

Strengthening the Collaborative Process for

# Building an Effective Anti-Money Laundering and Counter-Terrorism Financing Regime in Afghanistan



THE WORLD BANK



Sponsored by the World Bank Financial Sector and the World Bank Institute in partnership with the South Asia Region of the World Bank and the International Monetary Fund



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## **A Worldwide Challenge...**

In recent years, and especially since the events of September 11, 2001, worldwide efforts to combat financial abuse have assumed heightened importance. Money laundering and the terrorist financing are global problems that not only threaten security, but also compromise the stability, transparency, and efficiency of financial systems, thus undermining economic prosperity.

James D. Wolfensohn, president of the World Bank Group, has declared that the global community should act “where it really matters”—and, economically, money laundering really matters. At least \$1 trillion is laundered annually using increasingly sophisticated methods of moving funds across borders.

The success of a criminal enterprise is based on its ability to sanitize its ill-gotten gains by moving them through lax or corrupt national financial systems. The laundering allows criminals and terrorists to operate freely, using their financial gains to expand their criminal pursuits and fostering illegal activities such as corruption, drug trafficking, arms trafficking, smuggling, and terrorist financing.

Money laundering and terrorist financing can have devastating economic and social consequences for countries, especially those in the process of development and those with fragile financial systems. The economy, society, and ultimately the security of countries used as money laundering platforms are all imperiled. Here are just a few exam-

ples of how illicit financial flows can affect the economy and institutions of the host country:

- Financial institutions that accept illegal funds cannot rely on those funds as a stable deposit base. Large amounts of laundered funds are likely to be suddenly wired out to other financial markets as part of the laundering process, threatening the institution's liquidity and solvency. A financial institution's reputation and integrity can be irrevocably harmed through involvement in laundering money or financing terrorism.
- Local merchants and businesses may find that they cannot compete with front companies organized to launder and conceal illicit funds. Many such front companies offer their services and goods at below-market rates and even at a loss. Because their primary objective is laundering money, they do not need to compete in the marketplace and make a profit for their owners.
- Money laundering may also distort some economic sectors and create instability in their markets. Money launderers may channel funds to sectors or areas where funds are unlikely to be discovered, whether or not investment is needed or real returns are offered. The often sudden departure of investments from those sectors may impair the industries involved.
- Currencies and interest rates can be distorted by money launderers' investment practices, based as they are upon factors other than market returns.
- Money laundering and terrorist financing do nothing for the reputation of the host country. The loss of investor confidence that follows revelations of large-scale involvement in such activities can sharply diminish opportunities for growth. Once a country's reputation is tarnished, it takes years to repair.

The global agenda to curb abuse of financial systems calls for a cooperative approach among many different international bodies. Efforts to establish an international standard against both problems have been led by the 33-member Financial Action Task Force on Money Laundering (FATF), which has come forth with its "40 + 8" Recommendations—the

original 40 in the area of money laundering, and 8 more related to the financing of terrorism.

The boards of the World Bank and the International Monetary Fund have recognized these Recommendations as the appropriate standard for combating money laundering and terrorist financing and have intensified their work in this area. Both institutions worked with the FATF to develop a comprehensive global methodology for assessing country compliance with the FATF's international standards. They are also cooperating to provide training and technical assistance to member countries and to coordinate efforts with other international organizations, including the FATF, the FATF-style regional bodies, the United Nations, the Egmont Group of Financial Intelligence Units, regional development banks, and other donors.

The videoconferences of the Global Dialogue Series, which bring international experts together with those charged with planning or administering national systems to curb financial abuse, are an excellent example of collaborative international work in a critical area.



**Cesare Calari**

Vice President  
Financial Sector  
World Bank



**Frannie A. Léautier**

Vice President  
World Bank Institute



**Praful C. Patel**

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## **Strengthening the Collaborative Process to Build Effective Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Regimes**

**T**he risks posed by money laundering and terrorist financing to the reputation and integrity of financial systems are being recognized widely across the world. In response, government agencies and financial institutions are working together to develop robust programs and internal control systems in the area of anti-money laundering and combating the financing of terrorism (AML/CFT). Adoption of sound policies and procedures—among them know-your-customer (KYC) rules, suspicious transaction reporting (STR), and compliance testing—are critical elements in developing comprehensive AML/CFT regimes.

To be effective in the fight against abuses of financial systems, policymakers, law enforcement agencies, financial regulatory and supervisory authorities, financial institutions, nonbank financial institutions, and international organizations must forge effective partnerships, internationally and domestically. Strong links among international and domestic stakeholders will yield better decisions—decisions better understood by the authorities and better implemented by the private sector.

Toward this end, the World Bank's Global Dialogue Series on Anti-Money Laundering and Combating the Financing of Terrorism was designed to enable client countries, the World Bank, the International Monetary Fund (IMF), regional bodies emulating the international Financial Action Task Force, regional development banks, and other

international organizations to discuss and exchange information on the challenges faced in the struggle against illicit money flows, to share the lessons of successes, and to identify the types of assistance countries need to combat money laundering and terrorist financing.

The dialogue for Afghanistan on June 2, 2004 brought together representatives from the World Bank, the International Monetary Fund, and regulatory and financial sector representatives to exchange experience and information regarding Afghanistan's recent AML/CFT experience and the challenges associated with developing and implementing an AML/CFT strategy for the country.



**Margery Waxman**

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## Recommendations for Reforms Emerging from the Global Dialogue on June 2, 2004

**T**he dialogue provided an opportunity for the speakers and participants to discuss Afghanistan's anti-money laundering regime and efforts to combat the financing of terrorism.

Overall, it was discussed and agreed that in order to forge an effective AML/CFT regime, Afghanistan needs to enact adequate AML/CFT legislation and provide appropriate training to regulatory and law enforcement personnel.

More specifically, the following issues were discussed during the dialogue.

### **Commitment and Political Will**

All sectors must understand the importance of collaboration and be willing to cooperate if an AML/CFT regime is to succeed.

### **Legal and Regulatory Framework**

- *Enacting AML/CFT legislation as a first priority.* When building an effective AML/CFT regime, steps must be taken in sequence. The first is to enact legislation incorporating the revised FATF Recommendations. A financial intelligence unit (FIU) cannot operate without a legal basis.
- *Adopting a comprehensive legal framework.* The AML/CFT law needs to define money laundering and terrorist financing as

predicate offenses as well as expand the scope of covered institutions. The law should enable the authorities to penalize the criminal act.

- *Introducing the Wolfsberg Principles.* The Wolfsberg Group has outlined AML principles that banks should follow in international banking. Afghanistan should pay close attention to those principles when developing its AML/CFT regime. So as not to be confused with the FATF Recommendations, the Wolfsberg principles should be introduced during training.
- *Consistency in application.* The new law must be approached consistently by all institutions, public and private, thus ensuring that all stakeholders understand their role and that uniformity prevails in all business sectors. Consistency will allow Afghan authorities and institutions to work together to meet international standards.
- *Establishing a clear and transparent regulatory framework for microfinance institutions and procurement.* Regulatory and supervisory agencies should consider the risks associated with Afghanistan's loose regulatory framework for microfinance institutions. A transparent procurement law pertaining to reconstruction projects was suggested.
- *Creating an effective FIU.* An FIU can be located in any of several different agencies— ministry of finance, central bank, or ministry of justice. Because each country is different, the decision of where to establish it should be made based on considerations of trust, resources, and supervisory capacity. It is important that an FIU be autonomous and have the authority to gather, analyze, and disseminate information. Except for modest startup costs for a business plan and software, an FIU does not have to be extensive or expensive to be effective. By sequencing donor aid according to the country's expected need, costs can be kept at a minimum. Given the current situation in Afghanistan, it was suggested that the FIU be located under the Central Bank, which has good human and material resources and suffers from little corruption.
- *Enticing the informal financial sector into the formal economy.*



The informal financial sector—which uses alternative remittance systems (ARS) such as *hawala*—can easily be abused to facilitate transnational crime and money laundering. In Afghanistan, financial institutions are not registered. Therefore, it was suggested that a basic law to license business operations (and criminalize unlicensed operations) should be enacted.

