijckeghem & Weder 1997, ACR 2015, and Dev et al. 2016).

2.3. Consequences of financial crime and money laundering

Countries have lost huge amounts of revenue through money laundering and financial crimes. Financial crimes have continued to increase in form, scale, as well as in the overall damage they cause both the global economy and individual national economies. According to the then Australian Crime Commission (ACC)[6], as at December 2015, cost of financial crimes in Australia was estimated to be about US$27.40 billion (A$36 billion Australian dollars) per year, which equates to UD$1,188.02 (A$1,561 Australian dollars) out of every individual Australian's pocket, and thus, adds 6.3% to each individual's average cost of living. Similarly, as at 2013 and 2014, ACC estimated that cost of organized crime in Australia stood at US$4.8 (A$6.3 Australian dollars) per capita. These figures are based on estimates, because the interconnectedness of legal and illegal financial activities thwarts efforts to correctly assess the exact magnitude of financial crime in Australia. Having highlighted Australia as an example, some of the notable cases of money laundering activities and estimated amounts involved across the world are summarized in Table 1.

[6] https://www.acic.gov.au/sites/g/files/net1491/f/2017/08/oca_2017_230817_1830.pdf. Retrieved 16th December 2017.

Table 1: Notable cases of money laundering activities and estimated amounts involved

Year	Country	Bank	Reason	Amount involved	Amount fined	Authority imposing fine
2016	Singapore	BSI[7]	Serious breaches of AML rules, & poor management oversight of the bank.		Outright bank closure	Monetary Authority of Singapore
2014	U.S	BNP[8] Paribas	Falsifying records and violation of U.S. sanctions against Cuba, Iran and Sudan		US$8.9 billion	United States Sanctions
2014	UK	Standard Bank, UK subsidiary[9]	Failures in its AML controls.		US$12.6 million	UK Financial Conduct Authority
2013	U.S	Liberty Reserve[10]	Money laundering	US$6 billion	Outright bank closure	United States Federal Authorities
2012	U.S	HSBC[11]	Money laundering which occurred throughout 2000s.		US$1.9 Billion	United States sanctions
2012	U.S	Standard Chartered[12]	Money laundering in the 2000s over a decade of 60,000 transactions worth hundreds of billions US$ for Iran.	US$250 billion	US$330 million	United States government agencies
2006	Kenya	Charter House Bank[13]	Money laundering via multiple accounts of missing customer information.	More than US$1.5 billion	placed under statutory management	Central Bank of Kenya
2005	US	Bank of New York[14]	Money laundering via accounts controlled by bank executives in 1990s.	US$7 billion	US$38 Million	US government
2000	Nigeria	Sani Abacha[15,16]	Money laundering by former Nigerian military president, Sani Abacha and family in 1990s	Between US$2-5 billion	Money to be returned to Nigeria	Nigerian and Swiss governments
1998	Nauru	offshore shell banks[17]	Russian criminal laundered money through Nauru banks	US$70 billion		Russian central bank
1996	US	Franklin Jurado-Rodriguez[18]	Jurado-Rodriguez laundering for Cali Cartel in 1990s (Kochan 2011)	About US$65 Million	About 2 years imprisonment	US government
1996	US	Michael Abbell[19]	Abbell charged for using legal skills to promote cocaine trafficking enterprise	cocaine worth		US government

