

Combating Money Laundering in Malaysia: Current Practice, Challenges and Suggestions

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ABSTRACT

Money laundering is a global threat to financial institutions especially the banking industry since it may weaken and expose the institutions to serious risks such as operational, legal and reputational risks. Against this background, the objectives of the study are to analyse the current practice on the prevention of money laundering in selected banks in Malaysia, to investigate the barriers to the implementation of effective Anti-Money Laundering (AML) regulations and to identify the ways to improve the implementation of AML in Malaysia. The study was conducted using qualitative method via interviews with 6 respondents from 6 Islamic & Conventional banks in Malaysia. The preliminary findings showed that the banking institutions' current practice is fully complying with AML regulations under the AMLA 2001. The findings also demonstrated that the barriers to effective implementation of AML regulations are in line with those of previous study, which are lack of expert staff as the top factor together with an additional factor, which is lack of customers' education and awareness on money laundering. Hence, to improve the implementation of AML in Malaysia, this study suggested to firstly strengthen the collaboration with government and relevant authorities to ensure strong enforcement action is taken against the criminals. Secondly, collaboration of BNM with banks and local media to increase public awareness and education on financial crime. Thirdly, to invest on employee training, upgrading system management as well as sufficient resources in compliance unit and finally to intensify the "Three Lines of Defence" in Bank Risk Management.

Keywords: Money laundering; AML; financial crime; banking institutions

INTRODUCTION

Money laundering is an endless phenomenon. In past few decades, the number of money laundering transactions on financial markets has tremendously increased. Globally, the estimated amount of money laundered is roughly at 2% to 5% of global GDP or approximately in excess of USD 2 trillion in a year (United Nations Office on Drugs and Crime 2017). This financial crime becomes a global threat and affects the financial institutions especially the banks. It might weaken the soundness of the banking institutions and exposed them to serious risks especially reputational, operational, legal and financial risks. In Malaysia, the central bank (Bank Negara Malaysia) in 2015 has successfully acquired six court orders requiring individuals or entities and prosecuted 182 criminal offences regarding financial illegal activities. Additionally, 26 new investigations have been opened during the year due to regulatory breaches and suspected illegal activities. Two Islamic banks have been compounded for RM1.05 million as the banks failed to comply with AMLA orders under Section 48 and Section 50 (IFSI Stability Report 2016). Due to the seriousness of money laundering and financing terrorism, large sums of money have continued to be spent and invested on improving anti-money laundering (AML) activity (KPMG 2014). The cost of compliance continued to rise as

regulations widened in scope and complexity. By 2017, the global spending on AML compliance was more than \$8 billion and set to grow more by the following year (PwC 2016). Continuous improvement in AML is a huge responsibility and a challenge to senior management to meet regulatory requirements.

Money laundering is done by criminals regardless of background. Workers in the private or government sectors are not excluded from financial crimes especially those from Special Category Customer (SCC) such as Politically Exposed Persons (PEPs) and connected persons, government and state owned bodies, arm dealers, non-governmental organisations and gaming/gambling organisations. Berita Harian on 10 July 2018 has highlighted odious debt issue. Odious debt is an unauthorised debt made by the previous government for personal gain, which then becomes a burden to the new government and people. One of the cases involving odious debt is the case of Mobutu Sese Seko, a former President of Democratic of the Congo who had misused \$4 billion into his personal account during his reign. This odious debt involved the issue of money laundering, fraud and corruption. The effect of this odious debt was the assets involved were freeze under various oversight bodies including AMLA and Office of Foreign Assets Control (OFAC). The assets will not be returned except under

certain circumstances (A.Ghaffar & Hakimah 2018). The involvement of PEPs in financial crimes has been widely reported in local and international media. Surprisingly, although AMLA 2001 has been implemented and deemed as an extremely powerful legislation in Malaysia (Salleh Buang 2018), financial crimes are still occurring. Thus, this study explores whether or not the current practice in banking institutions in Malaysia are parallel with AMLA 2001. Specifically, the objectives of this study are as follows: 1) to analyse the current practice in preventing money laundering among selected banks in Malaysia, 2) to investigate whether or not there are barriers in implementing effective AML regulations, and finally 3) to identify ways to improve the implementation of AML in Malaysia. The findings of this study are hoped to help the regulators and the practitioners in improving the implementation and framework of AML especially for Islamic banking institutions.

Following the objectives in this study, the following study questions were developed:

1. What are the current practices on the prevention of money laundering in banking operations?
2. What are the challenges to implement effective AML regulations and what is the top factor of the barriers?
3. How can financial institutions in Malaysia improve the AML implementation?
4. Does Islamic banking need specific AML regulations?

This study is structured as follows: Section 2 provides the literature review, Section 3 presents the study methodology and Section 4 demonstrates the findings and discussions. Meanwhile, the last section of this study presents the conclusion and implications.