- *Strict enforcement.* The public must be assured that criminals will never get access to the money they laundered even after their jail term.

### **Feedback Mechanisms**

- *Ensuring coordination with law enforcement and providing appropriate feedback to the private sector.* The FIU should facilitate communication between law enforcement agencies and the financial sector. The FIU should develop a mechanism to provide constant feedback to financial institutions, especially on suspicious transaction reporting and typology studies. The law must explicitly permit the authorities to provide such feedback to overcome presumptive legal constraints.
- *Ensuring appropriate feedback to the private sector.* The FIU should provide feedback to banks on the quality of their financial disclosures and on the use of such disclosures by law enforcement, the FIU, and courts.

### **Cooperation**

- *Forging cooperation with agencies of other governments.* Recognizing the need for an effective global AML/CFT system, Afghanistan welcomes international cooperation. The United States, for example, could provide assistance with cross-border issues such as an illegal exchange and barter. The U.S. Customs Service may be able to provide assistance in tracking suspicious cross-border transactions using its Numerically Integrated Payment System (NIPS).

- *Seeking technical assistance from international organizations.* Because building an effective AML/CFT regime requires resources and training, Afghanistan should communicate with international organizations to identify specific technical-assistance needs.

### **Training and Education**

- *Educating all relevant constituencies.* All stakeholders—supervisory agencies, law enforcement agencies, financial institutions, and designated non-financial businesses and professions (DNFBP) need to be educated about money laundering so that they may contribute to the search for an appropriate AML/CFT regime for their country. Supervisors must have a thorough understanding of what money laundering is, how it occurs, and why it is important. Law enforcement agencies must develop techniques to track money laundering, as well as procedures for indictment. In Afghanistan, both banks and DNFBP, such as dealers in precious metals and stones, must understand the risks associated with money laundering as well as best practices for prevention, including suspicious transaction reporting.
- *Ensuring continuous training for the public and private sectors.* Regulatory and supervisory authorities need continuous training to support enforcement. That training may include case studies that convey practical examples of the pressures and complexities they may face in implementing an AML/CFT regime. Financial institutions need continuous training for all levels of personnel on the application of new laws and preventive measures. Because money laundering and terrorist financing are dynamic issues, continuous study of AML/CFT typologies is necessary to keep up with changing criminal activities and to comply with international standards.

### **Guidance by the Public Sector**

- *Raising public awareness.* The public must be educated about the risks to the economy and polity of money laundering and

terrorist financing. It also needs to be made aware of the government's actions. If people have confidence that laws will be used for their intended purpose, they will see the benefits and be supportive. On the other hand, if the public views AML/CFT regulations as a way for institutions to collect more information about individuals, the new laws will not be supported or followed.

- *Assisting in the development of effective internal control systems.* The authorities should assist financial institutions in developing and implementing effective internal control systems to ensure compliance with requirements. Setting up a know-your-customer policy is one of the most important issues for Afghanistan's banks in to consider when developing effective internal control systems.

### **Information Sharing**

- *Using lists of suspicious persons.* Afghanistan's financial institutions and authorities should heed the lists of suspicious activities, individuals, and organizations published by the United Nations and individual countries.
- *Developing tools to comply with customer-due-diligence measures.* Once a law covering customer-due-diligence requirements has been enacted, financial institutions need to develop the tools necessary for implementation. The authorities need to centralize a national database for effective analysis and dissemination of information.

### **Risk-Based Approach**

- *Encouraging a risk-based approach.* Banks should evaluate customers based on risk criteria. By understanding what makes a customer risky, banks can become more cognizant of money laundering and terrorist financing. The risk-based approach simplifies due diligence, allowing banks to focus on higher-risk individuals and organizations. FATF specifies higher-risk categories (such as politically exposed persons, shell banks, and introduced

business) but deliberately does not specify lower risk categories, thereby allowing flexibility for each country to make its own assessments.

### **National AML/CFT Strategy**

- *Establishing a high-level interagency committee to discuss the draft AML/CFT law.* To initiate compliance with international AML/CFT standards, Afghanistan has established an interagency committee with representatives from the Ministry of Foreign Affairs, Ministry of Justice, and Ministry of Finance.
- *Modernizing the payments system.* The fewer formal banking activities a country has, the greater is the risk that money laundering will occur. Since the Afghan economy is largely cash-based, a robust national payments system needs to be developed. Modernization of the payments system will lay the groundwork for consistency among the country's financial institutions.

Various forms of technical assistance were discussed in the dialogue. Once Afghanistan passes its AML/CFT law (expected September 30, 2004), more detailed discussions of needs for technical assistance will be necessary.

## **Videoconference Agenda—June 2, 2004**

*Samuel Munzele Maimbo, Moderator*

### **Opening Remarks**

- *Alastair J. McKechnie*, Country Director for Afghanistan, World Bank

### **New International Standards on AML/CFT: Impact on the Financial Sector**

- *Joseph Halligan*, Senior Financial Sector Specialist, Financial Market Integrity Unit, World Bank

### **Implementing the International Standards: Developing an AML/CFT Strategy and Structure**

- *Ross S. Delston*, Consulting Counsel, Legal Department, International Monetary Fund
- *Ian De Vere Carrington*, Senior Financial Sector Expert, Financial Market Integrity Division, International Monetary Fund

### **AML/CFT Legal and Regulatory Reforms**

- *Abdul Fitrat*, First Deputy Governor, Da Afghanistan Bank

### **AML/CFT Activities in Afghanistan**

- *John Janes*, Managing Director, Standard Chartered Bank Afghanistan

### **Open Discussion with a Panel of Experts**

- The participants listed above, plus:
- *Theodore Greenberg*, Senior Counsel, Legal Vice Presidency and Financial Market Integrity, World Bank
- *Ahmed Elbashari*, Regional Specialist, Middle East and North Africa, Financial Crimes Enforcement Network (FinCEN), U.S. Department of the Treasury

### **Wrap-up**

- *Samuel Munzele Maimbo*, Financial Sector Specialist, South Asia Region, World Bank

## Speaker Biographies



### **Ian De Vere Carrington**

Ian Carrington joined the IMF as a senior financial sector expert in 2002. Previously he has worked in the private banking sector in Barbados and with the Ministry of Finance and Planning as a Budget Analyst. He went on to become the Director of the Bank Supervision Department of the Central Bank of Barbados from 1997–2000. After leaving the Central Bank in 2000, Mr. Carrington served as a financial sector expert with the United Nations Global Program against Money Laundering in the UN’s Office of Drug Control and Crime Prevention Vienna Austria.



### **Ross S. Delston**

Ross S. Delston is a consulting counsel in the Legal Department of the International Monetary Fund (IMF), specializing in AML/CFT activities. Previously, he consulted for the IMF and World Bank on matters related to bank regulation and insolvency, central banking, and deposit insurance. Mr. Delston has participated in IMF and World Bank missions to more than a dozen countries and territories. He has lectured on AML/CFT and banking issues at numerous international conferences.

Mr. Delston is the author or co-author of three papers on banking issues and a member of the editorial board of the *Journal of International*

*al Banking Regulation*. He received his J.D. (with honors) in 1976 from The George Washington University in Washington, D.C.



