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Recognition and Reporting of Suspicions

FATF Recommendation 13 contains the basic requirement for reporting suspicions in the following terms:

> *If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU).*

Recommendation 16 specifically extends this requirement to lawyers and accountants as follows:

> *The requirements set out in Recommendation 13 apply to all designated non-financial businesses and professions, subject to the following qualifications:*
>
> *a) Lawyers, notaries, other independent legal professionals and accountants should be required to report suspicious transactions when, on behalf of or for a client, they engage in a financial transaction in relation to the activities described in Recommendation 12(d). Countries are strongly encouraged to extend the reporting requirement to the rest of the professional activities of accountants, including auditing.*

Recommendation 11 concerns an additional requirement relating to vigilance in respect of large and unusual transactions:

> *Financial institutions should pay special attention to all complex, unusual large transactions and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors.*

Legislation in each particular country will determine whether financial institutions, professional firms and other relevant businesses are required to undertake compulsory transaction reporting (CTR), i.e. routine reporting of transactions above a specified financial threshold; or only to report knowledge or suspicion of money laundering (reporting of suspicions); or to do both.

Countries with CTR requirements already in place will also need to introduce the reporting of suspicions in line with the FATF recommendations.

12.1 Compulsory Transaction Reporting

The basis for compulsory transaction reporting is set out in Section 7.4. The reporting limits, the information to be provided and the types of financial institutions and business activities within the scope of the requirements will be laid down in the legislation. As with exchange control regulations, the system is mechanistic, strictly controlled and the penalties for breaching the requirements can be high.

12.2 The Obligation to Report Knowledge or Suspicion of Money Laundering

12.2.1 What is Meant by Knowledge?

Knowledge is now generally defined in legal statutes to be actual knowledge.

12.2.2 What is Meant by Suspicion?

Suspicion is personal and subjective and falls far short of proof based on firm evidence. Suspicion has been defined by the courts as being beyond mere speculation and based on some foundation, i.e.:

- *A degree of satisfaction not necessarily amounting to belief at least extending beyond speculation as to whether an event has occurred or not;* and
- *Although the creation of suspicion requires a lesser factual basis that the creation of a belief, it must nonetheless be built upon some foundation*

Because financial sector staff are not trained to be detectives, a person who believed that a transaction was suspicious should not be expected to know the exact nature of the criminal offence or that the particular funds were definitely those arising from the crime.

12.2.3 What is Meant by Reasonable Grounds to Suspect?

In addition to a criminal offence arising when actual knowledge or suspicion of money laundering is proved, FATF Recommendation 13 introduces the requirement to disclose information when reasonable grounds exist for knowing or suspecting that another is engaged in money laundering. This introduces an objective test for one of the ways in which proof of guilt may be established. This arises when there are proved to be facts or circumstances from which an honest and reasonable person engaged in a business in the regulated sector would have inferred knowledge or formed the suspicion that another was engaged in money laundering.

In order not to fall foul of the objective test, it is likely that staff within financial institutions and other designated businesses would need to be able to demonstrate, taking a risk-based approach, that they took all reasonable steps in the particular circumstances to know the customer and the rationale for the transaction or the instruction. However,

it should be noted that reasonable grounds to suspect cannot be based on generalities or stereotypical images of certain groups or categories of people being more likely to be involved in criminal activity.

The type of situations giving rise to suspicion will depend on an institution's customer base and the range of products or services. As some products and services are more vulnerable to money laundering than others, a risk-based approach might be appropriate. Illustrations of the type of situation that might give rise to reasonable grounds for suspicion in certain circumstances are:

- Transactions which have no apparent purpose and which make no obvious economic sense;
- Where the transaction being requested by the client, without reasonable explanation, is out of the ordinary range of services normally requested or is outside the experience of the firm in relation to the particular customer;
- Where, without reasonable explanation, the size or pattern of transactions is out of line with any pattern that has previously emerged;
- Where the customer refuses to provide the information requested without reasonable explanation;
- Where a customer who has entered into a business relationship uses the relationship for a single transaction or for only a very short period of time;
- The extensive use of offshore accounts, companies or structures in circumstances where the customer's needs do not support such economic requirements;
- Unnecessary routing of funds through third party accounts;
- Unusual investment transactions without any discernable profitable motive.

