

TRAINING SEMINAR ON ANTI-MONEY LAUNDERING

Address by Mr. R. Basant Roi, Governor, Bank of Mauritius

October 25, 2001

Members of the Board of Directors of the Bank of Mauritius

Fellow Banker

Mr. Stephen Platt

Ladies and Gentlemen

Good morning,

I am pleased to have this opportunity to share with you some of my thoughts on money laundering, its implications for macro-economic management and principles that our financial institutions need to embrace in order to minimise risks of contamination with financial crimes.

Money laundering gathered momentum in the 1980s largely due to rapidly expanding illicit drug trade and money derived from other criminal activities. The inherent destructive forces that reside in laundered money gave birth to the international legal anti-money laundering regime. The legal regime is largely based on the guidelines from the United Nations Vienna Convention of 1988, and was subsequently reinforced by the establishment of the Financial Action Task Force in 1989 and 1990. The Task Force generated 40 recommendations urging countries to implement them thus

criminalising money laundering and giving force to seizure undertakings. As countries in the Western Hemisphere implemented anti-money laundering legislation thus tightening controls on financial flows in the formal market and making abuses more difficult, the sense of creativity of money-laundering operators has sharpened. Money launderers have discovered new entry points and come up with more complex techniques of layering and integration. While authorities across the world are still refining current framework for dealing with money laundering as part of an attempt to counteract old techniques of money laundering, electronic system – a new platform for moving illegal funds almost on an anonymous basis - is already gaining prominence. Money laundering operators are never short of ingenuity. Their discoveries are likened with what we often

refer to as the 'balloon effect' – squeeze a balloon at one point and the air inside moves to another point. Likewise, money-laundering operators facing pressures from regulatory authorities keep making nomadic moves to jurisdictions where bank supervision and regulations are weak and expertise in law enforcement is deficient.

Various other reasons could be identified as to why money-laundering operators choose to operate in specific centres or regions. Beside the two I have just mentioned, a third reason is the degree of sophistication of the financial system of the selected centres or regions. Banks and other financial institutions in such centres provide a branch system throughout the world. Dollar trading runs in billions, which render layering and integration far easier. Strong economies supported by good communications and telecommunications provide rather safe and suitable avenues for investment in the formal economy. A fourth reason is the existence in the host country of a large underground economy with payment and settlement systems of a kind that is uncommon. Funds readily move from the underground economy to the formal economy and money laundering is not perceived as a problem by the society. A fifth reason for the selection of particular centres or regions is the absence of watertight secrecy laws and protection to beneficial owners of companies. Easy incorporation of companies and the virtual absence of reporting requirements for large cash transactions by the regulatory

authorities, if at all they exist, attract laundering activities. This is why the Bank of Mauritius has systematically issued offshore banking licenses to reputable banks only despite years of caustic criticisms levelled against its far-sighted and sterling approach. A sixth reason is the proximity of the selected centres to countries whose Governments, for political, subversive or other motives, are in the hit list of rivals. A seventh reason is whether the host country is a drug producer or the extent to which the host country is plagued with the consumption of drugs. An eighth reason is the degree to which the host country is ridden with bureaucratic procedures, how far law enforcement agencies are ineffective and how far corruption is an accepted way of life.

This is not an exhaustive list of reasons as to why money-laundering operators reveal preferences for certain centres or regions. They are nonetheless the main ones. You might have wondered why I have listed them out. My purpose of mentioning the reasons is to provide you with a basis for assessing the extent to which Mauritius is exposed to financial crimes. True, Mauritius with its liberalised financial system is clearly not exempt from exposure to money laundering activities. But given the character of our financial system as well as the supervisory and regulatory capabilities, though not absolutely perfect, money laundering is far from being an endemic phenomenon. Often we are made to believe with much excitement what is not true. Not only does the prestige but also the economy and the

financial system get afflicted every time allegations of money laundering based on mere suspicion are not that decently brought to the notice of the public and the world at large.