**Abdul Fitrat**

Abdul Fitrat is the first deputy governor at Da Afghanistan Bank in Kabul, the Central Bank of Afghanistan since 2002. He was previously a Consultant Economist in the Middle Eastern Department of the International Monetary Fund, Washington DC. Before joining the IMF he was the Governor of Da Afghanistan Bank. Mr. Fitrat has also been the President of Banke Millie Afghan (BMA), Afghan National Bank, from 1993 to 1995.

Mr. Fitrat has a number of years of experience in the banking sector. In 2003 Mr. Fitrat was involved in drafting the Law on Anti-Money Laundering and Proceeds of Crimes for Afghanistan. He headed Afghan Delegation to many international meetings and conferences.



**Theodore Stewart Greenberg**

Ted Greenberg joined the Legal Vice Presidency of the World Bank in May 2003 after a career in the U.S. government. Among other duties, Mr. Greenberg advises the Financial Market Integrity Unit on legal and policy issues related to money laundering and terrorist financing and represents the World Bank on the Financial Action Task Force (FATF).

During his 29 years at the U.S. Department of Justice Mr. Greenberg was chief of the Money Laundering Section, deputy chief of the Fraud Section, special attorney in the Organized Crime and Racketeering Section (New Jersey Strike Force), and deputy chief of the Fraud Corruption Unit.



**Joseph Halligan**

Joseph Halligan is a senior financial specialist in the Financial Market Integrity unit of the World Bank where he works on money laundering and terrorist finance issues. Before joining the



Bank in July 2003, he spent four years as head of the U.K. Treasury division dealing with the same issues. He also served as head of the U.K. delegation to the Financial Action Task Force.



**John Janes**

John Janes is managing director of Standard Chartered Bank Afghanistan. Since joining the Standard Chartered Bank in 1971, he held various positions in customer services, trade services, foreign exchange, consumer banking including mortgages and card services and country management team for Bangladesh, Cambodia, Sierra Leone, and Zambia. Work locations included Brunei, Doha, New York, Hamburg, Singapore, Kuala Lumpur, Jakarta and Kabul.

Mr. John Janes has over 30 years of experience in the banking sector. He was also a chairman of Lusaka Stock Exchange and director of Standard Chartered Bank Zambia PLC.



**Samuel Munzele Maimbo**

Samuel Munzele Maimbo is a financial sector specialist in the South Asia Region of the World Bank. His work on Afghanistan's financial sector reform efforts includes a detailed study of the country's informal payment system. *The Money Exchange Dealers of Kabul: A Study of the Hawala System in Afghanistan* was published by the World Bank in August 2003. From September 2001 to March 2002 he worked on the World Bank's Global AML/CFT Program, producing a detailed study entitled *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System* (International Monetary Fund, 2002).



**Alastair J. McKechnie**

Alastair J. McKechnie is the World Bank's country director for Afghanistan. Prior to taking this appointment he was Operations Director in the office of the Vice President, South Asia Region. During his career at the World Bank, he served as Energy Sector Director in the South Asia Region, Division Chief for energy, infrastructure,

financial sector and private sector development in the Middle East, and manager of a global energy technical assistance program. Prior to joining the World Bank, he was a senior consultant at Coopers & Lybrand Associates, London.

## Opening Remarks

***Alastair J. McKechnie***, Country Director for Afghanistan, World Bank

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A detailed study of the financial sector in Afghanistan, just completed by the World Bank, recognizes money laundering as a potential risk for the development of the financial sector. As Afghanistan's formal financial sector begins to emerge, it is important that the appropriate technical assistance be provided to prevent, or at least make much more difficult, the movement of money clandestinely through formal domestic and international financial channels. Typically, an effective anti-money laundering framework will involve the following steps:

- *Adopting AML/CFT legislation* that complies with FATF Recommendations, including the criminalization of money laundering and terrorist financing and the establishment of effective measures to block and freeze assets.
- With appropriate laws in place, *training and technical assistance* can be brought to bear to develop the three core entities responsible for implementing those laws. Training is provided for criminal investigators in customs and other law enforcement services to assist them in detecting and tracking money laundering and in developing the evidence to support indictments and prosecutions against criminals and terrorists. Training is provided for the

regulators who supervise the financial sector so that they can ensure that banks and nonbank financial institutions know and follow know-your-customer rules, report suspicious transactions, implement best practices, and observe proper procedures in record keeping. Training is provided for prosecutors and judges who will prosecute criminals, terrorists, and their supporters.

- Usually, the capstone to this effort is the development of a *Financial Intelligence Unit (FIU)*. The FIU is often asked to develop the regulations that banks and nonbank financial organizations must follow. The FIU collects and analyzes suspicious transaction reports and other intelligence, sharing information as appropriate to develop cases domestically and internationally through FIUs in other countries.

Afghanistan's unique circumstances include the prevalence of an active informal financial system that can easily be abused for money laundering. Investigation after investigation confirms the growing role of alternative remittance systems—*hawala*, the black market peso exchange, and other forms of trade-based money laundering—in facilitating transnational crime and terrorism.

It is difficult to quantify and document the degree to which *hawala* is used to launder money in Afghanistan. It is equally difficult to trace illegal money flows, to separate legal from illicit flows, and to establish the financial links to criminal activities. Law-enforcement agencies are often unable to penetrate informal financial systems because of cultural and linguistic barriers or the close business or kinship ties of the participants. Additional constraints in Afghanistan include poor monitoring of cross-border currency movements, the absence of reporting requirements for large cash transactions, lack of uniform guidelines for identifying suspicious transactions, large parallel black-market economies, and few opportunities to share financial information with foreign law-enforcement authorities.

The World Bank has recently engaged the problem of opium production in Afghanistan. A recent Bank report on the subject details the

increasing threat that opium production poses to Afghanistan's development. The report greatly benefited from extensive consultations with the Afghan government, the United Nations Office on Drugs and Crime (UNODC), the government of the United Kingdom, and other agencies and parties, some of whom are present today.

Many of the issues in the drug economy involve political and security concerns that are beyond the mandate of the World Bank. However, the Bank is not the only international organization concerned about the issue. By collaborating with the government, various international organizations can work together to address this growing threat. However, cooperation needs to occur within a strategic framework. One aspect of that framework is the financial sector.

Through this dialogue, we are recognizing that one area in which the international community can take an active role in the fight against drugs in Afghanistan is in strengthening the country's AML regime.

Internationally, the phrase "follow the money" remains an effective thrust of law enforcement and other international efforts in the fight against money laundering. Identifying, freezing, and seizing assets to major criminals is an effective long-term strategy for combating the growth of a narco-state. As is the case in other opium-growing jurisdictions, money will continue to motivate, lubricate, and sustain the industry.

The success of our collective attempts to combat money laundering and opium in Afghanistan will be determined by our capacity to design technical and operational assistance that takes into account the financial underpinnings of these activities.

I look forward to the outcome of this morning's discussion. Thank you. New International Standards on AML/CFT: The Impact on the Financial Sector



## **New International Standards on AML/CFT: The Impact on the Financial Sector**

***Joseph Halligan***, Senior Financial Sector Specialist, Financial Market Integrity Unit, World Bank

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My task is to give a brief overview of international standards on fighting money laundering and terrorist financing, with particular reference to their impact on the financial sector.

FATF's 40 Recommendations on money laundering have been international standards since 1990. They were revised in 1996 and again in June 2003 in response to international developments—among them the growing use of companies as front organizations, more sophisticated ways of laundering money, and penetration by money launderers into new economic sectors. The 2003 revisions also include developments in international best practices reflected in national legislation (such as the U.S. Patriot Act) and incorporate several points that first appeared in the Eight Special Recommendations on terrorist financing adopted by FATF in October 2001. And finally, several international treaties and standards related to money laundering, such as the Palermo Convention of 2000 on transnational organized crime and the Basel standards on customer due diligence, were revised between 1990 and 2003.