LITERATURE REVIEW

A group of studies have been carried out to delve into several issues regarding compliance measure of money laundering and how the money is laundered. Jamaliah et al. (2013) claimed that commercial banks in Malaysia are serious in carrying out their responsibilities in money laundering and terrorism financing compliance measures. However, further study by Jamaliah et al. (2013) showed that the actual implementation level by the banks is significantly lower as there is a significant difference between the perceived important level and the actual anti-money laundering prevention measures level adopted. The results also signified that the supports from expert staff, top management, technology infrastructure and existence of political influence was the top factor to ensure the success of money laundering prevention measures implementation (Jamaliah et al. 2013).

Normah et al. (2015) examined the level of awareness as well as perceived impacts and views on the AML/CFT requirements among Malaysian accountants as one of the non-financial business and professions (DNFBPs). The study showed that most of the respondents are aware

on the anti-money laundering requirements and agreed that there should be more information sharing between the reporting institutions and the most effective way to prevent and detect money laundering is through the enforcement by the law enforcement authorities (Normah et al. 2015).

Aspalella (2015) emphasised the importance of corporate governance in AML measures. The study had focused on the roles and responsibilities of senior management and board of directors of banking institutions in implementing relevant and effective AML measures to ensure that banks are operated in a safe and sound manner. An efficient AML measure with good governance will reduce the prevalence of money laundering activities (Aspalella 2015). Besides, banks can benefit on improved reputation and competitive conditions. An example of good governance is ensuring that all employees from all levels understand the money laundering risks by investing on continuous training and human resource development. A weak governance will expose banks to money laundering risks and cause them to be subjected to legal action under AMLA 2001 (Aspalella 2015).

Nadim et al. (2016) highlighted the necessity to have specific AML for Islamic Banking due to no common understanding of money laundering/terrorism financing associated with Islamic finance. The authors urged the FATF, the Islamic finance standard-setters and national regulators to seek a great understanding of the specific money laundering/terrorism financing risks that may arise in Islamic finance and to develop an appropriate AML framework. However, IFSI Stability Report (IFSB) 2016 mentioned that the standard-setting bodies in the Islamic financial services industry (IFSI) have not yet found adequate reasons to prioritise standard setting work in the AML/CFT domain. This was because the money laundering/terrorism financing risks faced by Islamic financial services (IIFS) are not very dissimilar from those faced by conventional financial institutions (IFSB 2016). IIFS also applied the common regulatory regime into their businesses and very dissimilar compliance and risk management systems, control and processes to address AML/CFT risks with those employed by conventional financial institutions.

Most previous studies have been conducted using quantitative method focusing on the issues of compliance measure of money laundering, level of awareness and perceived impacts and views on AML requirements among non-financial business and professions. Therefore, using qualitative method via interview, this study analysed whether or not the actual practice and implementation of AML in banking institutions are parallel with AMLA requirements, the new challenges they face and how to overcome those challenges. This study also collected the respondents' views on the need of specific AMLA for Islamic banking. The findings will contributed to the understanding on the current practice of AMLA in banking operations, identify the challenges to effective

implementation the AMLA and suggestions to improve the implementation.

AN OVERVIEW OF MONEY LAUNDERING

The Malaysia Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 defined money laundering as:

“Any person who directly or indirectly engages in a transaction involving illegal activities or instrumentalities of an offence; acquiring, receiving, possessing, impersonating, transferring, converting, exchanging, bringing, disposing of or using proceeds of an unlawful activities of instrumentalities of an offense; bring into or removes from Malaysia proceeds of an illegal activity or instrumentalities of an offense; conceal, disguise or obstruct the establishment of the actual nature, origin, location, disposition, movement, rights, or possession, results of an unlawful activity or instrumentalities of an offense.”

According to the Financial Action Task Force (FATF), money laundering can be referred to as a process whereby criminals disguise the ownership and control of the original proceeds of criminal conduct by making such proceeds to appear coming from a legitimate source.

The main purpose of money laundering activity is to make “dirty money” legal and to take the profit out of crime. Money laundering process has been basically described by three distinct stages namely placement, layering and integration. In the first stage, the proceeds from the illegal activities are introduced into the financial system. The large amounts of cash are broken up into a smaller funds that are then directly deposited into a saving account or by purchasing a few monetary instruments that are later collected and deposited into accounts at another bank or location. Usually, launderers prefer to move their funds through a stable financial system (FATF 2009).

In the second stage, layering takes place after the funds have been safely deposited in the financial system. Layering is sometimes defined as structuring. This is the most complex stage where the funds often involve international movements. The main objective of this stage is to erase the sources of the illicit money. Criminals are accomplished through a series of wire transfers into different accounts or trading in the financial markets or through investment in shell operations (Aspalella 2008). During the placement and layering stages, money laundering has the greatest impact on banks and financial institutions. This is because the illegal funds have been laundered but are not yet fully integrated into the economy (Aspalella 2008).

Integration is the final stage in money laundering where the funds re-enter the legitimate economy by providing a legitimate-appearing explanation for the funds. Examples of integration include buying business, investing in luxury goods, buying commercial or residential property and business ventures. Money laundered is attracted to use the banking system as one of the most important vehicles for financial crime activities because banks are

convenience, accessible and secure. They make use of the whole range of modern international financial services and wire transfers remain a crucial tool in laundering process (Aspalella 2008).