[7] https://aml-cft.net/singapore-bsi-bank-ordered-to-shut-down/ *AML-CFT. 25 September 2016. Retrieved 12 December 2017.*
[8] https://web.archive.org/web/20140715004002/http://www.fbi.gov/news/stories/2014/july/bank-guilty-of-violating-u.s.-economic-sanctions/ . *Retrieved 12 December 2017.*
[9] https://mg.co.za/article/2014-01-23-standard-bank-fined-126-million-for-failures-in-anti-laundering-controls
[10] http://abcnews.go.com/US/black-market-bank-accused-laundering-6b-criminal-proceeds/story?id=19275887.*Retrieved 12 December, 2017.*
[11] https://dealbook.nytimes.com/2012/12/11/hsbc-to-pay-record-fine-to-settle-money-laundering-charges/.
[12] https://dealbook.nytimes.com/2012/12/06/standard-chartered-to-pay-u-s-330-million-to-settle-iran-laundering-claims/.
[13] https://correctiv.org/en/investigations/mafia-africa/articles/2015/04/16/charter-house-bank-money-laundering-machine/.
[14] http://www.nytimes.com/2005/11/09/business/bank-settles-us-inquiry-into-money-laundering.html.
[15] http://saharareporters.com/2014/03/06/how-abacha-and-associates-stole-billions-dollars-nigeria-%E2%80%94-report.
[16] http://www.newsweek.com/nigeria-switzerland-sani-abacha-corruption-434971.
[17] http://www.nytimes.com/2000/12/10/magazine/the-billion-dollar-shack.html.
[18] http://www.nydailynews.com/amp/archives/news/admits-laundering-drug-cash-article-1.716159.
[19] https://www.washingtonpost.com/archive/politics/1995/06/18/from-respected-attorney-to-suspected-racketeer-a-lawyers-journey/d60f376a-b7eb-4f48-8acb-8e5daf99fa4f/?utm_term=.7af01f113352.

			in Cali, Colombia	US$2 billion		
1991	US and UK	Bank of Credit & Commerce International (BCCI)[20]	Financial crimes, money laundering, drug trafficking, bribery, concealment of treasury losses etc., in 1980s	Unknown, estimated in billions of USD		UK and US investigators
1991	Philippines and US	Ferdinand Marcos	Real-estate deals of former Philippines head, Ferdinand & Imelda Marcos Government assets laundered via banks in US, Liechtenstein, Panama, Cayman Islands, Vanuatu, Hong Kong, Vatican, Singapore, Bahamas, Switzerland, etc.	Unknown, estimated in US$10 billion		Philippines and US
1987	Italy	Institute for Works Religion (IOR)[21]	Suspected money laundering by the IOR to several Italian banks in 1980s	US$218 million		Italian authorities

3. Anti-Money Laundering (AML) Measures

Prior to 1980, money laundering laws were meant to fight drug abuse and drug smuggling, mainly in the US. In fact, criminalization of drug abuse/smuggling in the 1920s was followed by several decades of US government's fruitless efforts to minimize drug smuggling. In the attempt to win the said "war on drugs", the regime of former US president, Bill Clinton, came up with the idea to confiscate earnings from drug deals, based on a refrain: "*If one could not get to drug dealers.., then at least they should be discouraged, with the realization that they could not reap the monetary benefit of the illicit acts*" (Unger 2013, p. 53). Based on this new anti-drug strategy, the US established the first anti-money laundering law in 1986, i.e., Money Laundering Control Act (1986), which then deemed money laundering a federal crime.

Due to high level interconnectedness of money laundering activities and the ease of moving illegal earnings between countries, a specialist organization was established in the 1980s to set up global regulatory standards for AML laws. The Financial Action Task Force (FATF) was established in 1989 by seven member countries, which has now grown to 35 member countries as at 2017[22]. The main objective of FATF is to issue recommendations with the aim of evolving legislations and policies for AML. For further insights on this, some selected national AML measures are summarized in Table 2.

[20] https://www.globalsecurity.org/intell/library/congress/1992_rpt/bcci/04crime.htm.
[21] https://en.wikipedia.org/wiki/Institute_for_the_Works_of_Religion and *"Vatican Bank reported to be facing money-laundering investigation"*.
[22] Visit http://www.fatf-gafi.org/countries/#FATF for updates on country membership.

