

EAG Private Sector Program 2008
Money Laundering and Terrorist Financing
Methods and Trends

How the Financial Instability will Impact the Monitoring of AML/CFT Measures

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16–19 December 2008

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Financial Instability and ADB's Future Projections

- “Developing Asia” – 8 Central Asian Republics; 9 Southeast Asian nations; 8 South Asian + People’s Republic of China (PRC); Hong Kong, China; Republic of South Korea; Pacific; etc.
- 2009 – 5.8% (September 2008–7.2%)
- 2008 – 9.0% actual

ADB Projected Growth

- “Emerging East Asia” = 10 ASEAN nations + PRC; Hong Kong, China; Republic of South Korea; etc.
- 2009 – 5.7%
- 2008 – 6.9% actual

Risks to the Region

- Region economies are tied to global outlook, through trade and financial links. Projections for “growth engine” economies:
- **PRC** = 2009 – 8.2% (earlier 9.5%)
2008 – 11.9% actual
- **India** = 2009 – 6.5% (earlier 7.0%)

Impact on Banking Sector

- Impact on foreign exchange
- Foreign Direct Investment flight
- Domestic impact limited – decreasing access to credit

Correspondent Relationships

- Financial markets are global.
- **Banks** need correspondent relationships to do business.
- Poor AML systems will lead to end of correspondent relationship as regulators in developed economies increase scrutiny.

Correspondent Relationships

- Even in absence of supervisory framework, increased internal monitoring from:
 - demands of correspondent institutions & correspondence services requirements
 - foreign ownership & implementation of internal group policies
 - Legislative controls driving this—e.g., 3rd European Directive + USA PATRIOT Act

Why Securities Markets?

Securities Markets

1. Comprise **money** and **capital markets**
2. Form an **important part** of an efficient financial system
 - offer intermediation for debt and equity instruments
 - ensure greater competition among financing sources
3. Promote development

Money Markets

PRODUCTS TRADED

- **Short-term** debt instruments – e.g. Treasury Bill
- **Medium to long-term** debt instrument – Treasury Bond
 - Provide a market-based reference point for interest rates
- **Other Instruments**
 - Interbank deposits, bankers' acceptance, certificates of deposit and commercial paper (issued by nonfinancial corporation)
- **Why Important**
 - Source of funds for governments and commercial banks

Capital Markets

- Stock exchanges = trading vehicle
 - deal in equities and longer-term debt (e.g., corporate bonds)
 - Make long-term investments liquid
 - Risk diversification – shared by more parties
 - Improved corporate governance (SROs)
 - Savings mobilization

Terminology used in Securities Industry

TYPES OF PRODUCTS/INSTRUMENTS

1. **Equities** or stocks = share in a company (private, public, state owned)
 - IPO = initial public offering
 - Secondary offerings (transactions)
2. **Bonds/Bill** = loan from government or corporates – amount, interest rate, and loan period
3. **Derivatives** = futures, warrants, and options contracts
 - Futures = an **obligation** to buy or sell a specific commodity – e.g., rice or gold – on a specific day for a specific price
 - Options = the **right** to buy or sell a specific item – e.g., stocks or currency – for a preset price during a specified period of time
 - Warrant = longer-term option

Stockbrokers

- **Trading Services**
- Stockbroking services to buy or sell securities, stock market advisory services, merger advice, provide margin lending facilities, and act as stock underwriters (selling IPOs – new shares of stock issued by corporations)
- Stockbrokers, banks, other financial institutions
- **Delivery channels**
- Traditional face-to-face contact, telephone, the internet, and email
- Issues of KYC and CDD
- **Regulators**
- Securities commission
- Stock exchange, clearing house (self-regulatory organizations)
- IOSCO

Derivatives

- “In the money” option
- US\$ currency option – right but NOT the obligation to buy US\$ in 90 days at an exchange rate of Indonesian Rupiah (Rp) 9,000 (strike price). CALL OPTION
- “out of the money”
- US\$ currency option – right but NOT the obligation to sell US\$ in 90 days at an exchange rate of Rp 20,000. PUT OPTION
- Usually not proceed with transaction #2 if rate still Rp9,000/US\$1. If transaction not lapsed, payment between specific trader = ML
- If future contract, **must** settle the transaction at maturity.

ML within the Securities Industry

- Payment methods – “layering”
 - cash,
 - personal and business cheques,
 - bank drafts,
 - credit cards
 - wire transfers,
 - internet transfers, eBay payments, etc.

Fraudulent Trading Activities

- Embezzlement
- Insider trading
- Securities fraud
- Market manipulation, e.g., churning – share price inflated to transfer funds

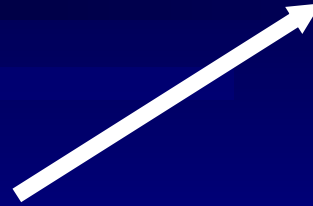
Buy 9.90
Buy 9.95
Buy 10.00

BUYER

Sell 10.00
Sell 10.05
Sell 10.10

SELLER

Buy 9.90
Buy 9.95
Buy 10.00



Sell 10.00
Sell 10.05
Sell 10.10

BUYER
BROKER

\$\$\$\$



Seller
BROKER

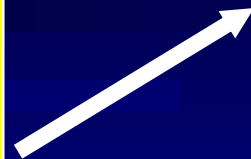
↑
Buyer

↓
Seller

ADB

Buy 9.90
Buy 9.95
Buy 10.00

Sell 10.00
Sell 10.05
Sell 10.10



BUYER
BROKER

\$\$\$\$

Seller
BROKER



Buyer



Seller

ADB

Buy 9.90
Buy 9.95
Buy 10.00
Buy 30.00

Sell 10.00
Sell 10.05
Sell 10.10
Sell 30.00



BUYER
BROKER

Seller
BROKER

\$\$\$\$



Buyer



Seller



Collusion

Avoid KYC - Nominees

- Use of nominee to avoid KYC requirements – can be a company, broker nominee company, or illegal company
- Allows the true owner of the company to hold assets and conduct transactions in the name of the company while being hidden by the corporate veil.
- A complex web of trusts and corporate trustees is the common means of obscuring true ownership and making it very difficult to detect beneficial ownership.

Illegal Transactions/Accounts

- **Illegal transactions**
- Changes in share ownership via OTC trade can be used to:
 - ❖ transfer wealth from one jurisdiction to another;
 - ❖ from one person to another behind the veil of incorporation
- **Brokers' Accounts**
- Hold clients funds – like a bank but without controls
- Funds being held in the account but with no trading activity occurring.
- Risks heightened when stock broking accounts opened and operated through non face-to-face internet facilities – easier to get around KYC requirements.

Cross-border trades

Stockbrokers are advised to be aware of funds being transferred into, or out of, such accounts to **high-risk jurisdictions** or to observe **unusual patterns** of transactions on these accounts.

THANK YOU

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