12.3 'Know Your Customer': The Basis for Recognising Suspicions

As stated in Chapter 11, satisfactory 'know your customer' procedures, e.g. identification evidence and effective use of 'know your business' information provide the foundation for recognising unusual and suspicious transactions. **Where there is a business relationship, a suspicious transaction will often be one that is inconsistent with a customer's known legitimate activities or with the normal business for that type of account.** Therefore, the first key to recognition is knowing enough about the customer and the customer's normal expected activities to recognise when a transaction, or series of transactions, is abnormal.

Sufficient guidance must be given to staff to enable them to recognise suspicious transactions. However, the type of situations giving rise to suspicions will depend on an institution's customer base and range of services and products.

Questions that staff might be encouraged to consider when determining whether an established customer's transaction might be suspicious are:

- Is the size of the transaction consistent with the normal activities of the customer?
- Is the transaction rational in the context of the customer's business or personal activities?
- Has the pattern of transactions conducted by the customer changed?
- Where the transaction is international in nature, does the customer have any obvious reason for conducting business with the other country involved?

Examples of what might constitute suspicious transactions are given in Appendix B. These are not intended to be exhaustive and only provide examples of the most basic ways by which money may be laundered. However, identification of any of the types of transactions listed should prompt further investigation and be a catalyst towards making at least initial enquiries about the source of funds.

Financial institutions might also consider monitoring the types of transactions and circumstances that have given rise to suspicious transaction reports by staff, with a view to updating internal instructions and guidelines from time to time.

12.3.1 Monitoring Procedures to Assist a 'Know Your Customer' Approach

Ongoing monitoring of customer activity, either through manual procedures or computerised systems, is one of the most important aspects of effective 'know your customer' procedures. The type of monitoring procedures introduced will depend on a number of factors, including the size and nature of the business and the complexity and volume of the transactions or activity. Financial institutions and professional firms can only determine when they might have reasonable grounds to suspect money laundering if they have the means of assessing when a transaction or instruction falls outside their expectations or when it falls within one of the circumstances that should normally give rise to further enquiry, such as those illustrated in section 12.2.3 above.

The extent of 'know your customer' information necessary both at the outset and later, and the transaction monitoring that is required, will need to be assessed taking a risk-based approach. However, the information requested and updated must be reasonable in the circumstances and regard must be had to a customer's right to privacy.

Higher risk accounts and customer relationships will generally require more frequent or intensive monitoring. For higher risk situations, e.g. private bank accounts and wealth management relationships, the following should be considered:

- Institutions and firms should assess whether they have adequate procedures or management information systems in place to provide relationship managers and MLROs with timely information. The type of information that may be needed includes trans-

actions made through a customer's account that are unusual, the nature of a customer's relationship with the firm and any readily identifiable connected accounts and relationships.

- The personal circumstances and sources of wealth and income for higher risk customers should be recorded, reviewed on a regular basis and, wherever possible, verified to check their legitimacy.
- Institutions and firms should seek to develop a clear policy, procedures and controls in respect of business relationships with customers who are known, suspected, or advised to be politically exposed person or with persons and companies that are clearly related or associated with them. As all PEPs may not be identified initially, and because existing customers may subsequently acquire PEP status, regular reviews for identifying PEP customers should be undertaken.
- Institutions and firms should consider reviewing the 'know your customer' information held on file and the activity for higher risk customers at least annually. Consideration should be given to centralising data in order to streamline the audit of higher risk customers.

12.4 Reporting Suspicions

Legislation will generally contain a provision for staff to report suspicions of money laundering to a money laundering reporting officer. Some financial institutions may choose to require that such unusual or suspicious transactions be drawn initially to the attention of supervisory management to ensure that there are no known facts that will negate the suspicion before further reporting to the MLRO or an appointed deputy.

All financial institutions, professional firms and designated businesses should ensure that:

- Each relevant employee knows the identity and responsibilities of the MLRO;
- Each relevant employee knows to which person he/she should report suspicions;
- There is a clear reporting chain under which those suspicions will be passed without delay to the MLRO;
- All internal reports reach the office of the MLRO, even if a supervisor or manager believes the suspicion is not valid.

It is normal under most money laundering legislation that once an employee has reported his/her suspicion to the 'appropriate person', he/she has fully satisfied their statutory obligation.