Table2: Selected examples of national AML measures

Country	AML regime	Purpose of regime	Date initiated	Laws and Acts
Afghanistan	Financial Transactions & Reports Analysis Center of Afghanistan (FinTRACA) 2014	To protect integrity of financial system, by combating money laundering.	2014	FinTRACA was first established FIU under the AML and Proceeds of Crime Law in 2004.
Australia	Australian Transaction Reports & Analysis Centre (AUSTRAC)	Assesses information from cash deals to mitigate money laundering.	2006	Proceeds of Crime Act 1987. *AML & Counter-Terrorism Financing Act 2006*
Bangladesh	Central Bank of Bangladesh & Bangladesh FIU	Ensure country compliance with Int'l AML laws		FIU is governed by Money Laundering Prevention Act, amended and modified in 2002, 2008, 2009, 2012
Canada	Financial Transactions & Reports Analysis Centre of Canada (FINTRAC).	Ensure compliance with reporting stds, law & regulations. Prevent terrorism finance & threat to financial security.	1991	Proceeds of Crime (Money Laundering) Act (PCMLA). Amended in 2000, and called Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA). 1st enacted in 1991, amended in 2000, 2002 & 2006
India	Enforcement Directorate. Ministry of Finance. Department of Revenue.	Prevent money laundering. Confiscate properties involved in money-laundering	2002	Prevention of Money Laundering Act (PMLA) 2002, amended in 2013.
Indonesia	Indonesia's FIU, known as the PPATK	To combat money laundering	2002	Indonesian Financial Transaction Reports and Analysis Center (INTRAC). Incorporated fight against terrorism finance in 2007.
Slovak Republic (Slovakia)	Slovak FIU of the National Police Agency	To prevent money laundering		
South Africa	Financial Intelligence Centre (FIC) and South Africa's FIU	Fight financial crimes, including money laundering, tax evasion & terrorism financing.	2001	Financial Intelligence Centre Act (FICA). 1st amended in2013. In 2017 FICA amended to incorporate risk-based approach.
United Kingdom	The Financial Conduct Authority (FCA)	FCA for all financial crime responsibilities formerly held by the British Financial Services Authority		1. Terrorism Act (2000) contains UK AML laws 2. Anti-terrorism, crime and security Act (2001). 3. Proceeds of Crime Act (2002). 4. Money laundering regulations (2007). 5. Money laundering regulations, terrorist finance & transfer of funds regulations (2017)

United States	Financial Crimes Enforcement network (FinCEN), which is US's FIU			1. Bank Secrecy Act (1970) 2. Money Laundering Control Act, 1986 3. Money Laundering & financial crimes strategy Act , 1998 4. Annunzio-Wylie AML Act, 1992 5. Intelligent Reform & Terrorism Prevention Act, 2004

4. Money Laundering, Tax Haven and Transparency

The major question to be answered amidst in the money laundering saga is: what attracts a country to the proceeds from illegal activities? According to a report for the European parliament (PANA), in March 2017[23], launderers were attracted to countries characterized by: developed financial institutions and markets, low record of corruption, and most importantly high secrecy and relatively fewer AML rules. Per this report, big European countries have high probability of being attractive to money launderers, with the UK on top of the list and exposed to billions of Euros of laundering annually; followed by France, Belgium, Germany, Luxemburg, Netherlands and Austria.

However, according to Van Fossen (2003), since the 1970s offshore financial centers in the Pacific Islands have been battling with the threat of being cut off from the global financial system, due to accusations that they, as offshore centers, promote money laundering and harmful tax practices. Activity of tax havens in this region was brought to limelight in the Nauru saga, when Nauru was involved in the Bank of New York scandal of money laundering, tax evasion and illegal capital movement involving Russia. It was then understood that tax havens around the world facilitate placement, layering and integration of hundreds of billions of dollars earned from illegal drug deals (Van Fossen 2003).

According to Kudrle and Eden (2003), the term tax haven refers to countries with suspicious financial activities that appear large relative to the size of their total economy; thus, tilting their national policies toward creating: (1) *Productive haven*, where comparatively low tax rates are used to attract investment from other countries. (2) *Headquarters haven*, where firms are enticed with low tax rates to incorporate or re-incorporate in that jurisdiction. (3) *Sham haven*, where firms keep funds out of reach of their countries of domicile. (4) *Secrecy haven*, where investors disguise ownership of assets by investing offshore.

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[23] http://www.europarl.europa.eu/RegData/etudes/STUD/2017/595371/IPOL_STU(2017)595371_EN.pdf.

