The risk-based approach to anti-money laundering: problems and solutions

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Abstract

Purpose – The purpose of this paper, which is a part of a PhD thesis, is to detect problems associated with the risk-based approach to anti-money laundering (AML), as well as present ways to improve the risk-based approach.

Design/methodology/approach – The method is law and economics. The PhD thesis itself is also based on a comparative analysis of the Danish and British AML regimes.

Findings – The main findings are: failure to develop adequate risk-based AML systems, taking into account varying levels of money laundering risk, is not only to be considered in the context of legal risk but also and more importantly in the context of integrity risk; anti-money laundering (AML) has to be made part of financial and non-financial institutions' corporate social responsibility policies; the *Risk Analysis Manual* provided by the Central Bank of The Netherlands lists very specific and comprehensive assessment criteria for a broad range of risks facing financial institutions. This manual could be considered by international bodies and individual financial institutions in informing their risk control; due to their intelligence access, cross-national agreements of cooperation and exchange of information and contacts to multiple stakeholders, financial intelligence units are better placed in educating financial institutions on AML matters by means of regular typology publications and other guidance based on SARs and other intelligence; and AML considerations should be incorporated in other areas of law, such as immigration law concerning wealthy individuals, if the AML regime is to achieve its intended impact.

Originality/value – The paper highlights how the AML regime in general and the risk-based approach in particular could be improved so as to meet concerns of both regulatory authorities and regulated entities.

Keywords Denmark, United Kingdom, Money laundering control, Law, Risk-based approach, Legal risk, Integrity risk, Risk of money laundering, Creative compliance, Letter and spirit of the law

Paper type Research paper

I. Introduction

Business and entrepreneurship have been and are being driven by risk taking and exploration of new opportunities. The concept of risk has been an inherent part of the business lexicon for quite a while. In certain areas of law, the concept of risk has likewise manifested itself. Clear examples are insurance law, tort law and international trade law. Since 1988, the concept of risk has also been incorporated into financial markets law (Basel I), specifically capital adequacy regulation which aims at ensuring that financial institutions hold sufficient regulatory capital to compensate for credit risk, market risk and operational risk. Different concepts of risk are continuously introduced into the legal lexicon. In 2003, the concept of risk was explicitly introduced into the AML regime (FATF standards). It is a central concept and it reoccurs continuously in the AML regime. However, the concept risk does not have one settled meaning. The International Organisation for Standardisation (ISO, 2009) has given

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a general definition of "risk" – the effect of uncertainty on objectives. The research's primary focus is legal risk which is defined by The Basel Committee on Banking Supervision (2005, p. 140) as exposure to fines, penalties or punitive damages resulting from supervisory sanctions as well as private settlements. Failure to comply with the AML regulation may trigger both criminal and administrative liability.

The AML regulation bears some distinctive features. It is itself organised around the concept of risk, not legal risk but risk of money laundering. The AML regulation maintains that financial institutions' efforts must be proportionate to risk of money laundering, by focusing more resources on high-risk transactions and fewer resources on low-risk transactions. Some examples of high- and low-risk transactions are already provided by legislation. The extent of legal duties, i.e. risk-based duties will depend on risk pertinent to transactions implying that high-risk transactions will require more extensive monitoring and customer due diligence measures. However, while listing examples of high- and low-risk transactions, legislation nevertheless provides that it is financial institutions' ultimate responsibility to identify risks of money laundering pertinent to their own business (Directive 2005/60/EC, Recital 10). Once they have defined certain transactions as high risk or low risk, financial institutions then bear a burden of proof in justifying their approach to supervisory authorities (The Danish FSA, 2010b, Section 10.4.2 (32); Ketteringham, 2011). The failure to develop risk-based AML systems may result in deficient customer due diligence measures which implies exposure to penalties. Both the UK and Danish enforcement cases have shown that supervisory authorities will not hesitate imposing multi-million fines.

The ability to develop adequate risk-based AML systems has an impact on financial institutions' exposure to penalties, i.e. legal risk.

I argue throughout my research that the legal duty to develop risk-based AML systems and controls should not only be viewed in the context of legal risk but also in the context of integrity risk.