How do you set up an AML/CFT system, working from scratch? The steps appear below.

### **Criminalize money laundering and terrorist financing**

FATF's minimum standard is that 20 categories of offenses should be made "predicate offenses" for money laundering, whereby the activity of laundering the proceeds of those offenses is deemed a crime. The offenses include drug trafficking, fraud, bribery, and corruption. They do not include fiscal offenses—to date there is not agreement on whether fiscal offenses should be made a predicate offense for money laundering.

The requirement incidentally is to cover the underlying criminal behavior. It is not necessary to have a specific law on fraud or bribery, for example, as long as some provision of the penal code covers those behaviors. Although the U.K. criminal code has no law against fraud, fraud is prosecuted under the Theft Act, which makes the obtaining of funds by any dishonest mechanism a criminal offense.

Because different countries have different legal systems and traditions, FATF is flexible about how the criminalization of money laundering is implemented. It sets out three possible approaches in the standard. The first—and in many ways is the simplest—declares that laundering the proceeds of *any crime* is an offense. The second—the so-called threshold approach—declares that laundering money from any offense carrying a maximum sentence of more than 12 months is a criminal offense. This approach is acceptable to FATF as long as all 20 categories of offenses—drug trafficking, fraud, bribery, corruption, and so on—are caught under that approach. In the third approach countries list in their penal codes all of the offenses that are predicates for money laundering. That is the approach taking in the United States, for example. Again, FATF's minimum requirement is that all 20 categories of offenses should be listed.

FATF's Eight Special Recommendations urge that terrorist financing should be criminalized whether the source of funds is legal or illegal. The previous FATF standard covered terrorist financing only when the funds came from another crime.



### **Confiscate the criminal assets of convicted money launderers and freeze terrorist funds**

International standards require that the proceeds of money laundering should be confiscated by the state. It is not enough to put criminals in jail—they must not be allowed to enjoy the proceeds of their crime once their sentence has been served. Confiscation is subject to the rights of bona fide third parties, in cases where laundered assets may have been innocently acquired from the criminal on a commercial basis.

Authorities must equip themselves with legal powers to identify the proceeds of crime and to seize and freeze, at an early stage, property alleged to be the proceeds of crime so that it is not dissipated between the process of investigation and conviction. That process can be a long one, and criminals often escape confiscation by moving funds to another jurisdiction or dissipating the assets. The confiscation should also be effective—confiscation orders issued by the court after conviction must actually be carried out. Too often they are not, which is why the standard insists on effective follow-through. And finally the authorities must have access to information about banking and financial transactions, because the criminals will try their best to hide them.

A new international requirement is that there should be a means of freezing the funds of terrorists and terrorist organizations. Two U.N. resolutions are relevant here. The first (U.N. resolution 1267) names individuals and organizations whose funds should be frozen. The second (U.N. resolution 1373) obliges states to freeze the funds of terrorists and terrorist organizations wherever they identify them, but it gives the states discretion in identifying such funds. Countries also should heed lists issued by other countries. They are not obliged to follow them, under international standards, but they are obliged to pay attention to them. Here, too, states must be able to freeze identified funds by administrative procedure rather than going to court, because the action needs to be taken very quickly. Otherwise, obviously, the funds will disappear.

**Implement the basic regulations required for the financial sector of the economy—customer identification, due diligence, record keeping**

The legal owner of funds arriving at a financial institution may be different from the “beneficial owner.” But international standards require institutions to know the *source* of the funds they receive—for as long as the account is active. How can it be possible to monitor the source of every customer’s funds? The answer lies in the risk-based approach.

A risk-based approach has always been implicit in the FATF standards, but it is something that the 2003 standards made explicit for the first time. Although the standards need to be applied with due regard to risk, if a country can demonstrate that the risk from a certain class of individuals is on the low side, simplified due diligence or, in a few cases no due diligence, may be applied.

The new standard identifies some special issues presenting unique, and in some cases higher, risk profiles. Because “politically exposed persons” have political influence there is reason to be concerned about the source of funds deposited on their behalf. In such cases, special care is required of correspondent banks to ensure that they are applying proper due diligence.

Business not conducted in person—for example, through shell banks, which are prohibited under the new standard—carries special risks. The FATF standard requires financial institutions to assess those risks, although it does not offer a great deal of guidance on how to do it. Here other documents, such as those issued by the Basel Committee, come in handy.

If a customer is introduced to an institution by a third party, the institution may accept the customer provided the third party has applied the same controls on money laundering and terrorist financing controls that the new institution is bound to apply.

**Observe the requirement to report suspicious transactions**

Suspicious transaction reporting is now applied not just to financial institutions, but also to certain nonfinancial businesses and profes-

sions—among them lawyers and accountants engaging in financial transactions for a client (but not when they are simply giving advice), dealers in precious metals and stones (for cash sales over \$15,000), and trust services engaging in transactions for a client. The reporting obligation for lawyers and accountants is subject to the professional privilege exemption, which is left to countries to define, but their definition of professional privilege must be reasonable. Lawyers and accountants are allowed to report through a self-regulatory organization.

Institutions that make report suspicious transactions must be exempted from liability for breach of confidence and privacy. Similarly, institutions must refrain from informing the customer that a report has been made to the authorities.

### **Regulate and supervise to ensure compliance with requirements**

The standard spells out a four-tier approach to regulating and supervising institutions covered by AML/CFT controls. Core institutions—banks, insurance, and securities—must apply the regulations and supervise their application. Money transfer and money exchange businesses, believed to be the next riskiest, should apply the regulations and register all businesses involved in this activity so that the authorities know they exist and can apply money laundering regulations to them—a requirement falls short of full-blown prudential supervision on the Basel model. For other financial businesses, each jurisdiction has discretion to supervise or regulate to the extent of risk, which in some cases might mean little or nothing. Among nonfinancial institutions, casinos should be very tightly regulated; others are according to risk,

The best way regulate and supervise is by establishing an FIU to receive suspicious transactions, analyze them, pass them on to law enforcement for investigation and follow-up, and exchange information about suspicious transactions internationally.

The three possible models of accomplishing these functions are administrative FIUs, FIUs attached to law enforcement agencies, and FIUs attached to prosecuting agencies. Each has pros and cons. Ad-

ministrative FIUs linked to government departments tend to command more confidence among institutions that must report to them. On the other hand, they tend to be less independent. Financial institutions may be reluctant to make reports to FIUs linked to law enforcement or prosecutors, but such FIUs are in a stronger position to be independent. FIUs should be independent and immune from undue influence from the authorities.

### **Cooperate**

Because money laundering is an international phenomenon, international cooperation is needed to fight it. Most major money laundering and terrorist financing cases involve cross-border transfers of funds. If these funds are to be tracked and intercepted, the authorities in different countries must cooperate.

International cooperation includes obvious elements: exchanging information, enforcing overseas freezing and confiscation orders, and making money laundering and terrorist financing an extraditable offense. If the country's constitution forbids extradition of its own citizens, it must equip itself with the ability to prosecute the offense domestically.

Thank you for your attention.

## **Implementing the International Standards— Developing an AML/CFT Strategy and Structure**

**Ross S. Delston**, Consulting Counsel, Legal Department, International Monetary Fund

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I want to thank Mr. Halligan for such a detailed and clear presentation of the international standards on money laundering and terrorist financing. The International Monetary Fund, with help from the U.N. Office on Drugs and Crime, has been working with the authorities in Afghanistan for about six months on AML/CFT legislation. We are hopeful that those laws will soon be enacted in Afghanistan.