ANTI-MONEY LAUNDERING REGULATORY FRAMEWORK

Many international and local communities have cooperated to put a great exert in combating money laundering and terrorism financing issues. In general, the national AML framework has been developed through the influence of Financial Action Task Force (FATF), Asia Pacific Group on Money Laundering (APG), the United Nations and the European Union through Recommendations and Directives. Some measures such as the AML legislation and setting up Financial Intelligence Unit (FIU) are taken from FATF 40 Recommendations as a drivers for the uniformity of approach (Jamaliah et al. 2013).

The recommendations are divided into four parts. Part One outlines the legal systems with a focus on the money laundering criminal offense, Part Two covers the financial institutions and non-financial business and professions aimed at preventing money laundering and financing of terrorism. Meanwhile, Part Three provides the recommendations to deal with key institutional measures in AML system and the transparency of legal persons and arrangements. Part Four deals with international cooperation in relation to investigation, prosecution and related proceeding of money laundering and terrorist financing (Aspalella 2008).

The variety of financial services offered domestically and offshore in Malaysia may be misused by those intending to launder money or support terrorism. Malaysia financial institutions are vulnerable to abuse by narcotic distributors, terrorist financiers and criminal elements (Bala & Haemala 2008). Hence, Malaysia has put efforts in combating money laundering by introducing the enactment of Anti-Money Laundering, Anti-Financing Terrorism and Proceeds of Unlawful Activities 2001 (AMLA) consisting eight parts, 93 sections and two schedules. All the requirements must be complied by the financial sectors to effectively combat money laundering and terrorism financing activities.

AMLA REQUIREMENTS

All banking institutions need to comply with anti-money laundering requirements in AMLA focusing on Customer Due Diligence (CDD), record keeping, on-going due diligence and business relationship monitoring, suspicious transaction reporting and internal controls.

Referring to AMLA Section 16 for CDD, it is a requirement for all banks to conduct CDD as a bank is prohibited to open and operate any anonymous account nor to conduct any business relationship or transaction involving false or erroneous name. Hence, the banks shall undertake CDD measures when establishing or conducting relationship with new or existing clients, any transaction,

any new account or other facilities to detect any reasonable doubt and suspicion of money laundering or terrorism financing offence. The CDD helps the banks to further understand their customers, which whom they are making a business relationship by gathering details information on what they do and the reasons their customers require banking services. Based on the information gathered, the banks analyses the customers' level of money laundering from their risk profile to help banks to decide whether to enter, remain or terminate the relationship with their clients (FATF 2014).

Under the retention of records AMLA Section 17 for record keeping, a bank must maintain any record under Part IV for a period from the date an account is closed, which is not less than six years or when the transaction has been completed or terminated. This section is in line with FATF recommendation under Recommendation 11 to maintain the record not less than five years for all required records from domestic and international on the transaction to enable them to comply promptly with information requests from the competent authorities (The FATF Recommendations 2012).

Referring to the FATF Recommendation 10 regarding on-going due diligence and business relationship monitoring, all documents, data or information collected under the CDD process by the banks must be kept updated and relevant by conducting review of existing records especially for the category of high risk customers. This requirement must be complied by conducting enhanced monitoring of business relationship and transaction surveillance conducted throughout the course of that relationship to ensure that the transactions being conducted are consistent with the bank's knowledge of the customer, their business and risk profile as well as the source of funds.

Furthermore, referring to AMLA Section 14 for suspicious transaction reporting, financial institutions should swiftly report to the competent authority if they triggered a transaction exceeding RM 50,000 or any amount specify, any transaction or property in which the identity of the person is involved, any circumstances

that concern any officers or employees of the institutions reason to suspect that the transaction involved proceed of an unlawful activity or related or linked to, is used or is intended to be used for any terrorist act/ group/ entity or person who finances terrorism.

Meanwhile for internal controls, as referred to AMLA 2001, Section 19 Compliance Programme states that a financial institutions must adopt, develop and implement internal programmes, policies, procedures and controls to safeguard and detect any offence under this Act. This programme is to ensure that employees have a high standard of integrity and a system to evaluate their personal, employment, and financial history and to update on-going employee training programmes, specify employee responsibilities and an independent audit group to check the compliance with such programmes. All branches and subsidiaries in and outside Malaysia must implement the compliance programmes. Besides, financial institutions should place a compliance officer at management level in every branch and subsidiary to conduct internal programmes and procedures, as well as to retain proper maintenance of records and STR. Last but not least, financial institutions should designate audit functions to evaluate such policies, procedures and controls to examine compliance with the measures taken by the financial institutions to comply with AMLA.

METHODOLOGY

This study was conducted using qualitative method to investigate the barriers in implementing effective Anti-Money Laundering (AML) regulations and to identify ways to improve the AML's implementation. This study conducted interviews with 6 respondents to gain detailed information regarding AML operations in banking institutions in Malaysia.