II. Integrity and AML

It has frequently been stated that the involvement of financial institutions in AML is due to several reasons. First, criminals are regarded to be rational actors. This position is further confirmed by the UK's threat assessment of organised crime (SOCA, 2009/2010). The involvement of financial institutions in AML is intended to make money laundering for criminals more difficult and expensive. Second, the involvement of financial institutions in AML is seen to contribute to the investigation and prosecution of underlying profit-generating crimes. Third, the AML regime aims at preserving integrity of the financial system (Reuter and Truman, 2004, p. 130). In the preamble of the EU money-laundering directive, the integrity of the financial system is further highlighted (Directive 2005/60/EC, Recitals 2 and 8). The UK has also developed a harm framework for organised crime, breaking down harm into five types (physical, social, environmental, economic and structural) and three levels (individual/local, community/regional and UK/international) (SOCA, 2009/2010, Annex A). Structural harm is defined as damage to individual and commonly shared perceptions of the integrity of public and private institutions and systems. This re-occurring concept of integrity is directly linked to AML initiatives as the integrity is seen to be one of the motivating factors behind the involvement of financial institutions in the fight against money laundering. For example, Global Financial Integrity is an international organisation working with policies aimed at curtailing the cross-border flow of illegal money.

Economics researchers have attempted to define the concept of integrity (Erhard *et al.*, 2009). In doing so, they distinguish between integrity, morality and ethics even though these concepts are interrelated. The definition of integrity is initially looked up in *Webster's New World Dictionary*. It has three meanings:

(1) the quality or state of being complete, unbroken condition, wholeness, entirety;
(2) the quality or state of being unimpaired, perfect condition, soundness; and
(3) the quality or state of being of sound moral principle, uprightness, honesty and sincerity (Erhard *et al.*, 2009, p. 39).

According to the economics researchers, being in integrity means honouring one's word. An example of service failure turning out positively is given in this connection. A family booked a room at the hotel. Upon their arrival, they discovered that all rooms were full. It turned out to be guests' fault as guests had not checked out as planned. The hotel staff could not find any other room in the city. So what the hotel staff did was that they transformed a small dining room into a bedroom by putting in some cots, pillows and bedding. The hotel did not keep its word, but it still honoured its word. The family rated this as one of their outstanding service experiences ever (Jensen, 2009, p. 20).

A person's word consists of each of the following: what you said, what you know, what is expected, what you say is so, what you say you stand for, social moral standards, group ethical standards and governmental legal standards of right and wrong, good and bad behaviour. An organisation honours its word, i.e. it is in integrity internally (between members of the organisation) and externally (between the organisation and those it deals with, outsiders) (Jensen, 2009, p. 19).

This definition of integrity provided by the economics scholars is correspondent to the understanding of integrity in banking law. The Central Bank of The Netherlands refers to integrity risk as:

> [...] being affected by the improper, unethical conduct of the organisation, its employees or management in contravention of legislation and regulation and the standards set by society or by the institution itself (De Nederlandsche Bank, 2005a).

Among constituent parts of integrity risks, the Central Bank of The Netherlands specifically refers to money laundering:

> [...] the risk of reputation loss, financial loss and/or other loss arising from preventive or repressive action by the competent authorities in response to the (unwitting) involvement in money laundering by customers, intermediaries or the institution's own staff (De Nederlandsche Bank, 2005a).

The authors of the widely acclaimed book on AML state that financial institutions, particularly banks, sharing and abiding by generally accepted social and ethical codes of behaviour and rules related to prevention of money laundering, help protect the integrity of the core financial system as a whole. The authors argue that core financial institutions are to varying degrees quasi-public institutions with access to government safety net. As quasi-public institutions, they are expected to deliver a public good which is the prevention of money laundering (Reuter and Truman, 2004, p. 130).