Importantly, in 2012[24], the OECD identified four key factors that could be used to ascertain whether or not a country can be deemed a tax haven:

1. No taxes or only nominal taxes apply,
2. Lack of transparency,
3. Presence of policies that thwart or impede exchange of information for tax purposes, and
4. Absence of requirements for verifying tax related activities.

5. Financial Institutions and Compliance with AML Laws

Given that without necessarily following the three identifiable phases of money laundering (placement, layering and integration), soiled money still get laundered largely through financial institutions, the reality, therefore, is that financial institutions and markets are smack-dab in the middle of money laundering. From our summary of notable money laundering activities in Table 1, all those activities went through banks of different countries. Notably, some of those transactions went through multiple banks before reaching their final destinations. The core of banking – financial intermediation – makes banks susceptible to involvement in money laundering directly or indirectly and willingly or unwillingly. For example, the Australian Criminal Intelligent Commission (ACIC, 2017) [25] notes that major money laundering channels exist as legitimate banking services such as money transfers, remittances, etc. (Chaikin 1991, 2006 & 2011)

5.1. Financial institution roles in money laundering and possible remedies

Money laundering activities and other financial system abuses can potentially undermine the stability of financial institutions and markets or the global financial system as a whole. Money laundering can alter resource allocation and wealth distribution; and it can be costly for an economy to investigate, detect, and eradicate money laundering activities. Damages to an economy can also arise not just as a result of abuse of the financial system, but as a result of the negative perceptions of the country exposed to or engaged in money laundering (Bartlett 2002). Due to such detrimental effects, many laws and regulations have been evolved to combat money laundering activities, and they unsurprisingly target financial institutions, especially banks.

According to Levi and Reuter (2006), the fight against money laundering can be envisaged to follow a twin-track or twin-pillar approach, with one pillar referred to as the preventive track (policy) and the second pillar referred to as the repressive or enforcement track. The preventive pillar aims to prevent

[24] https://web.archive.org/web/20120512074208/http://www.oecd.org/document/63/0,3343,en_2649_37427_30575447_1_1_1_37427,00.html.
[25] https://www.acic.gov.au/sites/g/files/net1491/f/2017/08/oca_2017_230817_1830.pdf. Retrieved 16 December, 2017.

money launderers from using financial institutions to carry out their illicit activities, with the core objective being to protect the integrity of the financial system as a whole. This approach sets out identification and reporting responsibilities for bank. The repressive approach sets out laws to discipline money launderers (Van den Broek and Addink 2013). Specific forms of these pillars follow.

5.1.1. Customer due diligence

This focus ensures that financial institutions know the identity of their customers, with the major aim being to prevent institutions from engaging with disguised clients who deal in suspicious activities traceable to money laundering or other financial crimes. The Basel Committee on Banking Supervision, in 2001, noted that "know your customer (KYC)" policy is very crucial in safeguarding the soundness of banks and the integrity of the financial system as a whole.

5.1.2 Reporting requirements

Under the preventive AML policy, financial institutions are required to report any transaction suspected to relate to money laundering, terrorist financing, or any other form of financial crime to the country's financial intelligent unit (FIU). There are variations in reporting methods globally; and each national jurisdiction usually decides the form of their report. While some financial institutions in some countries engage in defensive reporting to avoid potential penalties (rule-based), some in other countries report only significant suspicious transactions (risk-based), thereby risking criticism and penalties for failure to disclose sufficiently (Levi and Reuter 2006)..

Bergstrom, Svedberg-Helgesson & Mörth (2011) document that the risk-based approach in relation to customer due diligence has blurred the boundaries between private and public sectors, and opine that involving the private sector in the process of setting the rules may compromise the normal understanding of accountability. However, some countries such as South Africa, as recently as June 2017, amended their Financial Intelligence Centre Act (FICA)[26] and introduced the risk-based approach to reporting.