12.4.1 Internal Reporting Procedures

Reporting lines should be as short as possible, with the minimum number of people between the person with the suspicion and the MLRO. This ensures speed, confidentiality and accessibility to the MLRO. Once the reporting procedure has commenced, it is advisable for it to be followed through to the MLRO, even if the suspicion has been set aside by management within the reporting chain. In such cases the report should be annotated with the comments of the supervisor or manager giving the reasons that remove the suspicion. No person other than the MLRO, the deputy MLRO or the person nominated by the MLRO to consider internal reports should decide that a suspicion is without foundation and will not be reported to NCIS.

Larger groups may choose to appoint assistant MLROs within divisions or subsidiaries to enable the validity of the suspicion to be examined before being passed to a central MLRO. In such cases, the role of the assistant MLROs must be clearly specified and documented. All procedures should be documented in an appropriate manual and job descriptions should be drawn up.

All suspicions reported to the MLRO should be documented (in urgent cases this may follow an initial discussion by telephone). In some organisations it may be possible for the person with the suspicion to discuss it with the MLRO and for the report to be prepared jointly. In other organisations the initial report should be prepared and sent to the MLRO.

Reports from staff should include:

- The name of the reporting person, department or branch;
- Full details of the customer;
- As full a statement as possible of the information giving rise to suspicion;
- The date when the person with the suspicion first received the information and became suspicious; and
- The date of the report.

The MLRO should acknowledge receipt of the report and at the same time provide a reminder of the obligation to do nothing that might prejudice enquiries, i.e. 'tipping off'. All internal enquiries made in relation to the report, and the reason behind whether or not to submit the report to the authorities, should be documented. This information may be required to supplement the initial report or as evidence of good practice and best endeavours if, at some future date, there is an investigation and the suspicions are confirmed.

12.5 The Role of the Money Laundering Reporting Officer

The type of person appointed as MLRO will vary according to the size of the financial institution and the nature of its business, but he or she should be sufficiently senior to command the necessary authority. Larger institutions may choose to appoint a senior member of their compliance, internal audit or fraud departments. In small institutions, it may be appropriate to designate the chief executive or chief operating officer. When several subsidiaries operate closely together within a group, there is much to be said for appointing an overall group MLRO.

Legislation may impose on the MLRO a significant degree of responsibility. He/she is required to determine whether the information or other matters contained in the transaction report received give rise to a knowledge or suspicion that a customer is engaged in money laundering.

In making this judgement, he/she should consider all other relevant information available within the institution concerning the person or business to whom the initial report relates. This may include a review of other transaction patterns and volumes through the account or accounts in the same name, the length of the business relationship and referral to identification records held.

If after completing this review, he/she decides that the initial report gives rise to a knowledge or suspicion of money laundering, then he/she must disclose this information to the appropriate authority.

The MLRO will be expected to act honestly and reasonably and to make their determinations in good faith utilising all the information available. Providing that the MLRO or an authorised deputy does act in good faith in deciding not to pass on any suspicions report, there should be no liability for non-reporting if the judgement is later found to be wrong.

12.5.1 Formal and Documented Deliberations of the MLRO

If the suspicion raised is an 'open and shut case', the MLRO should report it immediately. In other cases the MLRO is required to evaluate the substance of the suspicion by way of confidential enquiry within the organisation. The MLRO is not required to undertake any enquiries with other organisations. The MLRO may request an appropriate person to make discrete enquiries of the customer, taking care to avoid any risk of tipping off.

Suspicion falls far short of proof based on firm evidence. It may, however, have substance in many ways, and may be based on the nature of the business being offered, an unusual transaction, etc.

The MLRO's enquiries must therefore be suited to the circumstances of the case. As a basis of approach, it is sensible for the MLRO to enquire into:

- Client identification and location;

- Type of business or pattern of business;
- Length of business relationship;
- Source and destination of funds; and
- Existence of earlier suspicions.

After making the enquiry, the MLRO must decide whether or not to make a report to the authorities.

After the enquiries have been undertaken, the decision and the reasoning behind it should be documented and retained securely. This information will be required either for the report to the authorities, or as evidence of good practice and best endeavour, if at some future date there is an investigation and the suspicions are confirmed.

Any documents called for by the MLRO as part of the enquiry should be listed and retained.

12.6 Reporting Suspicions to the Authorities

National legislation will determine the central reporting point within the various agencies. This is usually a financial intelligence unit within law enforcement.

