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Money Laundering Risks in New Banking Systems

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Agenda

- What is meant by New Banking Systems?
- Risks identified with New Banking System and their mitigation
 - Prepaid Cards
 - E Wallets
 - Correspondent Banking Agents
 - Cryptocurrencies
- Red flag indicators
- Case Studies

What did I do?

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"How am I? I don't know, let me check Google."

What is meant by
New Banking Systems?



Easy access anywhere/anytime to banking as opposed to traditional branch-based banking



Enabled by high-speed internet and increased usage and affordability of mobile phones



Motivated by the agenda of 'financial inclusion' and direct transfer of government benefits to the end user

New Banking Systems

Benefits of New Banking Systems

- Much larger reach as compared to the traditional banking
- Lower cost of transaction
- Supports low value transactions both at urban and rural markets
- Larger penetration among unbanked customers

The logo for Knab, featuring the word "knab" in a bold, dark blue, lowercase sans-serif font with a registered trademark symbol (®) to the right.The logo for Ally, featuring the word "ally" in a lowercase sans-serif font. The "a" is purple, and the "lly" is black.The logo for 5 BANKS CONNECT, featuring a purple circle with a white number "5" inside, followed by the words "BANKS" in purple and "CONNECT" in green, all in a sans-serif font.

Back to the basics...

What is Financial Inclusion?

Individuals and businesses have access to:

- **Useful and affordable financial products and services** that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.
- Being able to have **access to a transaction account** is a first step toward broader financial inclusion since a transaction account allows people to store money, and send and receive payments.

Source: World Bank

Further – the World Bank says...

Great strides have been made toward financial inclusion and 1.2 billion adults worldwide have gotten access to an account since 2011.

Today, 69% of adults have an account.

Moving from access to account to account usage is the next step for countries where 80% or more of the population have accounts (China, Kenya, India, Thailand).

These countries relied on reforms, private sector innovation, and a push to open low-cost accounts, including mobile and digitally-enabled payments.

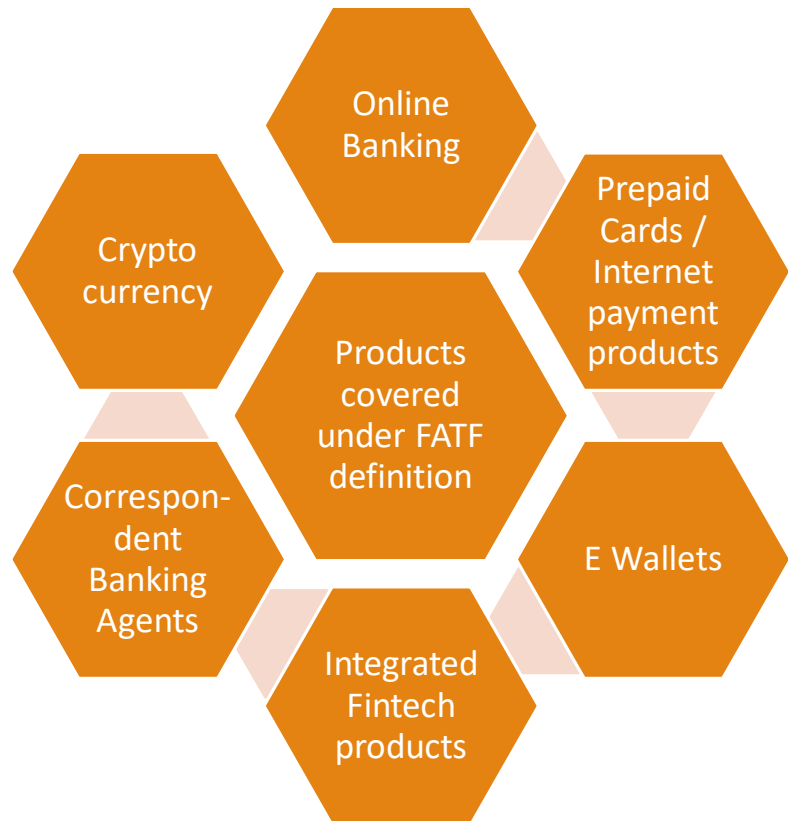
However, close to one-third of adults – 1.7 billion – are still unbanked, according to the latest [Findex data](#).