Integrity is closely linked to how institutions and systems are perceived by outsiders. If negatively perceived, there is a resulting loss of faith, confidence and trust in those institutions and systems. A lack of confidence and trust in institutions and systems leads to unwillingness to utilize specific institutions and systems. It has correctly been noted that the seriousness of decline in reputation may vary from society to society (Reuter and Truman, 2004, p. 130) depending on social, ethical and cultural standards prevalent in those societies and also individual experiences. On the surface, integrity is a concept incorporating moral and ethical considerations but as one takes a closer look, it becomes apparent that integrity is a pathway to economic prosperity. Abandonment of moral considerations may lead to significant economic losses due to people's unwillingness to utilize certain service-providers or commodity providers. Especially in the current age of high technology and countries' increased cooperation in different areas of banking law, information about companies spreads in less than no time due to internet. Initiation of an investigation against a subsidiary of the banking group in one part of the world may draw supervisory attention to its parent undertaking in another part of the world and vice versa. For example, Saxo Bank which became subject to a warning issued by the Danish Financial Supervisory Authorities (FSA) in 2010 received public criticism of the FSA in Dubai in 2011 for its deficient compliance with AML rules (Danish Broadcasting Corporation, 2011). There is a reason to assume that one investigation may have lead to another as countries' FSAs increasingly cooperate and exchange information with each other in matters related to criminal finance. Furthermore, news and results of investigations in different countries are published on internet.

Integrity slogans are self-sanctioning mechanisms of free trade and free economy, placing limit on how much you can allow yourself to do in pursuit of profit. One of the distinguished economics professors has concluded the following in relation to the root cause of the current financial crisis:

> If I had one recommendation for improvement to the curriculum of every business school, it would be to make it very clear to students that cost-benefit analysis is very important almost everywhere in life-*but not with respect to honouring one's word* (author's note-, i.e. being in integrity) In my view, this is a major root cause of the current economic crisis (Jensen, 2009, p. 19).

III. Common risk language

Integrity refers to moral, ethical and legal standards of right and wrong, good and bad behaviour. Against the background of the risk-based approach, it is difficult to know with 100 percent certainty what is right and what is wrong, what is good and what is bad. Even calculations of costs and benefits are based on assumptions which may turn out to be wrong. In any calculation, there is a risk of overestimation or underestimation (HM Treasury, 2011, p. 117). This becomes especially true for risk assessment which is not expressed in numbers and other mathematical terms as it is the case in the AML regime.

The main problem is that there is no common risk language/risk vocabulary and no articulated understanding of what different actors mean by different risks. Institutions within the same country and individuals within the same institution may use different risk languages in the sense that they mean different things even when they use the same words. In the cross-border context, the use of the risk language becomes even patchier. So far, the FATF has not had any formal standard or interpretative note on the risk-based approach. The plans to insert a comprehensive statement on the risk-based approach are a step towards formulating a common risk methodology (FATF, 2010, pp. 4-5). The risk management vocabulary developed by the ISO has been referred to in one of the FATF's internal documents (Schmoll and Eckert, 2010, p. 2). This risk management vocabulary could constitute a platform for developing a common risk vocabulary in the AML context.

One institution which has articulated the common risk language for financial institutions is the Central Bank of The Netherlands (De Nederlandsche Bank, 2005b). In its *Risk Analysis Manual*, the Central Bank lists concrete assessment criteria against which risk control is to be carried out for each risk category, be it legal risk, integrity risk, credit risk or market risk. Concrete assessment criteria are often missing in discussions on risk as there is an assumption that regulated entities can figure out these criteria themselves without any external aid. Nevertheless, the latest submissions from financial institutions located in different countries have shown that there is a demand for a more articulated and concrete guidance on risk criteria. The ISO (2009, Section 2.22) defines risk criteria as:

> [...] terms of reference against which the significance of a risk is evaluated. Risk criteria are based on organisation objectives and external and internal context. Risk criteria can be derived from standards, laws, policies and other requirements.

In the Central Bank's *Risk Analysis Method Manual*, money laundering is referred to in the section on integrity risk which itself is linked to reputation risk, fraud risk (aspect of operational risk) and legal risk.