Why do we need legislation? First and very obviously, there is now no law in Afghanistan to combat money laundering or the financing of terrorism. It is not sufficient to use secondary legislation, regulations, or guidance notes to criminalize new activities, because international best practice tells us that criminalization should be done through legislation. Existing legislation—notably the central bank law that governs the Da Afghanistan Bank and the banking law that deals with supervisory issues—is not broad enough to encompass all of the elements of the international standards—particularly customer due diligence, filing of suspicious transaction reports, and internal controls for businesses regulated by Da Afghanistan Bank. My colleague, Mr. Carrington, will discuss some of these issues in greater detail.

We also need legislation because a new group of nonfinancial businesses and professions, such as lawyers and accountants, are now covered by the anti-money laundering standards. Thus the law needs to address them. And finally we need legislation to create a new government agency, the FIU, and to endow it with the power to obtain information and monitor compliance by entities required to report suspicious transactions.

What needs to be done once Afghanistan's AML/CFT law is in place? An FIU will need to be created, possibly within Da Afghanistan Bank. The police and prosecutors will need to work with the FIU to set up a structure to investigate and prosecute a new set of crimes. Da Afghanistan Bank itself will require a new set of regulations and directives to implement the law. The IMF and the World Bank stand ready to provide technical assistance in these endeavors.

***Ian De Vere Carrington***, Senior Financial Sector Expert, Financial Market Integrity Division, International Monetary Fund

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I will consider the implementation of measures adopted to comply with international standards and national legislation.

The first issue is the supervision of the institutions required to report under the law. Several models exist—each reflecting the circumstances, conditions, and judgments of officials in the country. In some countries specific financial activities are regulated by different regulators. The insurance sector may be regulated separately from the banking sector, and so forth. In those circumstances you may find that regulations related to AML/CFT are spread across the regulatory institutions themselves. Then there is the model in which the FIU is itself responsible for regulating the reporting institutions, including the financial sector institutions, for AML/CFT purposes. Afghanistan, like any other country, is free to decide which of the several available models is most appropriate.

Whichever model is used, there is the question of the adequacy of resources. Supervisors are continually stretched by increasing de-

mands. The level of regulation in the insurance and securities sectors, for example, has been scaled up dramatically over the past 10 years and regulators are finding that demands on their time have increased. Adequacy of resources is relative to the complexity and type of financial sector activity involved, and also to the specific skills demanded for AML/CFT.

Overtaxed regulators must decide where to focus their attention. Looking solely at assessing risk and supervising AML/CFT concerns, one must ask what types of activities and institutions carry the highest risk. To be effective in regulation, one must apply one's resources in accordance with that assessment of differential risk. When dealing with nontraditional activities that in many cases have legitimate objectives and serve legitimate needs, regulation has to be sensitive to the unintended consequences that might flow from the regulatory activity or approach. The question is how to regulate an activity in such a way that it can continue to meet the legitimate need for which it was established while lessening the risk that it will be used for money laundering or terrorist financing.

A number of methodologies can be employed in supervision of the financial sector. In so-called off-site methodologies, the regulator, sitting in his or her office, reviews the policies, manuals, and other documentation that institutions use to guide themselves in complying with legal requirements. Regulators may design periodic questionnaires for institutions to complete to paint a picture of the institution's compliance structure. Of course, no regulatory or supervision system would be complete without on-site inspections to verify the information that one has received and to test the system that the institution has in place, while speaking to the staff and getting insights not available through off-site surveillance.

Regulators should have a clear idea of what, exactly, they want to put their finger on. When they visit a reporting institution they want to get to the root cause of the problems they have identified. The fundamental questions they want to ask are: Is there a weakness in the institution's policy on a particular matter? Or is the weakness that the

institution's systems do not allow it to live up to its stated policy? Even if the systems are adequate to meet the policy objectives, it may be that for lack of training the staff is not able to use the systems as intended? If all of these elements are in place—policy, systems, training—one may face a case of internal fraud, wherein members of the staff are facilitating illicit activities.

When a regulator enters a financial institution and speaks to the staff, he should assess the level of their awareness of the laws and regulations, the adequacy of the policies that the institutions have in place, and the adequacy of the information systems and databases that the institutions have. This is particularly important, because if institutions are to know their customers and their business—they need to be able to recognize that a transaction is outside the scope of the profile established for the customer. Clearly they need information systems that will assist them in making such judgments.

Regulators must consider how the institutional official responsible for reporting suspicious transactions is integrated into internal reporting systems and procedures. They must satisfy themselves that employees have access to that individual; that he or she has relative freedom to make judgments on the reports that the institution will make to the FIU. Regulators must verify that institutions have an ongoing compliance function that ensures that all these systems work, as well as an internal audit function to perform periodic assessments. Because international standards change over time, the staff must be kept fully aware, through ongoing training, of the changing standards and the responsibilities that those standards impose on them.

Once you have identified the root cause of the problem, you must make appropriate recommendations in view of the enforcement measures and powers that are available. Many years ago, many regulators had the power to revoke a banking license but could do little else. This is not really effective, because institutions know that revocation is not something a regulator will do easily. The international standards expect regulators to have a ladder of actions available to them—among them civil fines and sanctions. Without an array of enforcement tools, the effectiveness of the regulatory regime is questionable.



Joseph Halligan mentioned the importance of international cooperation. The laws and regulations that govern the supervisory agency clearly need to allow it to be able to share information when appropriate with other national and international authorities, and with other agencies in the regulator's country.

Finally, a challenge: Regulation of the new categories of institutions now covered by the FATF 40 Recommendations. Unlike banking, insurance and securities, there is as yet no internationally accepted standards for the regulation of lawyers, notaries, accountants, real estate agents, casinos, etc. That is going to be a challenge for those of us involved in assessments. It will be a learning experience for us, as it will for national regulators and regulated institutions. It will be necessary to look around the world to learn what others are doing, what is accepted and deemed appropriate in certain environments.

Thank you for your attention.



## **AML/CFT Legal and Regulatory Reforms**

***Abdul Fitrat***, First Deputy Governor, Da Afghanistan Bank

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It gives me immense pleasure to speak on behalf of the central bank of Afghanistan in this Global Policy Dialogue.

Da Afghanistan Bank (DAB) recognizes the global need to combat the financing of terrorism and the laundering of proceeds of crimes at the national and international levels. To that end, in collaboration with the International Monetary Fund and United Nations Office on Drugs and Crime (UNODC), DAB has been working to establish the legislative basis that is the prerequisite for an institutional framework to suppress money laundering and terrorist financing. To date, the government of Afghanistan has not yet adopted a law, but under an agreement with the IMF, the government of Afghanistan has made a commitment to enact legislations on money laundering and terrorist financing by September 30, 2004. More importantly, for the purpose of compliance with U.N. Security Council Resolution 1373, the government of the Transitional Islamic State of Afghanistan became a party to all U.N. conventions and protocols relating to the financing of terrorism and laundering of funds and assets, including the International Convention for the Suppression of the Financing of Terrorism (December 1999) and Convention against Illicit Traffic in Narcotics and Psychotropic Substances (1988), also known as the Vienna Convention.

Article 28 of the new constitution of the Islamic Republic of Afghanistan, adopted in January 2004, removed the biggest obstacle to extraditing citizens of Afghanistan to another foreign state for trial. None of Afghanistan's previous constitutions had contained any provision for the extradition of individuals wanted in a foreign country in connection with internationally accepted extraditable offenses. Article 28 brings the Afghan legal system in line with the requirements of the U.N. Security Council Resolution 1373, which asks member states for increased cooperation.

