Money laundering prevention: a strategic goal

FINMA has set itself the goal of achieving a sustained impact on institutions in their efforts to prevent money laundering. Its focus in 2017 was on institutions' reporting systems and their risk management.

Consistent compliance with measures designed to prevent criminal financial activity is strategically important to Switzerland's export-oriented and internationally networked financial centre. The reporting system prescribed in the Anti-Money Laundering Act (AMLA) is a significant measure in that regard. Once market participants involved in criminal activity realise that financial institutions are likely to report suspect funds to the Money Laundering Reporting Office Switzerland (MROS), they will be more reluctant to bring illicit funds into Switzerland; reporting suspect funds also helps the criminal authorities with their work. FINMA therefore stepped up its supervision and investigations of reporting under AMLA with 23 on-site supervisory reviews in 2017. It also filed criminal charges in seven instances based on contravention of the reporting obligation in Article 9 in conjunction with Article 37 AMLA. FINMA imposed its own enforcement measures in a number of cases.

FINMA encountered good and bad practices in the course of its supervisory and enforcement activity during the reporting year. Some of the more common situations are outlined below.

Examples of good reporting conduct

- ✓ After criminal proceedings are initiated against a client due to a serious offence, the financial intermediary conducts its own enquiry. It then submits a report as it cannot exclude the possibility that the assets in question are connected to the offence.
- ✓ A financial intermediary conducts an in-depth investigation of a client in response to media reports of a suspected criminal offence. The investigation includes checking information according to the know-your-customer (KYC) principle, examining the money flows and time sequences in detail and documenting the findings. The financial intermediary concludes that the assets demonstrably are not linked with the matter reported in the press and are therefore not tainted. The analysis is documented.
- ✓ The financial intermediary has internal guidelines to regulate in which situations it would (as an exception) also inform FINMA of a reported matter in accordance with Article 34 AMLO-FINMA. These include the client's involvement in a major international money laundering scandal or a case that could develop into such a scandal due to, for example, the client being a politically exposed person (PEP) and having received funds of several million francs.

Examples of poor reporting conduct

- × An international wealth management bank fails to regularly check its client base against a database maintained by an external compliance provider. It is unaware of new information coming to light about its client which otherwise should have led to the filing of a report.
- × Unusual transactions are connected to a criminal offence committed abroad punishable by a custodial sentence of several years. The financial intermediary delays on reporting the issue. Instead it commissions a law firm to draw up a detailed legal opinion on the foreign criminal offence and its aptness of being a predicate money laundering offence (see Federal Administrative Court decision B-6815/2013 of 10 June 2014).
- × The financial intermediary investigates money laundering suspicions arising from a dubious business relationship involving substantial assets and comes to the conclusion that there are no grounds for making a report. It does not document its investigations or the reasons why it did not exercise its right to report.

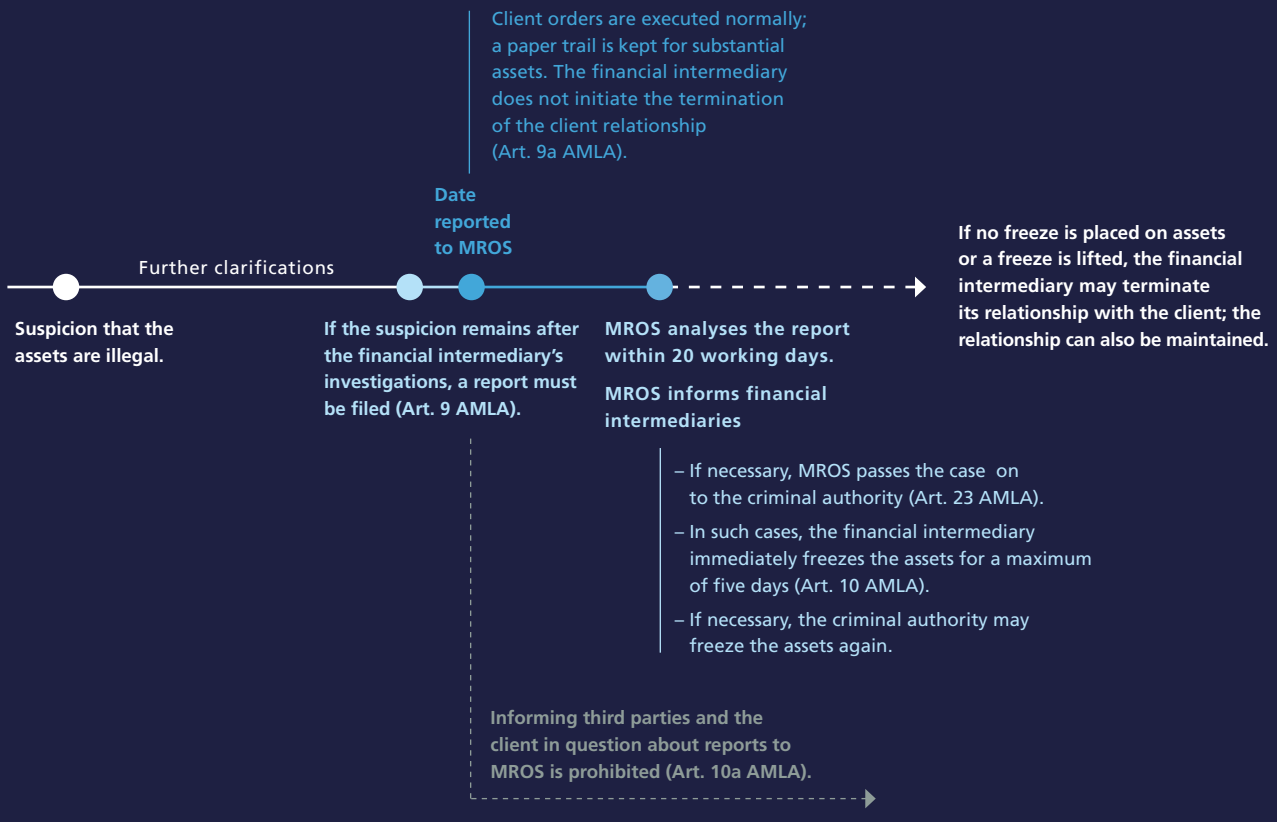
Case law and practice for reporting requirements