Integrity risk comprises money laundering, insider trading, conflict of interests, financing of terrorism and improper conduct according to the Central Bank's manual (De Nederlandsche Bank, 2005a). There is a rating scale consisting of low, fair, material and serious risk (De Nederlandsche Bank, 2005a). Each rating corresponds to specifically listed criteria. Not all criteria will be applicable depending on the institution's internal and external context and depending upon which constituent part of integrity risk is looked upon. For example, the criteria "High share in total customer base of customers having group companies registered in countries described as tax haven" will only have a limited application or none if a financial institution primarily targets the average Dane or Brit, i.e. a retail customer-employee. The criteria "High number of insiders on total payroll" will be more relevant when assessing risk of insider trading as part of integrity risk, rather than financing of terrorism for example. The major benefit of these clearly formulated criteria is that they help businesses take an outside look at own activities as a preparation for external examinations of regulators, external auditors, etc. Some financial institutions may already hire external advisory and consultative firms for risk-management purposes but not all institutions have a sufficient budget for this purpose which makes these public *Risk Analysis Method Manuals* even more welcome.

This specific *Risk Analysis Method Manual* illustrates by numerous examples what constitutes a business model that runs a high risk of being used for money laundering purposes. This explanation is sought after in the light of the conclusion that the Danish FSA came to, having examined AML systems and processes of Saxo Bank (The Danish FSA, 2010a). According to the *Risk Analysis Method Manual*, international businesses are more likely to be misused for money laundering than domestically or locally orientated businesses. Another feature is provision of products and services facilitating access of third parties apart from immediate contract parties, namely documentary credits and provision of trust services or company setup services. Non-transparent complex transactions or cash flows at non-market prices such as derivatives as well as private banking are also included (De Nederlandsche Bank, 2005a).

What strikes is the absence of negotiable documents such as checks and bills of exchange. In Danish case law, there have been several cases of misuse of checks (The Danish High Court, 1995/2002). As those real-life cases have shown both in Denmark and beyond, negotiable documents are particularly good at facilitating identity theft, fraud and money laundering. They should have been included in the list of criteria. On the other hand, this list is not exhaustive but rather indicative.

In the meantime, what is positively outstanding about this list of criteria is the focus on tax-related matters in the context of money laundering. For example, location of activities in offshores, high number of customers having group companies registered in tax havens, large number of complex products with strong tax implications, significant number of customers with strongly tax-driven business location policy are all listed. The connection between money laundering and tax crimes is sometimes avoided in discussions on money laundering especially when tax crimes are not predicate offences of money laundering in certain jurisdictions. At the EU and FATF level-tax crimes are currently not predicate offences but some EU and FATF Member States have nevertheless chosen to include tax crime in the list of predicate offences at the national level, e.g. the UK.

Another positively outstanding risk criterion is strong pressure on management to realise ambitious results. This criterion is not mentioned elsewhere in international official documents on money laundering. The strong bonus-driven culture of financial institutions may have an impact on how diligently financial institutions perform checks on persons coming in with investment and other sources of liquidity. Staff's inadequate knowledge of legislation and regulation and financial institution's poor track record in compliance, corruption, bribery, front-running, churning, insider dealing are relevant criteria listed as well. The fact, that the Central Bank of The Netherlands has decided to include money laundering in the context of integrity risk, contributes to a more extensive, even if not altogether perfect, list of assessment criteria.

The approach taken by the Central Bank is more inclusive as it draws attention to matters left out at the international level, e.g. the FATF level. Role of insiders such as management and staff in AML is given a more prominent role in this manual. The FATF does emphasize the importance of training but it is not explicit in linking money laundering to a broader corporate culture driven by high bonuses and profits.

Considering money laundering risk as part of integrity risk is likely to capture more criteria relevant for following the spirit of the AML law which aims at safeguarding the integrity of the financial system. As it has already been noted, financial institutions have been granted discretion with regard to development of risk-based AML systems and controls. Discretion provides scope for human action, error, manipulation and creative compliance.

Creative compliance is essentially the practice of using the letter of law to defeat the spirit of law (McBarnet, 2007, p. 1). The spirit of law is the aim of the rule, the goal to be achieved and the harm to be prevented (Morgan and Yeung, 2007, p. 154).