5.1.3. Supervision

Financial institutions are obligated to keep records of identification and transactions in relation to the first focus of preventive (AML) policies (customer due diligence), for instance KYC documents, as well as archive or store data related to all transactions. The essence of this focus is to enable regulatory

[26] https://www.fic.gov.za/Documents/A%20NEW%20APPROACH%20TO%20COMBAT%20MONEY%20LAUNDERING%20AND%20TERRORIST%20FINANCING%20(2).pdf.

authorities to be able to carry out their supervisory oversight function of banks. Safeguarding data related to every transaction also facilitates investigation of cases of suspicious money laundering activities.

5.1.4. Sanctions

Financial institutions are subjected to sanctions, penalties, fines, and their likes, as a consequence of breach of AML laws. As highlighted in Table 1, banks and other financial institutions have been fined or closed down due to breaches of AML laws. Notwithstanding several existing AML laws, banks surprisingly still expose themselves to fines, confiscation or freezing of assets, etc. Besides fines and sanctions, banks incur other costs (related to training, administration, technological upgrade, etc.) in the quest to comply with AML laws (Roth et al. 2004). Because of uncertainties in determining the true amount or extent of monies laundered, and the cost of complying with AML laws, it is difficult to determine which AML techniques work better or which ones are more or less cost-effective.

In light of this surmised and/or implicit relative inefficacy of extant money laundering mitigation mechanisms (AML policies) deployed by banks, could a more efficacious solution(s) be found elsewhere, especially within the bank's ambit?

6. Any Role for the Board of Directors of Banks?

According to a white paper for the Association of Certified AML Specialists (ACAMS), by Jeffrey Haude[27], banks' boards of directors have the responsibility to oversee their activities, including AML compliance programs which, in turn, contribute to the safety and soundness of financial institutions and markets in general. These boards have the right to demand accurate, complete and timely data regarding money laundering or any other financial activity. The board also has the right to challenge management and offer direction, where needed, as to ensure that key risks are mitigated and banks' objectives of profitability cum social responsibility are achieved.

In line with this report, we argue in this chapter that banks' boards of directors have a role to play in combating money laundering, which is widely acknowledged to occur largely via banks. With the substantial economic costs associated with money laundering, the boards should not only insist on strongly encouraging their banks to comply with AML laws so as to avoid costly fines and attendant reputational capital loss (that can come about due to money laundering offences), but they should also insist on it, both in appearance and effect, on the grounds of corporate social responsibility (CSR), as

[27] http://www.acams.org/wp-content/uploads/2015/08/A-Principles-Based-Approach-for-Auditing-Board-Reporting-Jeff-Houde.pdf.

responsible corporate citizens of the economic community within which they conduct business (Ojah, 2014). To illustrate the wisdom of this position, we recall how, e.g., the share value of Commonwealth Bank of Australia declined by over 10% immediately after AUSTRAC announced, on 2nd August 2017, that it has commenced legal action on the bank over money laundering accusation[28].

Risk-based approach to reporting suspicious money laundering activities often primarily depends on banks' discretion. Boards should commit to engaging with bank management based on both cost-benefit analysis and CSR to, for instance, decide either to adopt rule-based or risk-based approach to reporting illegal activities. The major question to address is: Should banks be fine with operating in fear and, as a consequence, incur attendant high cost of reporting, or absorb the risk of not reporting all suspected activities and supposedly keep their cost of compliance to perceived low levels (with little regard for the effective economic consequence of this myopic view)?

A socially responsive board should proactively advice its firm (the bank) to choose the rule-based AML reporting approach, as a way of signaling integrity and probity, even if the national regulatory authorities offer latitude on the use of the discretionary reporting approach as well. The view here is that, "CSR is only effectively costly when firms adopt some public relations oriented program around CSR instead of adopting CSR as a strategic initiative that is an integral part of doing business" (Ojah, 2014). That is, the issue of contestation between high cost of reporting all transactions as demanded under rule-based approach and the risk of reputational damage/penalty for failure/refusal to disclose sufficiently under risk-based approach should be a non-issue here.

