



When white is too white

Money laundering, financial sanctions
and their impact on financial institutions



Money laundering and financial sanctions

As money laundering schemes become more complex and sophisticated and the volume of such schemes continues to amplify, financial institutions are increasingly faced first, with the risks associated with money laundering, second, with the need to comply with anti-money laundering (AML) regulations imposed by regulatory bodies and governments across the globe and ultimately, with the risk of becoming a sanctioned entity as a result of suspected intentional participation, or unintentional facilitation of money laundering. The risks that financial institutions are facing, especially those operating in the Middle East and North Africa region (MENA), have intensified as financial sanctions are imposed on governments, financial institutions and individuals across the region, especially politically exposed persons (PEPs).

Financial institutions are particularly aware of, and are focusing on, the need for the adequate evaluation of risk of exposure to PEPs, especially in the wake of recent events and developments across the Arab world and increase in the number of firms, PEPs and governments even, that have been subject to sanctions by global authorities.

Financial institutions are now required to exercise more scrutiny over transactions made by PEPs and to assess and consider their own ability to verify the sources of funds that flow into their accounts because in many instances, these have become sanctioned parties by global authorities, sometimes overnight.

With these financial institutions' operations expanding globally, the repercussions of non-compliance with AML regulations and risk of financial sanctions is greater

With these financial institutions' operations expanding globally, the repercussions of non-compliance with AML regulations and risk of financial sanctions is greater – their need for continuous assessment of changes in the political and economic environment is hence crucial.

Impact of non-compliance

Failure to comply with AML laws and regulations and breaches of financial sanctions can have serious consequences: punitive fines, criminal proceedings, damaged reputations and sanctioning – all crystal clear motivations to justify efforts of compliance.

All the consequences listed above can lead to serious damage to a financial institution's credibility and performance. Becoming a sanctioned party due to breaches of financial sanctions can be even more damaging.

Becoming sanctioned by one or more global bodies considerably reduces, if not halts, a financial institution's ability to provide for and cater to its international customers' needs for performing global transactions. Notwithstanding that financial sanctioning, which includes the freezing of assets by counterparties, will result in tremendous pressure on the sanctioned financial institution's liquidity.

The above consequences could and have, in some instances, led to a sanctioned financial institution's complete inability to continue operations and therefore, its demise as a viable ongoing concern.

Mitigating responses

Faced with evolving and increasing AML laws and regulations and financial sanctions that impose stringent compliance requirements and impose severe repercussions in instances of non-compliance, financial institutions are increasingly aware of the need for further substantial investment in systems and human capital to assess, manage and mitigate the perils of non-compliance, whether due to intentional staff breaches, error, or a breakdown in the systems and processes implemented.

Investment in systems and processes

The need to consider the solutions available, whether moving towards a single platform approach, outsourcing, or upgrading and developing the existing systems to satisfy anti-money laundering and financial sanctions needs is a major concern for senior management. These need to assess the risks and advantages of each of the available solutions and need to ensure that adequate controls and reviews are in place over the systems implemented, irrespective of the solution adopted, as responsibility for compliance with AML regulations and financial sanctions lies, ultimately, on the management, whether compliance is undertaken internally or outsourced.

In addition to investing in compliance systems and processes, financial institutions are under pressure to increase their investment in systems and resources to enable timely and adequate assessment of the impact on operations, profitability and financial position of financial sanctions being imposed on neighboring governments and other financial institutions. Financial institutions are now also investing in developing

strategies to deal with the difficulties and effects of the changes in the business environment to respond to the restrictions imposed on transacting with sanctioned parties.

Investment in human capital

Financial institutions need to ensure that their staff possess the appropriate knowledge, competencies, awareness and understanding of anti-money laundering regulations and financial sanctions, especially staff charged with developing and implementing compliance systems, processes and controls and internal audit staff. Spending on staff training is continuously growing as financial institutions become aware of the consequences of non-compliance arising from staff error or ignorance of procedures.

Senior management responsibility

Ensuring that effective and consistent systems and controls operate across the organization and that adequate resources are allocated is a crucial senior management responsibility. Senior management commitment is required to ensure that policies and procedures are developed to address money laundering issues and financial sanctions and compliance with applicable and related regulations.

Management has taken a risk-based approach towards anti-money laundering compliance and financial sanctions breaches. Without understanding the regulations and the anti-money laundering regulations and financial sanctions regimes, risk assessments undertaken by financial institutions are likely to be inaccurate and consequently, systems and controls put in place to prevent non-compliance might not be effective or efficient.

The above consequences could and have, in some instances, led to a sanctioned financial institution's complete inability to continue operations

Conclusion

Risks associated with non-compliance with anti-money laundering laws and regulations and how to deal with financial sanctions imposed by global bodies and risks associated with ensuring compliance with them should be high on the agendas of board of directors, executive management and risk committees at financial institutions, especially those operating in the MENA region.

Financial institutions have to be increasingly proactive and vigilant in their daily operations and transactions to deal with the conflicting and overlapping sanctions regimes in addition to continuous efforts to comply with anti-money laundering regulations. Regular risk assessment reviews are a priority for financial institutions that are striving to maintain operationally effective systems.

by **Nada Maalouf**, Audit partner, Deloitte in the Middle East