The interviews were done in Malay and English languages mostly at branches of the respective banks located in Klang Valley. This study consists of three objectives; hence, the interview questions were divided into three parts known as Part A that analyses the current

TABLE 2. Profile of Participants

No.	Respondents	Types of Bank	Bank Name	Position
1.	Mr. C	Conventional with Islamic Window Local Bank	Bank B	Branch Manager
2.	Mr. V	Conventional with Islamic Window Foreign Bank	Bank C	Manager of Financial Crime and Compliance
3.	Mr. B	Conventional with Islamic Window Foreign Bank	Bank H	Assistant Manager of Financial Crime and Compliance
4.	Mr. F	Full fledge Islamic Bank	Bank I	Branch Manager
5.	Mr. J	Conventional with Islamic Window Local Bank	Bank M	Branch Manager
6.	Mr. K	Development Bank	Bank R	Branch Manager

practice on the prevention of money laundering, Part B that investigates the barriers in implementing effective anti-money laundering regulations and Part C that defines the ways to improve the implementation of anti-money laundering in Malaysia. The interviews were transcribed and analysed using content analysis.

The interview process lasted 60 to 95 minutes and was guided by the following protocols:

Current Practice of AMLA

1. How does your bank conduct customer identification and verification?
2. What types of information does your bank currently gather as a part of its CDD process?
3. What kind of scenario that requires Enhance Due Diligence (EDD)?
4. Does your bank store CDD information as paper files/ images or in an electronic format?
5. How long does the CDD information can be kept with the bank?
6. How frequent does your bank updates its customer profile?
7. Is your bank's CDD information updated on a regular basis or only when there is a triggering event?
8. Are adverse media searches performed as part of your bank's CDD?
9. How does your bank identify, investigate and deal with suspicious transaction/unusual activity?
10. Has your bank developed an effective control structure?
11. Does your bank provide complete training awareness programme to ensure that its staff adhere to policies, procedures and to limit and control risks?
12. Do you think investment in AML activity is important?

Barriers to effective implementation of AML regulation

13. What are the challenges to effective implementation of AML regulations?
14. What are the top factors of the barriers?

How to improve the implementation of AML in Malaysia

15. Do you feel AML practice at your bank is able to fight money laundering and terrorist financing?
 16. In your opinion, how can the financial institutions in Malaysia improve the AML implementation?
 17. Is there any difference on AML practice between Islamic banking and Conventional banking?
 18. Do you think we need specific AML regulations for Islamic banking?
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RESULTS

The respondents were provided with a list of anti-money laundering requirements in AMLA that has to be complied by all the banking institutions, focusing on Customer Due Diligence (CDD), record keeping, on-going due diligence and business relationship monitoring, suspicious transaction reporting and internal controls. They were required to give their point of view and elaborate further on each question listed. Table 3 summarises the interview analysis for three objectives studied.

THE CURRENT PRACTICE OF AMLA IN BANKING INSTITUTIONS CUSTOMER DUE DILIGENCE

From the interview, it was found that the requirement for CDD has been successfully complied by all respondents. In terms of opening a new account, Mr. F, Branch Manager of Bank I, explained that during the on-boarding of open account, a bank needs to conduct the customer identification and verification where a customer needs to fill up a Know Your Customer form and to provide the identity card (IC) for local residents. The customers need to fill up all the required personal details such as customer name, date of birth, country of resident, nationality, occupation / position, purpose of account opening and source of income. Meanwhile, an additional document is needed for foreign customers to open an account which they must provide passport, working permit or student identity card and confirmation letter from employer or university if they are working or studying in Malaysia. Every banks have built-in anti-money laundering system to verify customer information. The screening process is important to mitigate financial crime risk.

The respondents also explained that the banks do not require different CDD information from customers for opening other new accounts. However, additional information and documents are required from customers for financing products and for business/corporate customers. For financing line products, customers must provide additional documents such as salary statement and Employees Provident Fund (EPF) statement. This is required by the banks to ensure a valid source of income through the amount of EPF and SOCSO contribution. The banks need to validate all the information for risk profiling purpose and to avoid non-performing loan (NPL) risk. For business/corporate customers, they must provide additional documents of board resolution (BR), company's registration document from Companies Commission of Malaysia, Board of Directors information and other relevant forms. The CDD process must be conducted to all persons involved in a company, which is the board of directors.

CDD must be performed to all customers; individual, corporate customers, club/ societies/ charities and non-face-to-face business relationship. However, banks are required to implement Enhance Due Diligence (EDD) when the combination of product or service and customer is considered as a greater risk. This EDD is required to alleviate the increased risk. There are some situations that can be considered as high risks including during the on-boarding of opened account. The EDD is conducted by banks if customers provide insufficient information because they are reluctant to share their information and banks are not satisfied with the information provided, or if customers are classified as higher risk customers such as high net worth individuals, special categorised customer (SCC), individuals or entities listed under sanction as well as living/doing business in the high risk countries defined by high risk nature of their business or high risk product requested by customers. The second situation is when the account has been opened by the bank. All respondents