Creative compliance has received renewed attention in the common law countries since the Enron scandal. In that case, creative compliance was used in accounting and tax law. But it is not just these two areas, in which creative compliance takes place. Creative compliance can be found in any area of law (McBarnet, 2003, p. 231). Two factors contributing to creative compliance are the nature and operation of law and the attitude to law (McBarnet, 2003, p. 230). To tackle creative compliance, it is argued that one has to move from a positivist vision of law as a technical task to one where compliance also involves compliance with the spirit of the law (McBarnet, 2007, p. 2). Corporate social responsibility (CSR) is mentioned to be one of the developments in that direction. CSR essentially involves a shift in the focus of corporate responsibility from profit maximization for shareholders within the obligations of law to responsibility to a broader range of stakeholders, including communal concerns such as protection of the environment and accountability on ethical as well as legal obligations. CSR policies are usually expressed in corporations' Statements of Business Principles or corporate-specific Codes of Conduct, to enhance concern for the environment, human rights, fairness to suppliers and customers and opposition to bribery and corruption with the range of issues involved constantly expanding (McBarnet, 2007, p. 19).

In Codes of Conduct, one can, for example, read that "One of the company's most valuable assets is integrity" (Creative Labs, 2011, p. 1) As prevention of money laundering is seen to preserve the integrity of the financial system, it is logical to require regulated entities to include money laundering in their Codes of Conduct. According to common sense and logic, concerns for money laundering are part of CSR as much as concerns for human rights, corruption, labour conditions, bribery, etc. Codes of Conduct should further provide for concrete steps ensuring that money laundering concerns are met from top to bottom of the institution – from recruitment processes to accountability of directors and senior managers.

Thus, money laundering is logically a part of CSR policies and risk of money laundering is a part of integrity risk. Simply viewing risk of money laundering as legal risk is not sufficient as compliance which aims at mitigating legal risk can be creative. It is an essential element and attraction of creative compliance that it can claim to be not illegal, to be quite distinct from non-compliance. Creative compliance and non-compliance do, however, intertwine. For example, aggressive tax planning can in practice slip over the line into evasion (McBarnet, 2003, p. 232).

Concentrating only on legal risk due to potential AML compliance failure is self-defeating because AML compliance may be constructed as creative compliance which escapes the intended impact of AML regulations. Risk of money laundering has to be considered with regard to several other risks as it is made evident by the Central Bank of The Netherlands. These risks are integrity risk, legal risk but also business risk, operational risk, IT risk and outsourcing risk. Prevention of money laundering involves compliance with legal regulations, deployment of human and IT-resources, outsourcing of certain AML duties to third party, etc. Therefore, the above risks should be considered in the context of financial institutions' compliance with the AML regime. The *Risk Analysis Manual* provided by the Central Bank of The Netherlands lists very specific assessment criteria for a broad range of risks facing financial institutions in the course of their business. This manual could be taken into account by other bodies as more examples of assessment criteria or risk factors are sought after by financial institutions in the course of their compliance with the AML regime.

IV. AML and changes in other areas of law

As part of the review of the FATF (2011)standards, financial institutions were invited to provide their input into the process. The input provided by associations of financial institutions and individual financial institutions indicates problems faced by these institutions in implementing the FATF standards. Most of these problems are of operational character. Difficulties in identifying and verifying beneficial owners and politically exposed persons are one common problem voiced.

In many countries, including Denmark and the UK, there are no comprehensive public registries that record beneficial owners of all legal persons. In Denmark, there are private registries of Danish public and private companies. In the meantime, there are no registries recording beneficial owners of foreign companies registered in Denmark (FATF, 2006, pp. 27 and 98). Private registries of companies also exist in the UK. However, with regard to trusts, there is no central filing requirement for trusts and there is no register of all trusts in the UK (FATF, 2007, p. 237). The absence of centralised public registries containing data on beneficial owners is a major obstacle to verifying information on beneficial owners provided by legal persons. In some cases, verifying is in fact impossible due to the absence of independent reliable sources of information. Financial institutions are left to rely on the truthfulness of statements provided by legal persons and their private registries in the absence of independent sources of hard data on beneficial owners.

The same problem exists with regard to politically exposed persons and their family members and associates. There are no public registries of the above persons. Instead, apart from asking customers directly, financial institutions use lists of politically exposed persons developed by commercial companies. These lists do not, however, contain names of family members and associates of politically exposed persons (FATF, 2011, p. 192). The proposal has been put forward, according to which Member States of the FATF would prepare lists of politically exposed persons and distribute them to other Member States.