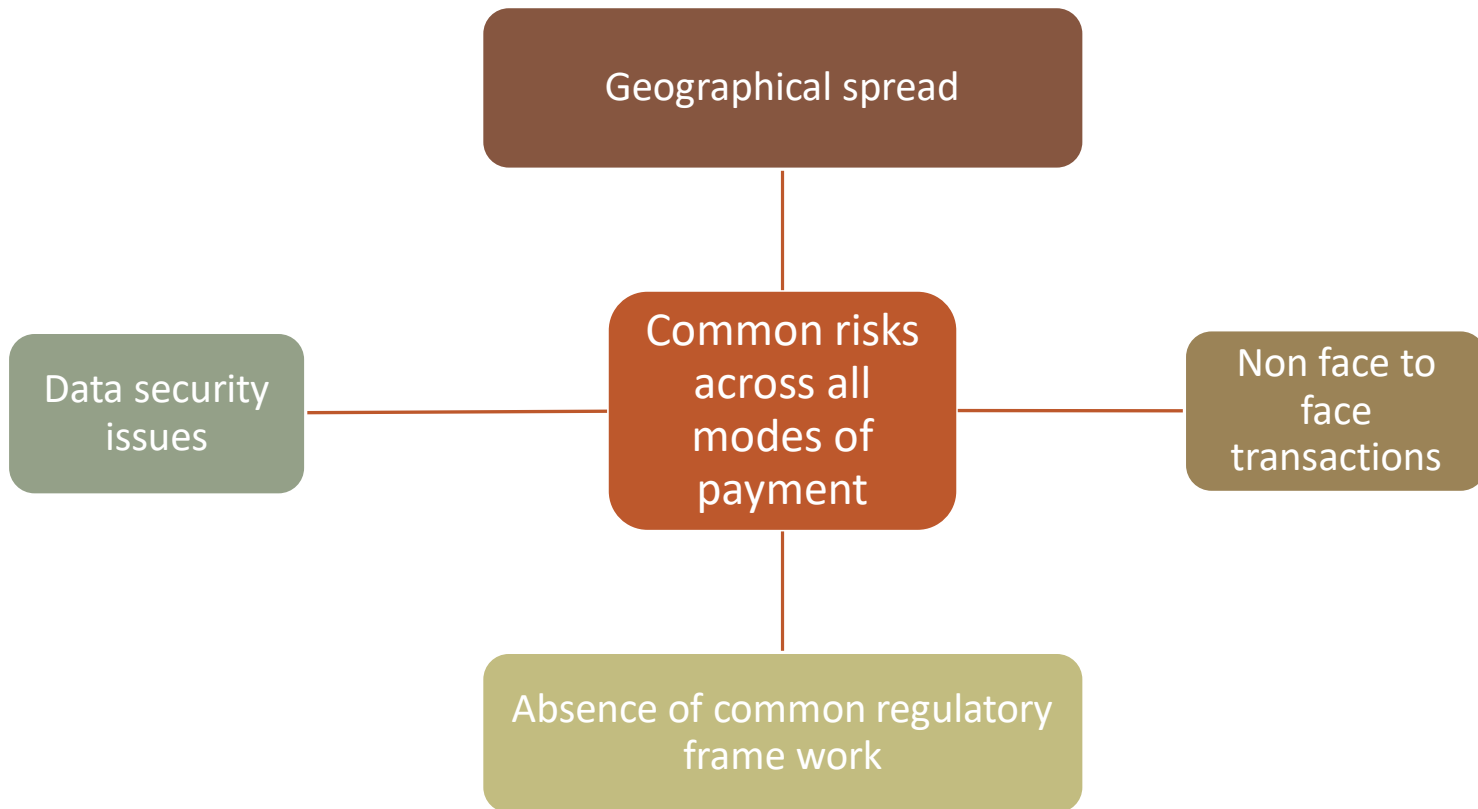
What are classified as New Banking Systems?

The FATF has coined two terms to describe these new developments

- New Payment Method (NPM)
- Internet Payment Systems (IPS)



New Banking Systems - Risk Perception



Prepaid Cards & Associated Risks

These cards are used in large scale by various agencies like:

- Government Agencies
- On line & Off line shopping chains
- Telephone Companies
- Banks
- Companies issuing cards for multiple use

The level of controls exercised vary widely for pre paid cards and therefore risks associated with such instruments can be quite large.

Prepaid Cards – Risks:

Anonymity

Source of funds

Limits

Multiple points of usage

Prepaid Cards - Risk Mitigation

Point of Sale

- Control at the time of issuance, details of the purchaser along with proof of identity and address of the purchaser
- Quality control at point of sale

Set Limits

- Set limits on value of the card at the time of purchase and reloading
- The limits should be such that it becomes unattractive for persons with criminal intent
- Usage of cash could be discouraged by using a lower limit for the same

Points of Usage

- Points of usage should be restricted to specific merchant sites
- Cash withdrawal should not be allowed

Records

- Records for sale, reloading and usage of these cards should be maintained in such a manner that individual transactions can be reconstructed if required

Prepaid Cards - Open Risks

- Multiple cards could be used to break up and transfer money and then could be encashed and consolidated later
- Source of funds will be difficult to trace in many cases
- Risks will be high in case of cards which can be used in multiple geographies, especially if it is issued at a place where regulatory control is weak

E Wallet (Digital Wallet) - Characteristics

- Electronic device that allows an individual to make electronic transactions
- Managed by entities or companies which also store some amount of cash as a float
- Payments like Government subsidies can also be directly made through these wallets
- While some E wallets operate completely in a virtual mode, others use agents and franchisee to increase last mile presence
- While these are generally set up for person to business (P2B) payments, there is no restriction on person to person (P2P) and business to business (B2B) transactions.