TABLE 3. Summary of interview analysis

Respondents/ Issues	Bank B	Bank C	Bank H	Bank I	Bank M	Bank R
Current Practice of AMLA:						
Customer Due Diligence	✓	✓	✓	✓	✓	✓
Record Keeping	✓	✓	✓	✓	✓	✓
On-going Due Diligence and Business relationship monitoring	✓	✓	✓	✓	✓	✓
Suspicious transaction reporting	✓	✓	✓	✓	✓	✓
Internal controls	✓	✓	✓	✓	✓	✓
Barriers to effective implementation of AML regulation						
Customer education and awareness	✓			✓	✓	✓
Existence of political influence	✓					
Expert staff		✓	✓	✓	✓	✓
Budget allocation		✓	✓	✓		
Technology infrastructure		✓	✓	✓		
Changing and unclear regulatory expectations			✓	✓		✓
Time and effort				✓		✓
How to improve the implementation of AML in Malaysia						
Strengthen the collaboration with government and relevant authorities				✓	✓	
Information sharing among the bank institutions on money laundering issues	✓					✓
Increase public awareness and education on financial crime	✓	✓	✓	✓	✓	✓
Invest on employees training and upgrade system management		✓	✓	✓	✓	✓
Provide sufficient resources in compliance unit			✓		✓	
Intensify the “Three Lines of Defence”		✓	✓			

gave similar explanations regarding this situation. Once the account is active, banks will monitor the account regularly. The EDD is performed if they identified any unusual transaction leading to suspicious transaction or if customers performed transactions with large amount.

“...if customers perform a transaction of large sums via Telegraphic Transfer to another person or entity, we will conduct the due diligence with customers to gather the information regarding the source of funds, beneficiary details (beneficiary name, address and account to be transferred), the purpose of transaction and invoice purchase. This is important to make sure that the transaction is made to the correct party for the correct purpose and to avoid money laundering / financing terrorism. We need to be careful with the payments made by customers especially for business purpose as money laundering can be hidden by business activity...” - Mr. F from Bank I.

High risk customers do not always mean that they will be involved in any financial crime, but there is a possibility for them to be involved. Thus, banks need to strictly perform the screening process to protect themselves from money laundering risks and to mitigate the risk efficiently.

The degree of risk may be diverse in nature and therefore, some risks may be higher than the others. The CDD will help banking institutions to clearly understand the different level of inherent risks and appropriate controls applied to each, ensuring the effective management of these risks.

RECORD KEEPING

All records collected through CDD measures such as photocopies of identification documents namely passports, driving license, visa or similar documents, business files and correspondence should be kept by the banks accordingly. Mr. J from Bank M explained that the bank stores the CDD information as paper files and in an electronic format in bank’s central system, which can be only accessed by authorised persons. The information is secure and protected by Personal Data Protection Act (PDPA) 2010.

Other respondents, Mr. F, Branch Manager of Bank I and Mr. K, Branch Manager of Bank R, also have similarity regarding record keeping.

“...For the period of time for record keeping, the records will be kept by the bank as long as the customers’ accounts are active and not in close status. Once their accounts have been closed and completely terminated, the records will be kept for at least 7 years from the date an account is closed...” Mr. F from Bank I

However, referring to the Central Bank of Malaysia Standard Guidelines on AMLA/CFT, the records will be kept out beyond the required retention period until it is confirmed by the Financial Intelligence Unit at the Central Bank if the records are subjected to ongoing investigations or prosecution in court. The records should be disposed once they are no longer needed.

ON-GOING DUE DILIGENCE AND BUSINESS RELATIONSHIP MONITORING

Based on the explanation by the respondents, all the banks have implemented the requirement by conducting ongoing CDD and updating the CDD information on a regular basis and when there is a triggering event.

“...at branch level, to update the CDD information, it will come from three sources: first, the customer walk-in to branch to update his personal information; second, instruction from headquarters to update the outdated customer’s information after obtaining the information from customer or if customer is tagged under high risk. Also, if there is a triggering events such as unusual high volume of transactions...” Mr. J from Bank M.

Mr. F from Bank I and Mr. C from Bank B also mentioned similar process of on-going due diligence as Mr. J. ongoing CDD and monitoring are able to help the banks to delve into and analyse the economic background, unusual transaction or business relationship, to identify related money laundering and terrorism financing transactions and also any changes to customer profiles. The changes in customer behaviour, products selection and the amount of money involved must be updated, which may require additional CDD measures.

Mr. B from Bank H explained that the bank has performed adverse media searches as part of their CDD to identify reputational risk on the customers as well as financial crime risk. This has been confirmed by another 5 respondents that their banks perform adverse media searches for high net worth and high risk customers. Certain banks employ the adverse media searches at branch level and headquarters while others only perform it at headquarters level by special department. This additional search is part of EDD to inform the individual / entities on customer risk assessment.

As part of customer risk rating in general, all financial institutions rely on customer statements of activity, actual activity combined with public source of information and other few criteria such as geographic location, political exposure and financial stability. All respondents explained that the customer risk rating will be based on their risk assessment model derived from many criteria especially geographic location and financial stability. For financial

institutions, this criteria is very crucial especially for high risk customers as the risk rating will be able to help the banks to assess their customers and identify the risk appetite. The banks need to particularly check whether the customers or entities are listed under sanctions or high risk countries based on their background information (country of residents, nationality, nature of business and occupation). Sanctions restrict and prohibit the banks to engage in business and other economic activities with certain countries, individuals, entities and industries (BNM 2015).