The Anti-Money Laundering Act (AMLA) specifies the procedures a financial intermediary should follow if it suspects assets might be illegal.

The provisions governing special duties of due diligence as outlined in Article 6 of AMLA require financial intermediaries to clarify the economic background and purpose of a transaction or business relationship if it appears unusual. The investigations carried out must be documented to enable third parties to reach a well-founded judgement on the transaction or business relationship and establish whether it complies with AMLA.

Reasonable suspicion exists when the results of these clarifications fail to refute the suspicion that the assets are linked with a crime. The financial intermediary must report such business relationships to MROS (duty to report under Article 9 AMLA; see decisions of the Swiss Federal Criminal Court SK.2017.54 of 19 December 2017 and SK.2014.14 of 18 March 2015, consid. 4.5.1.1). If it is unclear whether a report must be filed, the financial intermediary may still do so (reporting right in accordance with Article 305ter para. 2 SCC).

Procedure for handling suspected illegal assets



× A politically exposed person (PEP) deposits an eight-digit sum with an offshore domiciliary company as remuneration for "consulting services" in the commodities business. When making enquiries, the financial intermediary receives a written consulting contract that does not document the timeframe involved or the nature of the consulting services. It is not clear how the "consultant" is qualified to provide the alleged consulting services. The financial intermediary ends the client relationship without making any further investigations and without reporting it.

Connection to risk management

Shortcomings in the AMLA reporting system are not only a focal point at FINMA; the last country report by the Financial Action Task Force on Money Laundering (FATF) criticised Switzerland in that respect. Instead of resulting from public information such as articles appearing in the media, reporting should take place beforehand as a consequence of the financial intermediary's transaction monitoring process. Regulatory auditors should also examine compliance with reporting requirements more thoroughly when suspect transactions are involved.[12] This is where the connection between risk management and financial intermediaries becomes apparent, since only if a financial intermediary uses carefully selected criteria to assess high-risk business relationships and transactions can it then identify legitimately suspicious activity and report it to MROS.

Supervisory experiences of high-risk business relationships

Financial intermediaries are required to establish criteria to identify high-risk business relationships as part of their anti-money laundering regulatory obligations. The FINMA Anti-Money Laundering Ordinance-(AMLO-FINMA) and its annex contain non-exhaustive lists of potential risk criteria with reference to money laundering. The key criterion is that the risk factors selected by the financial intermediary are based on a detailed risk analysis of its client base.

FINMA observed the following activities when carrying out its supervisory role and evaluating the annual AMLA audits:

✓ The financial intermediary's risk assessment incorporates risks specific to the service or product offered.
✓ The definition of high-risk countries in its guidelines extends to the place where the client generates its assets.
✓ When a financial intermediary selects a high-risk country as a target market, it employs staff with specific knowledge of that country.
✓ It also draws up a list of clients with whom it will not establish a business relationship.
× The financial intermediary has great difficulty managing the large amount of high-risk business relationships (for example over 30% for wealth management banks) with current compliance resources.
× The low proportion of high-risk business relationships (for example below 10% for wealth management banks) does not mean the bank has a low level of risk tolerance, rather that it is carrying out inadequate risk assessments.
× Risk criteria do not exist for tax fraud as a predicate offence.
× The financial intermediary's guidelines do not define any high-risk professions or fields of business.

Supervisory experiences of high-risk transactions

In addition to business relationships, high-risk transactions must also be identified. Transaction monitoring, for example, must be able to identify trans-

[12] FATF country report on Switzerland of 7 December 2016, www.fatf-gafi.org/media/fatf/content/images/mer-switzerland-2016.pdf.

actions involving high-risk countries; it must also be able to spot deviations from normal activities, either involving the business relationship in question or similar relationships. Furthermore, it must take into account the financial intermediary's business activity. For example, a risk profile for transactions at a wealth management bank with an international clientele would focus on corruption risks, while a retail bank would concentrate more on risks from drug dealing.

In the past year, FINMA encountered numerous positive and negative examples of transaction monitoring:

- ✓ The financial intermediary's transaction monitoring is scenario-based (a combination of risk criteria) and the scenarios are structured according to the specific risks inherent in the business relationship.
- ✓ The risks posed by the business relationship and transactions are considered as being linked, e.g. a high-risk business relationship requires closer transaction monitoring. High-risk transactions also lead to a reassessment of the risk posed by the business relationship.
- ✓ Transaction monitoring combines static and dynamic criteria.
- ✓ International financial intermediaries update their internal sanction lists for terrorism financing and compare them against their client base at least once a week.
- × A large sum of money is shifted back and forth between accounts of the same beneficial owner. Since the accounts belong to the same beneficial owner, the bank believes nothing suspicious is taking place and does not pursue the matter further.