Correspondent Banking Agents/ Fintech Service Providers - Characteristics

- **Correspondent banking agents (CBA)** are now playing a major part in spreading the message of financial inclusion by providing banking facility to those part of the society who are not easily reachable by traditional banking channels. In most cases they work exclusively for one bank or FIs,.
- **Fintech Service Providers (Fintech)** offer easy reach to individuals especially in marketing loans, credit card etc. by acting as an intermediary between banks and the customers. They can have tie up with multiple banks. Some of them also carry on the basic credit assessment on behalf of the banks

E Wallets/CBA/Fintech - Risks

Customer Identification

Source of funds

Transfer of funds

Rapidity

Use of agents/ franchisees

E Wallets/CBA/ Fintech - Risk Mitigation

- Proper and detailed background check for all such service providers
- Proper customer identification systems
- Updation of customer details at regular intervals based on risk perception
- Set limits of transaction in terms of amount and frequency, maximum balance
- Regular audits of the process and the records
- Any process gap or deliberate attempt to bypass the system should be dealt with swiftly and any delinquent party should be adequately penalized.

Cryptocurrencies - Characteristics



DECENTRALIZED



THE SUPPLY OF
MONEY IS REGULATED
BY SOFTWARE AND
THE AGREEMENT OF
USERS OF THE
SYSTEM.



HIGHLY DIVISIBLE



TRANSFERABILITY IS
QUICK AND
INSTANTANEOUS



CONFIDENTIALITY -
INFORMATION
CANNOT BE
UNDERSTOOD BY ANY
OUTSIDER



INTEGRITY -
INFORMATION
CANNOT BE ALTERED.



NON-REPUDIATION



AUTHENTICATION -
SENDER AND
RECEIVER CAN
CONFIRM EACH
OTHER

Cryptocurrencies – Risks

- Anonymity
- Limited identification and verification of participants
- Lack of clarity relating to AML / CFT compliance, supervision and enforcement
- Lack of a central oversight body
- Speed of transaction
- Used for illegal activities like ransomware
- Possibility of providing additional layering
- Criminals can exchange one such currency for other before converting them to fiat currency

Cryptocurrencies – Risk Mitigation

- Set up AML / KYC requirements for all such transactions
- Place limits on transaction size, frequency, or volume per customer or group of customers and users
- Monitor licensed money service businesses executing transfers and exchanges
- Customer or user identification
- Collection of Records of transactions
- Effective IT infra to track and understand movement of funds
- Set up a world wide body to monitor and control crypto currencies
- The countries have to recognize the importance and instead of banning them try to regulate these transactions.

Other Related Risks

- Online prepaid cards issued by various online market places
- Cash on delivery option popular in online marketplaces especially in markets like Asia
 - Normally these companies have an advanced customer analytics system, which may identify such behaviour

Common Red Flags

- Discrepancies between the information submitted by the customer and information detected by monitoring systems
- Individuals who hold unusual number of accounts with the same service provider
- A large and diverse source of funds used in the same accounts (eg. Bank transfers, credit cards, cash deposits at various locations etc.)
- Multiple bank accounts from banks located in different cities used to fund the same account
- Funding of account always done by third parties
- Numerous cash transactions just below the reporting threshold
- Multiple third party funding followed by immediate transfer of funds to unrelated bank account or withdrawal in ATM within a short period of time
- Multiple transactions from various geographies

Summary

- Emerging areas need to be regulated by the respective regulators
- Regulations should consider the intrinsic risk of the particular New Banking Systems
- **Mitigating measures**
 - Keep record of all transactions
 - Set limits on balance in accounts, frequency of use and transaction value
 - Monitor transaction flows on the system
 - Periodic check on all service providers

Case Study 1

Silk Road

- Launched in January 2011 as online black market for selling illegal drugs, weapons, stolen identity and other unlawful good.
- It brokered deals between several thousand drug dealers and unlawful vendors and to distribute unlawful goods and services to over a hundred thousand buyers, a third of whom are believed to have been in the United States.
- It allegedly generated total sales revenue of approximately USD 1.2 billion (more than 9.5 million bitcoins) and approximately USD 80 million (more than 600 000 bitcoins) in commissions for Silk Road.
- FBI shut the website in October 2013 and arrested the kingpin Ross William Ulbricht (alias Dread Pirate Roberts) and he was sentenced to a life in prison without possibility of parole.
- Further a **Silk Road II** was launched in November 2013 but that was shut down in November 2014 and the operators were arrested.

Case Study 2

Charlie Shrem

- Charlie Shrem was co founder of Bit Instant and founder of Bitcoin Foundation
- He was arrested and sentenced to two years in prison for laundering USD 1 million to 'deep web' black markets like 'Silk Road'. He was also fined USD 950,000/- i.e. profits made in these transactions
- He had transferred money to accounts maintained by Silk Road customers who in turn used it to buy illegal drugs
- He also advised Silk Road merchants on how to avoid detection and being included in 'AML Suspicious Activity Report'

Questions?

Thank You

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