SUSPICIOUS TRANSACTION REPORTING

Based on the guidelines, all respondents explained that their financial institutions are aware about that and have specific guidelines for Suspicious Transaction Report (STR). Every employee at branch, head office or bank business shared service centre for every level shall escalate any customer’s suspicious transaction or unusual activity to their manager for further action. The STR report flow is displayed as in Figure 1:

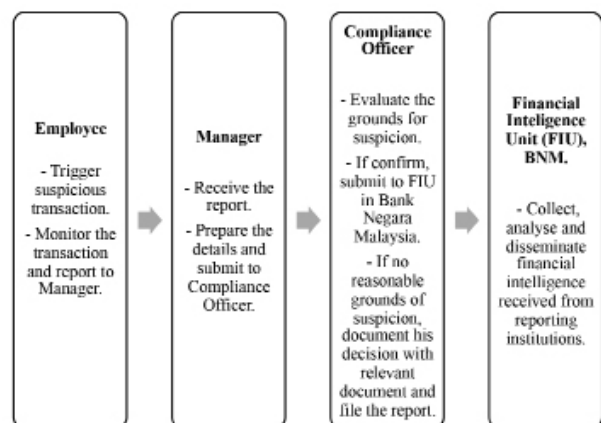


FIGURE 1. Suspicious Transaction Reporting Process

*Source: BNM, 2015

“...If an employee suspect any unlawful activity from customer’s transaction, he must report the STR to the manager without any hesitation. It becomes the manager’s responsibility to file the details and report to Compliance Officer in head office to evaluate the grounds for suspicion...” Mr. B from Bank H

Upon receiving the internal STR, the Compliance Officer should evaluate the grounds for suspicion and should promptly submit the STR to the Financial Intelligence Unit (FIU) in BNM if the suspicion is confirmed. However, if he decides that there is no reasonable ground for suspicion, the Compliance Officer should document his decision with relevant supporting documents and file the report. It is an offence for any employees in the financial institution to “tip off” / inform the person suspected of money laundering that a lawful disclosure has been made or to prejudice any investigation arising from the disclosure.

INTERNAL CONTROLS

From the interview with respondents, all the banks comply with the Section 19 and are focus on strengthening the procedures and policies, internal audit for compliance checking and on-going employee training programmes at all level. According to Mr. F, Mr. B, and Mr. C, similar explanations were given regarding the escalation on important updates and training programmes.

“...A briefing will be held daily or twice a week by manager to brief the latest updates on anti-money laundering procedures and policies, current news or issues within the banks, any financial crimes, fraud and social engineering attempts and etc...” Mr. F from Bank I

“...A prompt escalation to all employees is important to ensure that they received the latest information and updates. Besides briefing, the escalation will be sent through electronic media such as e-mail, intranet and advertisement within the banks...” Mr. B from Bank H

“...Every employee needs to complete the mandatory electronic learning (E-learning) assigned to them, which will become a part of their objectives. An action will be taken by the Human Resource Department if any employees did not complete the E-learning...” Mr. C from Bank B

All the initiatives programmes are to ensure that the employees adhere to the policies, procedures and process to limit and control risks. Therefore, investment in anti-money laundering programs is important for the banks to effectively implement the procedures and policies. All the respondents believe that their banks’ total investment in anti-money laundering activity had increased compared to previous years.

THE BARRIERS TO EFFECTIVE IMPLEMENTATION OF AML REGULATION

In investigating the barriers to effective implementation of anti-money laundering regulation, Jamaliah et al. (2013) found that the reasons for low level of money laundering measures adopted is due to the lack of top management support, expert staff, technology infrastructure, political support and inadequate allocation of resources. The findings of this present study were in line with those of the previous study. All respondents agreed that the factors mentioned in previous study are the challenges that banking institutions face to implement effective AML. A lot of efforts and time are needed for banking institutions to comply with AML regulations. However, there was an additional factor discovered in this study, which is customer education and awareness. This factor was due to customers’ lack of understanding and awareness regarding anti-money laundering, causing them to be reluctant to share information during the CDD process. Among of all, lack of expert staff is the top barrier to effective implementation of AML.

“...to implement effective regulations, we must have sufficient and strong manpower. We need expert staff to manage the workloads, analyse data, investigate, handle inquiries regarding regulations, improvise internal procedure and policies and so on. Expert staff are needed in every level at our bank especially at the branch as they need to conduct customer directly. If the staff is lack of knowledge regarding anti-money laundering, then how we can implement the regulations efficiently and how we can educate customers to fight the money laundering together?” Mr. J, Bank M.

“...if we have advanced technology but lack of expert staff to collect the information, to understand the systems and to deliver their expertise, then it will give bad impact to our banks. We can develop advanced technology infrastructure, but if staff are unable to use the system and do not have a better understanding regarding the anti-money laundering, then we will be unable to implement the regulations efficiently. Everything is related and depending on each other...” Mr. K, Bank R.