Nonetheless, our banks and bank-like institutions have to exercise due diligence and to stay watchful, for money laundering does have adverse macro-economic impact. Money laundering transactions, if sizeable, definitely pose two kinds risks, one is macro-economic and the other is prudential. Let me take the macro-economic risk first. Criminal money moves speedily from one centre to the other. Such funds are seldom parked in the same financial centre for too long a period. In other words, financial flows connected with crimes are intrinsically volatile. The larger the size of money laundering transactions, the more volatile is international capital flows. Therefore, greater also is the volatility of exchange rates due to unanticipated inflows and outflows. Given the vulnerabilities of the Mauritian economy, volatility of capital flows and therefore of exchange rate cannot but have damaging impact. Once laundered money is present in sizeable amounts in a market, Gresham's law becomes operational: dirty money drives clean money out of the market. The integrity of the market suffers a setback with the result that the very foundation of the market is destroyed. The efficacy of macro-economic policy is consequently lost.

The prudential risk is equally high. Massive and unanticipated movements of funds from one centre to another could threaten the

soundness of banks. Imagine a small bank in Mauritius welcomes laundered funds amounting to, say, US\$50 million which, by international standards, is no doubt a small amount. Unanticipated withdrawal of the US\$50 million, which is likely in the case of laundered money, could trigger the bank's failure.

We cannot also overlook the social and political dimensions of money laundering activities. All these considerations lend urgency to anti-money laundering efforts. The number of suspicious transactions voluntarily reported by both offshore and domestic banks to the Bank of Mauritius does confirm that our bankers are indeed mindful of the threat that money laundering poses to the financial system and the economy as well. To the laymen, tracking down money-laundering operators is an easy exercise. To bankers it is a highly demanding one. I am aware that bankers in Mauritius have taken the required steps within their own institutions to detect suspicious financial transactions in a timely manner. The 'Know Your Customer' (KYC) principle, however demanding a code of business conduct, is the golden rule that we all need to adhere to.

With the globalisation of financial markets adherence to the KYC principle has become much more demanding. This is why co-operation among banks, between supervisory bodies and financial intelligence agencies is getting more and more established. The US State Department's International Narcotics Control Strategy

Report of March 1993 illustrates how the underground banking system moves funds. 'Money can be transferred all over Southeast Asia, as in one case where a remittance company in Taipei sent Taiwanese currency (being drug proceeds) to a company in Hong Kong to be converted in US dollars. The US currency is then transferred from Hong Kong to company accounts in Japan and Singapore. It is then paid out from these accounts to associates in Burma as Burmese kyat'. To make matters worst, technologies have advanced so much that funds can be transferred electronically - indeed with lightning speed. You can imagine the perplexity of the poor Burmese banker who is required to adhere to the KYC principle and to instantly report to the authorities on suspicious transactions. Authorities that really comprehend the intricacies of financial flows and dexterity of money laundering operators tackle financial crimes in a rather discrete manner.

However, no banker can afford to be complacent with his existing prudential system. The ingenuity of money-laundering operators knows no bounds. They are all the time striving to stay a few steps ahead of bankers and bank supervisors, and hence the need for all of us to be well equipped to outwit them. But banks should also guard themselves against dishonest employees. This brings me to the last point of my address this morning: ethics in banking. Bankers occupy a position of trust. Good corporate citizenship and adherence to core ethical values form the basis of honest

bankers. In our respective organisations, we should all be 'choosing the good over the bad, the right over the wrong, the fair over the unfair' in the conduct of our businesses. Bankers cannot claim that it is fair to accept bribes in return for loans or to lend to related parties or to cheat their customers. There is sometimes a difference between what some bankers profess and what they actually practice. The recent Asian crisis amply demonstrated that banks and other financial institutions cannot afford to overlook ethical values. As one central banker has put it ' This increases the need for organisations to adhere to a strong set of values to steer them through the minefield of ethical choices with which they are faced as they make business decisions. It is also necessary to ensure that the behaviour of the organisation is in practice aligned with these values and that employees buy into them, so that the organisation actually practises what it preaches'. I cannot but urge you to issue a code of ethics to your employees. The International Monetary Fund has recently issued a code of ethics to its staff members and has even employed an 'Ethics Officer'.

Good corporate governance provides, in my opinion, the foundation for good banks and good banking.

Thank you.