### **Da Afghanistan Bank's Response to the Global Fight against Money Laundering and Financing of Terrorism**

After the collapse of the Taliban Regime in November 2001, the government of Afghanistan committed itself to the global war against terrorism. Da Afghanistan Bank sought technical assistance from the IMF in drafting a law on combating money laundering and proceeds of crime and a law on combating financing of terrorism. Work on English drafts of the proposed legislation was completed in early February and late April 2004 in Vienna and Washington, respectively. Again, with technical assistance from the IMF Legal Department, the Dari drafts of both laws were completed in early to mid-May 2004. To remove inconsistencies and make the proposed legislation compatible with existing Afghan laws, a high-level interministerial task force representing the ministries of foreign affairs, interior, justice, and finance, and the Office of Prosecutor General, has been formed at Da Afghanistan Bank's head office. On May 31, 2004, the final Dari draft of the money-laundering law was completed by the interministerial commission. The draft will be forwarded to the Legal Institute of the Ministry of Justice for further review this month before it is submitted to the Office of the President of the Islamic Republic of Afghanistan and the cabinet for final approval by early September. The same interministerial task force is scheduled to start discussion of the Dari draft of the CFT law on June 7, 2004.

Both laws are scheduled to go into effect on the date of their enactment on September 30, 2004. They will be published in the Official

Gazette of the Islamic Republic of Afghanistan. Pursuant to the requirements of both laws, an FIU will be established as a semi-autonomous body within DAB. It will become fully operational by January 2005.

The proposed AML law is based on the model law drafted by the IMF Legal Department for use in countries with civil law legal systems. The CFT law is based in part on the UNODC's Model Legislation on Laundering, Confiscation, and International Cooperation in Relation to the Proceeds of Crime (1999). Both laws incorporate provisions necessary for compliance with standards and requirements contained in the revised FATF 40 + 8 Recommendations (June 2003), as well as the 1988 Vienna Convention, the 1999 International Convention on the Suppression of the Financing of Terrorism, and U.N. Resolution 1373 in relation to customer due diligence and the processes for receiving, analyzing, and disseminating suspicious transaction reports and other related financial information

In addition, provisions from several other model laws were used in our draft laws. These include the IMF Draft Model Financial Transactions Reporting Act; EU Directive 2001/97/EC of the European Parliament and the European Council dated December 4, 2001; the Law on Prevention of Money Laundering of Slovenia; and Belgium's Royal Decree of June 11, 1993, on the composition, organization, operation, and independence of financial intelligence processing units.

Both the AML and CFT laws meet or exceed current international standards and deal principally with criminalization of money laundering and terrorist financing, customer due diligence, establishment of an FIU, international cooperation, extradition, confiscation of funds and assets connected with money laundering and terrorist financing.

### **Key Challenges**

Having good legislation is by no means sufficient for rooting out terrorist financing or preventing money laundering. Effective enforcement, a key to implementing any legislation, has many components and requires adequate resources. Among the many needs and challenges are training,

advanced technology, a centralized national database on suspicious transactions, coordination between relevant branches of law enforcement, and the ability to receive, analyze, and disseminate information in a timely fashion. In particular, periodic inspection of offices of reporting entities for the purpose of compliance with legislative requirements and standards poses significant challenges for DAB.

DAB may not be able, on its own, to overcome all of these challenges within the specified time span. In order to establish an effective FIU and make it fully operational by the target date (January 2005), DAB needs significant amounts of technical assistance and equipment to create a national database to store, process, and disseminate information received from the large number of reporting entities brought under its oversight.

Given the urgency of measures to be taken against money laundering of money and terrorist financing, the World Bank and the IMF, in coordination with the Asian Development Bank, the European Union, and other multilateral organizations should consider providing the necessary technical assistance to enable DAB to do what it is required to do.

I would like to thank the World Bank, and in particular Mr. McKechnie, for arranging this videoconference through the World Bank's Global Development Learning Network. I would also like to thank the Legal Department and the Middle East and Central Asia Department of the IMF for their hard work and dedication. Without their support, we could have not come this far.

Thank you.

## **AML/CFT in Afghanistan from the Financial Industry's Perspective**

***John Janes***, Managing Director, Standard Chartered Bank Afghanistan

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I will focus my presentation on some key challenges and unique situations in Afghanistan's financial sector—and on some of the things that could be done to meet those challenges. With some international banks now moving into Afghanistan, we have a chance to build on international best practice.

I will address five issues, moving quickly through the first two and spending more time on the last three.

It is important to remind ourselves of what money laundering is. Many of us think of drugs as being the source of the money that needs laundering, but there are many sources of dirty money and various types of illegal activities that can undermine an emerging financial system. We should remind ourselves of the three main tiers of money laundering: the placement of criminal proceeds, the layering of many transactions to avoid leaving an audit trail, and the integration of money when it comes back into the system.

The devices terrorists use to conceal their assets are similar to those used by money launderers: shell companies, alternative remittance systems, nominees, structuring, credit and debit cards, cash smuggling, and wire transfers. So preventing money laundering is an important way of countering terrorist financing.

Deputy Governor Fitrat and those of you in Washington have already talked about what is being done internationally, but it is important for us all to understand that tougher measures are being enforced in other jurisdictions. Perhaps we should start thinking in Afghanistan about adopting the Wolfsberg Principles, articulated a few years ago by 12 top international banks at a meeting in Switzerland. The Wolfsberg Principles cover private banking, the suppression of terrorism, the conduct of correspondent banking (which will be particularly important in the emerging financial sector here as Afghan banks start to operate), and the monitoring and screening of activities.

FATF pressures have induced countries named as noncooperating countries to introduce AML laws. Countries like the Cayman Islands, Lebanon, Russia, and the United Arab Emirates—long offshore centers—have all signed up. Transparency International's Corruption Perception Index has been similarly useful, because no country wants to be on the top of that list.

What are the risks for banks in Afghanistan? There are three—regulatory risk, reputational risk (because the bank is an institution of trust), and operational risk. What happens when something goes wrong with reputational risk? A few years ago the directors of the Bank of New York were sued by shareholders for being involved in money laundering. That is not a minor risk for an international bank operating in Afghanistan.

Over the past 18 months several banks have been fined, not for evidence of money laundering but they were not doing enough to prevent the possibility. They were fined for failure to maintain sufficient know-your-customer identification documentation, failure to ensure that suspicious activity reports had been made, and other internal weaknesses. The size and frequency of such fines is not likely to decrease.

At Standard Chartered Bank here in Afghanistan, as in the rest of the world, we use a risk-based approach to separate our business by level of risk and allocate attention and resources accordingly.

What are the main challenges faced by the financial industry in developing AML programs here in Afghanistan? The first thing that concerns us all is a lack of understanding of money laundering, the



risks and consequences of noncompliance, and how money laundering can hinder the rapid national development that is needed here. Our market is quite secretive. People are reluctant to explain what they are up to. That is their nature. It is cash-oriented. There is no national payment system through which banking customers can make and receive settlements at the end of the transaction chain. So even if you introduce electronic banking between banks and the central bank, there is a risk that either at the beginning or the end of the transaction a cash deal will settle the whole chain of events.

An allied problem that will hinder the development and monitoring of audit trails is a growing discrimination in Kabul recently against older and lower denomination U.S.-dollar notes, which is leading to a secondary market of discounting value—an added complication if you are trying to run a well policed banking service. We do not have a bankers' institute to present courses on modern best practices for lending institutions. At present, if you go through the know-your-customer formalities with customers, they become suspicious. One should not forget that most Afghans are not familiar with the legal and accounting practices that are so common in the rest of the world. Trust in those practices needs to be instilled.

Any bank licensed in Afghanistan must be able to demonstrate to Da Afghanistan Bank that they have an officer responsible for investigating and reporting suspicious transactions and preventing money laundering. If that practice takes root in the central bank, as has been said earlier, it would be a good way to begin. But DAB must start providing advice on procedures and training for bank staff, monitoring the operating risks in the country, and demonstrating that they have viable know-your-customer projects. Other presenters have spoken of a lack of qualified and trained personnel. Without undermining the efforts of DAB and its banking supervision team, the laws are only eight months old, and I am sure that many lessons are still being learned.