Another concern voiced by financial institutions is whether supervisory authorities understand and accept financial institutions' risk assessment. Financial institutions have voiced the position that risk assessment is not one-dimensional. That means that risk factors predetermined by legislation should not automatically lead to enhanced customer due diligence measures (FATF, 2011, pp. 226 and 240). For example, foreign politically exposed persons that are classified as high risk by the FATF standards and national legislation should not result in the automatic application of enhanced customer due diligence measures. A number of factors need to be taken into account when dealing with foreign politically exposed persons. For example, the product requested by a foreign politically exposed person may be deemed to be low risk which should justify normal or simplified customer due diligence measures. The position of many financial institutions is that the risk of money laundering depends on many factors and is not contingent upon one specific risk factor predetermined by international standards or national legislation.

The approach to customer due diligence measures should be flexible and non-prescriptive. Where risk factors are provided by legislators, these risk factors should be considered but these risk factors, by themselves or in isolation, should not lead to any particular conclusion or mandated process.

This approach is said to be in line with the spirit of the risk-based approach to customer due diligence. Otherwise, listing risk factors as determinative of risk of money laundering may result in financial exclusion and stifling of innovation (FATF, 2011, p. 241).

It has already been shown that improvements of the AML regulatory framework may require changes in company law or criminal law. For example, the creation of public registries of beneficial owners would require a mandatory obligation to report beneficial owners when companies are set up. This initiative was considered in the UK but it was however dismissed following a cost-benefit analysis of the project. If the AML regulatory framework is to be effective, AML considerations have to become integral parts of other areas of society and thus be reflected in other laws.

For example, in the UK, plans have been announced to enact new immigration legal provisions according to which investors with at least £5 million available to invest in government bonds and shares will gain residency after three years. Those in a hurry will be able to gain residency after just two years if they make £10 million available (Stevenson, 2011). Immigration laws encouraging capital investment should also consider that some wealthy people have not necessarily earned their assets by honest means. The UK is one of those countries that has already accommodated several businessmen accused of different economic crimes in Russia. According to the latest *Corruption Perceptions Index* report published by Transparency International (2010), Russia is placed 154 in the corruption rankings of 178 countries worldwide with the least corrupt countries on top and the most corrupt countries in bottom. This corruption report further suggests that capital investments coming from Russian entrepreneurs and businessmen have to be particularly scanned due to money laundering considerations. In its submission to the FATF, the British Bankers' Association has drawn specific attention to wealthy individuals with Russian connections as high-risk customers (FATF, 2011, p. 211). There is an understanding among financial institutions that these groups of customers have to be subjected to enhanced customer due diligence and reporting if necessary. The question remains as to whether there is a genuine political will at the British Governmental level to investigate and prosecute these wealthy individuals who are accused of economic crimes in Russia but who invest money in the British economy.

There is a method currently used in the USA to decrease reliance on credit rating agencies: removal of legal references to credit rating agencies. *E contrario*, one could insert legal references to AML measures in an increasing number of laws and regulations as a next step. Such legal references are necessary for raising public awareness which is prerequisite for subsequent action as money laundering is not confined to any specific sector or area of society. The creation of financial products such as derivatives should also take into account AML considerations. Furthermore, current loopholes exist in bearer instruments, such as travellers' cheques which may not always require names or addresses but only account numbers of payees (FATF, 2001/2002, p. 17), and one-off transactions instead of account-based transactions in money transmittance. In the former case, having only an account number may not be sufficient for carrying out customer due diligence. In the latter case, money transmittance businesses facilitate transactions which do not go via digitalised accounts and it is thus more difficult to carry out monitoring.