An effective way for boards of banks to prudently address this need for ensuring that banks entrench a sustainable ethos of anti-unproductive-behaviors is via appropriate board committees. Unlike nonfinancial services firms, where audit, financial, and remuneration and compensation committees, are considered priority; banking firms must have 'risk management', 'loan portfolio profile' committees and their likes ranked higher. Particularly, board members with dynamic risk management skills (e.g., financial economists, people with R&D/innovation and regulatory/supervision backgrounds) should be appointed to bank boards and made to staff and chair the 'risk management' committee.

Another area where we recommend boards should get involved in the AML stance is in providing the right incentives to personnel responsible for providing information regarding untoward activities, including money laundering. E.g., some firms adopt behavior-modifying mechanisms termed "claw-back policies", where performance bonus based on reporting accurate and reliable financial figures are withdrawn due to past period's sub-par performance. Moreover, boards can insist on hiring qualified

[28] https://www.ft.com/content/0b75c64a-9112-11e7-a9e6-11d2f0ebb7f0.

auditors or forensic/financial experts, whose forecasts and judgement are known to be based primarily on accurate data and research, rather than on mere suspicion of transactions[29].

Along the lines of boards insisting on proper matching of personnel expertise and key tasks through effective incentive designs, periodic training on evolution of the banking landscape – e.g., contemporary surveillance technology and disruptive business models engendered by dynamism of digitization – must be part of such vital training for board members. Such periodic training will acquaint boards with the true operational environment of their firms and equip them to push for appropriately designed incentive programs for bank management and personnel.

Given that money laundering indisputably thrives within a web of cross-border banking transactions, an obvious area needing boards' oversight and/or direction is the area of banks' external (international) engagement. Corresponding banks are generally 'money center banks', most of which are transnational firms which often have been caught up in illicit funds transfers/dealings and the likes (e.g., Barclays, HSBC, Standard Chartered and Citibank, to name a few that have been in the news recently). To signal probity and responsible corporate citizenry, proactive boards can insist on their banks' non-association with tainted banks as correspondent banks. Implicit here is the importance of a board committee that would reflect "cross-border/international and corresponding banking activities". In the same vein, boards can also insist on their banks keeping their offshore activities away from notorious tax havens (Kudrle and Eden 2003, Van Fossen 2003, Desai et al. 2006, and Dhamapala 2008).

7. Concluding Remarks

By exhaustively defining money laundering and related matters, we made the important point that money laundering comes about because of corrupt activities and the need for illicit funds to be moved around (laundered). We further observed that although other mechanisms for laundering such 'soiled funds' exist[30], banks in particular and other financial institutions and markets in general, are the dominant mechanism (platform) for effecting money laundering with minimal fuss or exposure on the part of

[29] In line with our view here, Commonwealth Bank of Australia recently overhauled its board of directors, on 4th September 2017, due to its recent money laundering scandal, believing that the scandal had significantly dented their reputation and the bank's management team, which in turn drastically affected their bank's share price. https://www.ft.com/content/0b75c64a-9112-11e7-a9e6-11d2f0ebb7f0.

[30] Transfer pricing, as the other important conduit/mechanism for money laundering, is not as amenable to scrutiny as are financial services firms because it sits between legitimate mode of business conduct and overt intent to subvert disclosure and/or tax laws; and it is carried out 'privately' within a firm.

launderers. This is so primarily because banks are legitimate, ubiquitous financial services institutions whose essence of being is to financially intermediate.

Expectedly, most extant anti-laundering (AML) laws and measures target banks' compliance with these AML requirements, as paramount. Yet because of the seeming conflict between banks' profit and CSR objectives, and the demand to demonstrate compliance, these bank-targeted AML measures appear ineffectual. This chapter, therefore, proposes that a more efficacious assistance may come from the role of banks' boards. At a general and/or high level, we recommend that the intervention of banks' boards must insist on: (i) the primacy of transparency and upholding of both real and perceived reputational capital of the bank, and (ii) ascertaining that their banks' relations with corresponding banks distributed across several national borders or banks domiciled in notorious tax havens, are demonstrably above board. And these guiding lights, we believe, will be effective in enthroning ethos of anti-unproductive bank activity and behavior via initiation of appropriate 'financial services firm' oriented board committees.

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