The minimum standards for all DAB-licensed banks should be vigorous internal controls, identification of customers and classifying them by level risk, and ongoing monitoring of outflows as well as inflows. Re-

cord retention is very critical in meeting those standards.

What more needs to be done? We have heard from Deputy Governor Fitrat the commitment of the government to introduce anti-money laundering legislation—and that is a most welcome first step. Adoption of the Wolfsberg Principles would be a good complement to the legislation. And there must be strong enforcement of the laws. It is no good having new laws if there is not a consistent approach by the central bank, national banks, and foreign banks in the way they operate. A robust national payment system accepted by all banks and the market is the key to starting this process.

Thank you all very much for listening.

## Open Discussion with a Panel of Experts

*Theodore Greenberg*, Senior Counsel, Legal Vice Presidency, World Bank

### Introductory Comments

I would like to follow up on our discussion by highlighting nine issues.

First, The Wolfsberg Principles versus the FATF 40 + 8 Recommendations. The Wolfsberg Principles represent the voluntary commitments of the large international banks; as such they have provided among other things, an excellent mechanism for the development of training programs. However, because they do not cover all of the FATF 40 Recommendations, I would suggest that rather than confusing the two sets of standards, regulators may wish to incorporate the Wolfsberg Principles into training programs rather than as a set of secondary rules.

Second, in other countries whose circumstances resemble Afghanistan's, and in some emerging markets in Eastern Europe, microfinance companies have been particularly susceptible to use by money launderers and, we suspect, terrorists. Small businesses financed by just one, two, or three people, have grown very quickly, adding large numbers of employees with a large payroll. It is an area of risk that you may wish to consider.

Third, you may want to look at the intersection of reconstruction financing and fraud and corruption. It is necessary to have transparent procurement laws, because most of the companies and individu-

als that obtain contracts of any sizable amount will—in some fashion and at some point—intersect with the international financial system. I was recently in Georgia watching the building of a large hotel and was surprised to learn that the local construction costs were paid almost entirely in cash.

Fourth, in terms of cross-border issues (especially with Pakistan) and the movement of barter goods, I might suggest to you the easy-to-use NIPS software (short for Numerically Integrated Product System) developed by the U.S. Customs Service. NIPS can be used either with paper-based or computerized customs systems, and it offers a very easy way to track the movement of goods in and out of your country. It will help pinpoint variations in the movement of goods that may indicate suspicious activities. In that regard, of course, coordination with colleagues in Pakistan would be useful.

Fifth, with respect to your request on FIUs, the World Bank recently brought together a small group of donors on behalf of the government of Georgia. I appreciate the caution inherent in your statement that you do not expect your FIU to be operational until January 2005, and that seems realistic. But it also needs to be remembered that the FIU does not have to cost a huge amount of money or require a large staff. Some items, of course, do cost money: site surveys, operational plans, business plans, analytic software. Fortunately, many different countries and FIUs are willing to share that information, and individual donors will be willing to provide different pieces. The key, I would suggest, is in sequencing donor aid with your operational objectives, because you cannot write the analytic software until you know what you want the FIU to produce. And you cannot buy the hardware until you have decided exactly what kind of software you want.

Sixth, there was a reference to terrorism going beyond drugs. The key is to assess vulnerability and consider the deployment of counter-measures. One example of the worst situation is the Colombian FARC. Recently it was alleged that the Peruvian intelligence chief, Mr. Montesinos, was arrested for dropping AK-47 Kalashnikov rifles into the Brazilian jungle for the FARC in exchange for money.

Seventh, with respect to banks, three themes came out of the discussion: (i) risk assessment, (ii) assessment of vulnerabilities, and (iii) assessment of internal controls. If we look at the learning process in the FATF countries, these things have taken years to develop. It may be very difficult, especially as you try to address the cultural changes needed to implement full know-your-customer and beneficial-ownership procedures. I would suggest that the most difficult but important thing is knowing your customer, especially when the customer is a “politically exposed person.” The importance of having rules and internal controls to deal with these issues are equally clear with respect to microfinance institutions and reconstruction loans.

Eighth, in terms of developing a system from the ground up, experience has shown us that you cannot do everything in a year. Once you have clearly articulated your political commitment to the framework and begun to lay out a sequence of steps, the rest will follow. All of us, no matter where we live, have learned that the key is education—education for ourselves, for the banks, and for our people.

Ninth, experience has demonstrated, especially in countries moving from command to market economies, that if the public has confidence that the laws against money laundering and terrorist financing are going to be applied to serious criminals rather than being turned on small-scale tax evaders and political rivals, then they will see the benefits of suspicious transaction reports. If, as in the circumstance of certain Eastern European countries, the people feel that the new laws are just being used as another way to gain information for purposes of extortion by the authorities, then they will not cooperate. Cross-border experiences have shown our colleagues in the banks and in governmental institutions that we all face the same problems. We look forward to working with you.

Thank you.

## **Main Points of Discussion**

### *The Informal Banking System*

What have been the experiences of other countries in trying to capture the informal banking system? The *hawala* system and microfinance seem to be the dominant forms of informal financial business in Afghanistan. Should the authorities seek to license their activities as financial institutions, or is there a way to enforce the reporting requirements without having them licensed?

Mr. Fitrat responded that in mid-April, the first meeting of the Supreme Council of the Da Afghanistan Bank convened and passed four regulations. Two dealt with money-exchange dealers and money transmitters, requiring them to retain records for at least five years, a requirement also mentioned in the AML and CFT laws. The regulations will take effect on the date of their publication in the official gazette of Afghanistan.

Article 3 of Afghanistan's Banking Law strictly prohibits a bank from operating without a valid license from the Da Afghanistan Bank. A recent case in which *hawala* dealers accepted some 70 deposits without a license from the central bank resulted in the closure of the business's deposit-taking operation. The World Bank, the Asian Development Bank, the Bank of America, and any other entity in which the word "bank" is an integral part of the name must annex the words "representative office" before its name.

Mr. Elbashari from FinCEN shared his view that countries in the Middle East deal with this issue in one of the following ways: (i) the officials do not talk about it; (ii) they talk about it, but the talk has no effect on the national economy; or (iii) they try to induce the informal sector to come together, register their activities, and be regulated.

Mr. Greenberg added that both regulation, which implies a process of determining whether people are fit and proper, and registration, which is less ambitious but still requires resources, are difficult in the beginning. He suggested sending bank inspectors out to do quick in-

spections of the informal operators who are being required to register or be licensed. By giving them a friendly warning the word spreads quickly if the central bank shows a little muscle.

### *Location of the Financial Intelligence Unit*

If the FIU is part of the central bank will that discourage reporting institutions from freely sharing information?

Mr. Carrington commented that it was a difficult question because the central bank, in its role as a prudential regulator, depends very much on a good working relationship with reporting institutions. It depends on the willingness of those institutions to submit information. If the FIU is a part of the central bank, and if reporting institutions believe that the information they provide may now be used for purposes other than the prudential regulatory concerns of the central bank, that may lessen, to some extent, the ease with which they provide information to the central bank. But when a country is about to implement an AML/CFT regime and has limited resources, the central bank may be the best institution to undertake the FIU function.

What needs to be in place at a minimum is a structure that isolates the FIU within the central bank, a system to erect walls between the FIU and the rest of the central bank. Generally measures are taken to assure the reporting institutions that, although the FIU is a unit within the central bank, it is operating autonomously, so that FIU information and records are kept confidential, as they should be regardless of where the FIU is located.