V. Better intelligence management and dissemination

Customer due diligence requirements imposed by the AML regime can be useful for preventing and detecting fraud, identity theft, etc. Gathering data about customers can also be beneficial from an economic point of view. According to the latest research carried out by two Danish economics researchers, companies with close customer relations have higher earnings than companies with more focus on the product than the customer. Close customer relations require companies to gather data about their customers. This marketing technique is called customer relationship management. According to the research, it has become harder to get in direct contact with new customers. Therefore, there is an increasing need of obtaining knowledge about existing customers and using this knowledge, especially in cases where customer retention and reacquisition are essential elements (Østergaard Jacobsen and Ringberg, 2011). Data on customers can thus be reused both for marketing and crime prevention purposes. Research on customer relationship management shows that marketing and money laundering prevention are not mutually exclusive. Both undertakings can be pursued in parallel using the same tool – customer data gathering. The reuse of data for different purposes may reduce administration, prevent duplication of efforts and ultimately save costs.

No institution has a monopoly of expertise, wisdom or relevant knowledge (Lander, 2006, p. 27). There is a need for an ongoing tight collaboration between public- and private-sector bodies in the context of AML. Better intelligence management and dissemination as well as greater transparency as to law enforcements agencies' use of SARs are called for. Regular publication of typologies (studies on money laundering trends and methods) based on SARs and other intelligence would be a valuable aid in informing financial institutions' risk-based AML systems. The FATF envisages an obligation requiring Member States to publish national money laundering risk assessments which would likewise be useful for informing risk-based AML systems (FATF, 2010, p. 4). Internationally, better intelligence management and dissemination should aim at providing a consolidated compilation of user-friendly typologies with a clear overview of specific red flags.

Existing typologies also raise the question as to when financial intelligence units (FIUs) forward cases for further investigation to law enforcement agencies such as police. FIUs play a key role in the AML regime. Owing to agreements of cooperation and exchange of information among national FIUs, they are in an ideal position of collecting valuable data on money laundering techniques from all over the world. At the national level, they are a link between financial institutions and law enforcement agencies having useful contacts to each side. Against this background, there is no other institution which is better suited for educating financial institutions in preventing and detecting money laundering. Despite the fact that FSAs have day-to-day prudential and market supervision of financial institutions, they do not have the same access to money laundering data and crime investigation expertise as FIUs, at least in countries such as Denmark and the UK. It would be more appropriate if national FIUs took a more active role in educating financial institutions in AML techniques through regular publication of updated typologies and other guidance.

VI. Conclusions

Financial institutions have a legal duty to develop AML systems and controls targeting high-risk transactions, i.e. transactions that facilitate a high risk of being used for money laundering. In this respect, financial institutions have been granted discretion. In relation to supervisory bodies, they bear a burden of proof in showing that their AML systems correspond to varying levels of risk. On one hand, financial institutions run a legal risk, i.e. exposure to fines if these systems do not capture high-risk transactions. On the other hand, financial institutions run an integrity risk associated with the improper, unethical conduct of the organisation, its employees or management in contravention of legislation and regulation and the standards set by society or by the institution itself. Discretion in developing risk-based AML systems provides scope for creative compliance which is the practice of using the letter of law to defeat the spirit of law, i.e. the law's intended impact. Both in the interests of regulatory authorities and regulated entities, it is essential to consider risk of money laundering in the context of both legal risk and integrity risk as these risks are interrelated. It is further suggested that AML is to be made part of CSR policies incorporated in codes of business conduct and ethics.

Financial institutions have voiced a demand for specific criteria against which risk of money laundering will be assessed. The *Risk Analysis Manual* developed by the Central Bank of The Netherlands provides very specific and comprehensive assessment criteria for a broad range of risks facing financial institutions in the course of their business. This manual is worth a closer look by international bodies and individual financial institutions. Furthermore, due to earlier mentioned factors, national FIUs are in a particularly good position to provide valuable input for development of financial institutions' risk-based controls. This input could take a form of regular publication of typologies based on nationally reported SARs and other intelligence obtained from law enforcement agencies and foreign FIUs. Better intelligence management and dissemination are vital in the AML regime.

If the AML regime is to achieve its intended impact, changes may be essential in criminal law or corporate law. For example, public comprehensive registers of beneficial owners may become a reality once there is an obligation requiring mandatory reporting and publication of information on beneficial owners during the setup and operation process of companies. AML considerations should also be taken into account when devising other legislation such as immigration law privileging wealthy individuals. Otherwise, there is a risk of having double-standard policies which is discouraging for those who put genuine efforts in preventing and detecting money laundering.

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