Based on the interview session, the lack of expert staff can be categorised as follows:

- Staff lack of understanding regarding anti-money laundering and financial crime.
- Staff lack of understanding on internal policies and procedures; local regulations and the consequences if involved in money laundering.
- Staff are unable to use the system tools provided properly.
- Staff lack of communication skills with customer to collect the right information and unable to explain the importance of KYC.
- Staff are unable to apply enhanced due diligence (EDD) measures effectively in higher risk situations.

Meanwhile, customer lack of education and awareness of anti-money laundering is categorised as below:

- Customer lack of knowledge regarding money laundering and financial crime.
- Customer did not aware about Anti-Money Laundering Act.
- Customer did not aware about the importance of fighting money laundering and KYC.
- Customer did not aware of the usage of bank as a channel for money laundering and terrorism financing activities.
- Customer did not aware of the impact of money laundering to the socio-economic and consequences should anyone involved in money laundering.

Other than the stated factors above, the tendency for employees to engage in financial crime was also considered as a barrier for anti-money laundering regulation to be implemented effectively. The employees may tend to disclose or “tip off” any information or activity reported to customer or any person involved in the activity that would reveal the existence or a decision of the unusual activity report (UAR).

SUGGESTIONS TO IMPROVE THE IMPLEMENTATION OF AML IN MALAYSIA

An effective implementation of Anti-Money Laundering, Anti Financing Terrorism and Proceeds of Unlawful Activities 2001 (AMLA) will ensure the safety and soundness of the financial institutions especially the banks. All respondents agreed that AMLA is sufficient to protect financial institutions in Malaysia from financial crime. They believe that the AML practice based on the AMLA at their banks will be able to fight money laundering and terrorism financing besides protecting the integrity of financial system.

Several trends have been identified in Malaysia, which are the use of cash transaction that remains as the preferred method to receive, transfer and spend the illegal proceeds; use of third parties account including mules account holders for moving illegal proceeds of criminal activities, receiving on behalf or transferring to foreign terrorist fighters (FTF) for terrorism activities; and social media have been used for soliciting the funds for FTF (APG Yearly Typologies Report 2017). In order to tackle this financial crime matter, the financial institutions in Malaysia must improve the implementation of the AMLA. The banks can employ a multi-pronged approach.

Firstly, financial institutions especially the banks should strengthen the collaboration with government and relevant agencies. The Central Bank of Malaysia (BNM) can work with relevant authorities to ensure strong enforcement action is taken against the criminals. Moreover, BNM need to share information with all financial institutions especially the banks regarding latest issues or cases of financial crimes. The information sharing regarding the cases will help the banks to have better understanding of money laundering / financial crimes trends or methods and to find effective solutions to handle the issues.

Secondly, the banks can collaborate with local media to increase public awareness and education regarding money laundering and terrorism financing. This is important to ensure that public is aware about the effects and consequences if they are to involve in financial crime. This is crucial to prevent the public to become financial crime's victims such as money mules or mules account holders. Referring to APG Yearly Typologies Report 2017, Commercial Affairs Department (CAD) Singapore has dealt with the money mule problem using this approach and has succeeded, resulting in a significant drop in the number of reports on the proceeds of international wire transfer fraud being laundered through Singapore "money mules". These cases can be a good example for financial institutions in Malaysia to improve the public education and awareness.

Thirdly, by investing on employees training to increase AML awareness as well as sufficient resources in compliance unit. A proper training helps to encourage staff to have appropriate skills, maintain high professional standards and to produce more expert staff for Financial Crime & Compliance department. Training requirements may vary based on staff job responsibilities, function and

length of service with the bank (Bank for International Settlements 2017).

Other than expert manpower, banks need to upgrade their system and technology for effective monitoring process. Advanced technology helps the banks to analyse and identify unusual transaction activity and business relationships as well as to file a suspicious transaction report (STR) to diminish the risk. It is also important to store customers' profile, accounts and transactions records. Therefore, support from top management is needed as the decision for budget allocation for AML purpose will be reviewed and decided by them as the budget allocation will affect the investment on human resources and technology development.

Last but not least, to intensify the "Three Lines of Defence" in Bank Risk Management. The "Three Lines of Defence" is a simple framework for aligning risk management across operating groups responsible for managing risk. This framework helps the banks to clearly identify the business units' roles and responsibilities, as well as to practice and sustain ongoing risk management activities (KPMG 2016). Besides, banks need to encourage effective communication among their employees from all levels, cascade every changes and latest updates regarding AML and to take immediate actions on every suspicious report submissions.

SPECIFIC AMLA FOR ISLAMIC BANKING

During the interview session with the respondents, they were asked two questions regarding the issue of specific AMLA for Islamic banking as below:

- (i) Is there any difference on AML practice between Islamic banking and Conventional banking?
- (ii) Do you think we need specific AML regulations for Islamic banking?

All the respondents stated that there is no difference of AML practice between Islamic banking and Conventional banking as all financial institutions in Malaysia are subjected to AMLA 2001. However, two out of six respondents expressed that Islamic banking needs to have a specific AML regulation.