If there is a standard report form, it should be used whenever possible. On all occasions when a report to the authorities has been made by telephone, it should be confirmed in writing.

The reporting institution should provide as much information as possible with regard to the suspicion, i.e. give the full story or as much as is known.

The information provided might usefully be structured to show:

- Information and suspicion initially reported to the MLRO;
- Enquiries undertaken by the MLRO; and
- The MLRO's reason for disclosing.

'One line' explanations of suspicion with reference to documents attached are not helpful; those receiving the reports may not be financial experts, and the documents themselves will often require interpretation.

12.6.1 Reporting Suspicions – The Tax Smokescreens

Initially, anti-money laundering legislation was confined to the proceeds of drug trafficking. The international move to 'all crimes anti-money laundering legislation' has changed the scope of crimes which are reported, although many countries do not include tax evasion within the scope.

Criminals soon learned that if they explained that an unusual or large cash transac-

tion was being handled that way 'for tax reasons', financial sector staff asked no further questions. Consequently, the interpretative note to Recommendation 13, states:

> *In implementing Recommendation 13, suspicious transactions should be reported by financial institutions regardless of whether they are also thought to involve tax matters. Countries should take into account that, in order to deter financial institutions from reporting a suspicious transaction, money launderers may seek to state inter alia that their transactions relate to tax matters.*

12.6.2 Secure Record Retention

All copies of reports and records should be retained and stored securely. The minimum requirement is lockable (and locked) filing cabinets with known key distribution.

It is suggested that the original of all internal reports should be filed upon receipt, with a copy for the MLRO's use. The MLRO's own 'suspicion evaluation record' should be treated similarly: the original should remain on file and any subsequent work should be done on a copy.

Records of suspicions raised internally but not disclosed should be retained for five years from the date of the transaction/suspicion.

Records of suspicions passed on to the reporting authority, but which the reporting authority have not advised are of interest, should be retained for a similar period.

Records of suspicions passed on to the reporting authority which are of interest should be retained until the authority has advised that they are no longer needed. If this causes any difficulties, the difficulties should be shared with the reporting authority or the investigating officer.

12.6.3 Protection of Staff Against Breach of Confidentiality

Normally financial sector staff would not divulge information concerning the accounts of transactions of their customers to third parties. Often banking secrecy legislation has rendered such action a criminal offence. The FATF has recognised this important issue and, as part of the national strategy FATF Recommendation 14 states that:

> *Financial institutions, their directors, officers and employees should be:*
>
> *a) Protected by legal provisions from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the FIU, even if they did not know precisely what the underlying criminal activity way, and regardless of whether illegal activity actually occurred.*

12.7 Confidentiality of Disclosures – Tipping Off

One of the most important requirements of a suspicious transaction reporting regime is that reports made are treated in absolute confidence. It is essential that the customer, or

prospective customer, should never become aware that a report has been made. One of the reasons for this is to guard against the risk of tipping off a customer that his/her account or transactions is/are under investigation. Tipping off is a criminal offence is many countries.

FATF Recommendation 14 b) states that:

Financial institutions, their directors, officers and employees should be

b) prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU.

Internal confidentiality of reports is also important and, for this reason, the internal reporting chain should be kept as short as possible. The more people in the chain who are aware of a suspicious disclosure, the greater the chance of tipping off either deliberately or inadvertently.

In most countries, the confidentiality of disclosures will normally be honoured by law enforcement during their investigations. If the suspicion is proved to be valid, law enforcement will serve a court order on the financial institution to obtain the information required to enable a prosecution to be developed. It is the evidence that will usually be presented in court. However, this cannot be guaranteed if the original disclosure is considered to be essential to the case.

12.8 Liaising with the Investigating Agencies

The MLRO will normally be appointed as the central point of liaison with the authorities concerning disclosures and issues arising out of them.

In the event that the disclosure report is of immediate interest to the authorities, either because an investigation is already underway or an arrest is imminent, or because there is concern that the suspected finds may be paid away, the authorities may make a specific request concerning the account or the particular transaction. Permission to undertake the transaction or continue operating the account may in fact be required following a suspicious disclosure.

In the event that a financial institution wishes to close out an account or a relationship following one or more suspicion reports, the MLRO should liaise with the investigating agencies and agree what course of action should be taken, or what explanation can be given to the customer to avoid tipping off the customer that a report has been made.