Mr. Elbashari related that the FinCEN was housed within the U.S. Department of the Treasury but conceivably might be better located elsewhere. He noted that some FIUs in the Middle East were placed within their central bank or the ministry of the interior, to facilitate criminal investigations and internal security. Other FIUs are housed within the ministries of justice or finance. FinCEN does not investigate. It receive suspicious activity reports, which are then referred to law-enforcement authorities for investigation and prosecution.

Regardless of its location, the FIU should meet the requirements of the Egmont Group of FIUs. It should receive suspicious transaction reports, analyze them, transmit the information or finding to law enforcement, and carry out exchanges with the international community. In the process of drafting legislation, those items should be covered so as to avoid having to amend the law when Afghanistan's FIU seeks to join the Egmont Group.

Although suspicious activity reports are very important, FIUs should also use other, more proactive, means to initiate investigations.

A related issue is the safekeeping of records. For security reasons within the country, it is important that records be shared only with competent authorities. An FIU in Latin America released suspicious activity reports implicating an official running for election; FinCEN has temporarily ceased relations with that FIU.

To raise awareness of AML/CFT issues, the FIU should maintain good relations with banks and law enforcement, and especially money laundering reporting officers, by engaging in dialogue and providing feedback on how useful the information in the suspicious transaction reports has been. In some countries the FIU's only contact with the banks is to acknowledge receipt of STRs.

Lastly, the political will should be there. Passing a law or joining the Egmont Group is not enough. The government must have the will to go after criminals.

Mr. Greenberg shared recent experiences in Georgia and Ukraine, which faced the same question of where the FIU would work best. After examining international experience, both countries decided to put the FIU under the umbrella of the central bank in a walled-off unit. They did so because the commercial banks trusted the central bank—and because the central bank, among all agencies in the government, was the most competent, least corrupt, and judged by peers to be the least likely to be politically motivated. Officials in those countries, as well as observers from FATF and Moneyval, have concluded, after two years in the case of Ukraine and nine months in the case of Georgia, that those seem to have been wise decisions.



Mr. Fitrat noted that Afghanistan investigated the possibility of putting the FIU somewhere other than the central bank as a completely independent entity, but given the lack of capacity in other institutions the central bank was the best option. As far as independence is concerned, the FIU is a semi-autonomous body. Its director-general is proposed by the governor of the central bank, approved for a period of five years by the Supreme Council of the Da Afghanistan Bank, and has the authority to hire and fire his staff. No one interferes in the activities and operations of the FIU.

### *Interaction between Formal and Informal Financial Sectors*

Do *hawala* dealers seek to open accounts, or would they prefer to set themselves up as financial institutions? What is the nature of that relationship, and have concerns about money laundering emerged?

Mr. Janes responded that once the AML and CFT laws are passed, consistency will be needed in institutions' approach to the laws. Consistency is needed because some commercial banks may be a little stricter than others in applying know-your-customer standards. The head offices of the international banks may well indicate that they engage in the procedure, but there has to be a consistency of approach. When banks are new to a market, they will not necessarily know who all the players are. There certainly have been approaches by the money changers to open bank accounts, and the Standard Chartered Bank considers that a Level 3 (very high) risk.

The central bank has received an application for a domestic bank that started as a money changer. So there is some interchange, but it is still informal and really quite small. The problem is that if you leave people who are involved in the industry on the edge and do not bring them in and start regulating them, they will remain on the edge and you cannot get a sense of what is happening.

### *Training on AML/CFT*

When the time comes to implement the AML law, where will the most

training be needed? Is it with the staff in the commercial banks or with regulators? And is there an ideal sequence?

Mr. Janes commented that training will be a huge task. If the public, members of the commercial sector, and bank staff can see the importance of trying to control illegal dealings by and between financial institutions and the informal sector, then one will be making some very real progress. Just as there are social awareness programs on the dangers of drugs, alcohol, and smoking, a major effort must be made to make people aware of the benefits of having a secure banking system.

Enactment of the AML law is an enormous opportunity to raise public awareness of the very real benefits of using banks in the new financial sector that we are all trying very hard to introduce into Afghanistan.

Mr. Fitrat added that because training is greatly needed both in the central bank and in commercial banks, it is important that the World Bank and other multilateral organizations share their experience and provide technical assistance in the form of training and equipment.

## Wrap-up

***Samuel Munzele Maimbo***, Financial Sector Specialist, South Asia Region, World Bank

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I will highlight one or two points that each of the speakers has raised for thought.

### **Alastair McKechnie**

- Money laundering and terrorist financing must be addressed in the larger context of threat that opium production poses to Afghanistan's development.
- Because no international financial institution has the capacity to address this problem on its own, international cooperation with our counterparts and colleagues in Afghanistan will be essential.

### **Joseph Halligan**

- International efforts have been made to encourage the criminalization of money laundering and terrorist financing, to develop the appropriate tools for confiscating criminal assets and freeze terrorist funds, to encourage suspicious transactions reporting, and to establish FIUs that can share information across borders.
- International cooperation includes: exchanging information, en-

forcing overseas freezing and confiscation orders, and making money laundering and terrorist financing an extraditable offense. If the country's constitution forbids extradition of its own citizens, it must equip itself with the ability to prosecute the offense domestically.

### **Ross Delston**

- Developing legislation is only a first step. A bigger challenge lies in the effective implementation of that legislation (by creating appropriate structures to facilitate implementation).
- Once Afghanistan's AML/CFT law is in place, an FIU will need to be created, possibly within Da Afghanistan Bank. The police and prosecutors will need to work with the FIU to set up a structure to investigate and prosecute a new set of crimes. Da Afghanistan Bank itself will require a new set of regulations and directives to implement the law.

### **Ian Carrington**

- The key challenge for the supervisory body is to be sure that the regulatory model chosen for the country is truly the most well-suited to Afghanistan's circumstances and that hiring decisions and systems development reflect an accurate assessment of the risks facing the country.
- To be effective in regulation, the central bank must apply its resources in accordance with an appropriate assessment of differential risk. When dealing with nontraditional activities that in many cases have legitimate objectives and serve legitimate needs, regulation has to be sensitive to the unintended consequences that might flow from the regulatory activity or approach.

### **Abdul Fitrat**

- The government of Afghanistan has shown determination in drafting AML and CFT legislation and in working to establish an

FIU. These activities will require international support and much coordination within the country.

- Among the central banks many needs and challenges are training, advanced technology, a centralized national database on suspicious transactions, coordination between relevant branches of law enforcement, and the ability to receive, analyze, and disseminate information in a timely fashion.

### **John Janes**

- Among the challenges specific to Afghanistan are raising awareness about the dangers of money laundering and creating an environment in which formal and informal financial institutions are able consistently to apply know-your-customer requirements and make suspicious transaction reports. It is important that whatever framework is chosen be applied consistently and uniformly to all financial institutions so as to create a level playing field.
- Any bank licensed in Afghanistan must be able to demonstrate to Da Afghanistan Bank that they have an officer responsible for investigating and reporting suspicious transactions and preventing money laundering. If that practice takes root in the central bank, it would be a good way to begin. But DAB must start providing advice on procedures and training for bank staff, monitoring the operating risks in the country, and demonstrating that they have viable know-your-customer projects.

### **Theodore Greenberg**

- In implementing the proposed AML/CFT legislation, the central bank may wish to consider: using the Wolfsberg Principles as a basis for developing training program; taking into account the susceptibility of microfinance institutions to money laundering; and, employing software in monitoring the movement of goods across borders,

Finally, I would like to add my own word that if we are to win the war against money laundering or terrorist financing, the informal financial sector is a segment that we cannot avoid. The informal financial system in Afghanistan has been at the centre of Afghanistan's legal and illegal financial transactions for a considerably long period of time.