"...we can have specific regulations on Islamic banking to ensure any dispensation / variation can be managed efficiently. It could be the same process but with different products. In terms of law implementation, they have separated law FSA and IFSA. So in that sense, it will be great to have specific AMLA for Islamic banking even though AMLA has a comprehensive framework to cover all aspects..." Mr. B from Bank H

Bank B, Bank I, Bank M and Bank R stated that there is no need for specific AML regulations for Islamic banking as AMLA is sufficient for both banking sectors. The guidelines in AMLA cover all the processes available in Islamic banking in aspects of process of opening account, customer due diligence, monitoring and reporting for unusual and suspicious activity. Besides, money laundering

and terrorism financing risks faced by Islamic banking are not very dissimilar with the risks faced by Conventional banking. Therefore, the laws and rules employed by conventional banking are applicable for Islamic banking. Mr. F from Bank I and Mr. C from Bank B have similar opinion:

“...Islamic banks are prohibited to invest in businesses that provide goods or services considered forbidden (haram). From this, Islamic banks will surely be more cautious and selective to open customer accounts or do any business with them. We will ensure that customer’s source of fund and source of wealth are from legitimate source and not accept any funds from illegitimate sources such as gambling or funds that consist of gharar, riba’ and maysir. Any income that falls under syubhah will not be declared as profit; hence, it is almost impossible for us to involve in money laundering...” Mr. C from Bank B.

From the above statement, we can see that Islamic banks are very concerned about Know Your Customer and customer due diligence. This process enables the Islamic banks to know the persons they are dealing with and to ensure that they do business with the correct customers as well as to avoid the relationship with money launderers or terrorism financiers. After all, the most important thing is that the Islamic banks must ensure that their aims and operations, businesses, affairs and activities are in compliance with Shariah as per IFSA Part IV Section 28 (1) (IFSA 2013).

There is not much evidence to support that Islamic banking are more exposed to money laundering / terrorism financing risk compared to those posed by the conventional banking sector (IFSB 2016). However, it would be a great action for Islamic banking sector to build a deeper understanding in assessing the money laundering / terrorism financing risks they are facing and effectively implement the AMLA tailored to the characteristics of their products and services. Islamic banks with local regulators and Bank Negara Malaysia can conduct a joint study and detailed research on this highlighted issue to enable them to identify the areas of high money laundering / terrorism financing risks and to improve existing mitigation measures.

CONCLUSION

There are three objectives produced by this study, which are to analyse the current practice on the prevention of money laundering in selected banking institutions in Malaysia, to investigate the barriers to effective implementation of AMLA and finally to identify ways to improve the implementation of AMLA in this country. The finding for the first objective of this study was in line with that of previous study by Jamaliah et al. (2013) in which banking institutions in Malaysia are responsible in money laundering and terrorism financing measures seriously by adhering to recommendations of AMLA 2001 and FATF 40. The respondents gave feedback that adhering to AMLA

is very important to protect the soundness of the banks as well as to mitigate money laundering risks especially reputational risk and to avoid from being subjected to legal action by Bank Negara Malaysia.

The findings for second objective were also in agreement with those of previous study where the barriers to effective implementation of AMLA are the lack of expert staff, budget allocation, technology infrastructure, changing and unclear regulatory expectations and existence of political influence (Jamaliah et al. 2013). Nevertheless, this study discovered one new barrier to effective implementation of AMLA, which is customer education and awareness. The tendency of employees to engage in financial crime was also considered as a barrier for AML regulation to be implemented effectively. The respondents stated that customer education and awareness is needed to ensure the effectiveness of the implementation as it can help customers to prevent themselves to become money laundering / financial crime’s victims as well as together with the bank to fight the financial crime.

For the third objective, this study demonstrated that to improve the implementation of AMLA a multi-pronged approach can be taken, which the banks need to strengthen their collaboration with the government and relevant agencies, to share information among the banks regarding money laundering issues, collaborate with local media to increase public awareness and education on money laundering and terrorism financing, invest on employees training as well as to provide sufficient resources in compliance unit and last but not least to strengthen the Three Lines of Defence in Bank Risk Management.

In summary, the present findings were consistent with those of previous studies. Previous studies have focused on issues regarding compliance measures of money laundering, which are level of awareness and perceived impacts among the non-financial business and profession (DNFBPs) and the importance of corporate governance in anti-money laundering measures. Meanwhile, this present study provided additional findings that focused on identifying a new challenge to implement effective AMLA, which is lack of public awareness and education on financial crimes and identifying additional measures to improve AMLA’s implementation by raising the awareness of the public on money laundering risks. This study has also discussed the need for specific AMLA for Islamic banking by gaining opinions from respondents.

Although this study contributed to the understanding on the current practice of AMLA in banking institutions, to identify the barriers to effective implementation the AMLA and find the solution to improve the implementation, there is still room for future study in this area. For instance, future studies may focus on specific Islamic banking to investigate any differences of money laundering risks between conventional and Islamic banking sectors and ways to protect the soundness of Islamic banking from money laundering / terrorism financing.

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