

INTEGRATED ANTI-MONEY LAUNDERING INITIATIVES IN THE MALAYSIAN BANKING INDUSTRY TOWARDS FATF FULL-COMPLIANT STATUS

¹Yusarina Mat Isa, ^{*2}Muhammad Nazmul Hoque, ²Zuraidah Mohd Sanusi & ¹Mohd Nizal Haniff

¹ Faculty of Accountancy, Universiti Teknologi MARA Cawangan Selangor,
42300 Puncak Alam, Selangor, Malaysia.

² Accounting Research Institute Menara Sultan Abdul Aziz Shah,
Universiti Teknologi MARA, 40450 Shah Alam, Selangor, Malaysia.

*Corresponding author: nazmul@uitm.edu.my

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ABSTRACT

This study aims to demonstrate the integrated anti-money laundering (AML) initiatives in the Malaysian banking industry, focusing on achieving the Financial Action Task Force (FATF) full-compliant status. It reviews and analyzes secondary data from relevant literature and documents about money laundering risk in the Malaysian banking industry. The review reveals that the integrated AML initiatives combine domestic and international efforts, which the Malaysian Central Bank and FATF anchor. Malaysia has proactively abided by the FATF requirements, and affirmative progression can be seen from the improved FATF-compliant status throughout the years. This study adds new knowledge to the literature by integrating domestic and international AML efforts. With the current integrated AML initiatives in place, Malaysia can achieve a full compliance status with the FATF, and this forms a strong pillar that could protect the Malaysian banking industry from money laundering risk.

Keywords: Money laundering, AML, risk, banking industry, Malaysia.

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1.0 INTRODUCTION

“Money laundering” is defined as processing illicit earnings to cover up their illegal source to legalize the benefits of crime (FATF, n.d.). Researchers have a common understanding of defining money laundering, albeit from different perspectives. According to Hinterseer (1997, p. 154), *“money laundering refers to a process used by individuals to prevent the origin and movement of money from being accurately traced so that the money can be used in the legal economy free of the taint of illegality and without fear of criminal, civil, or equitable legal sanction.”* Another definition of money laundering by Simser (2013, p. 41) advocates that *“money laundering is a technique used by criminals to disguise the origin of ill-gotten gains with the intent of enjoying their ‘cleansed’ money without interference from predatory underworld rivals or law enforcement.”* Money laundering risk is industry-aligned, and banking is categorised as one of the industries which is greatly exposed (KPMG, 2013). Banks are identified as the most inherently vulnerable sector to money laundering risk due to their nature of operations, including the diverse range of financial products offered (Bank Negara Malaysia (BNM), 2014; Edirisuriya, Gunasekarage, & Perera, 2019) and their extensive ability to move funds from entity to entity and from jurisdiction to jurisdiction rather swiftly (Ruce, 2011). Furthermore, with the advancement of both traditional-based and technology-based banking services, the penetration of money laundering risk has become even more susceptible for banks in which illegal money is passed through either consciously or unconsciously (Duncan, 2021; Idowu & Obasan, 2012). Banks are a preferred mode for money launderers (McLaughlin & Pavelka, 2013; Sathye & Islam, 2011), and this is a problem that threatens financial stability, not only in Malaysia but also in the rest of the world.

In recent years, several banks have been in the spotlight over their failures in managing money laundering risk. For instance, London-based HSBC Bank has been fined by the United States regulator almost \$2 billion for failing to stop Mexican drug traffickers from using its banking system to launder money (McLaughlin & Pavelka, 2013). Another example is Standard Chartered Bank, which the United States regulator fined \$340 million to settle allegations that the bank broke the United States money laundering laws in handling transactions for Iranian customers (Protess & Silver-Greenberg, 2012). Malaysia is not spared from this predicament, as there are cases of banks being fined for various money laundering-related issues. For example, AmBank has been fined RM53.7 million due to offences linked to the 1 Malaysia Development Berhad (1MDB) scandal (Raj, 2015). These banks are substantial in size and ostensibly regulated to have implemented reliable internal controls; however, they could not stop money launderers from utilizing them as a middleman to launder illicit funds. With these

kinds of cases involving banks, it comes to the question of what kind of mechanism should be in place to safeguard the banks from money laundering risk.

According to the Financial Action Task Force's (FATF), most recent and updated analysis of the 2018 Mutual Evaluation Report (MER), Malaysia has not yet fully complied with all 40 of the FATF's recommendations for anti-money laundering (AML) activities. The Malaysian Central Bank, which is Bank Negara Malaysia (BNM), the one that regulates the banking industry in Malaysia, is proactively making a concerted effort to counter money laundering risk by closely complying with the FATF recommendations (Latif & Abdul-Rahman, 2018; Nazri, Zolkafil, & Omar, 2019). However, further improvements still need to be made, particularly in implementing an integrated AML regime. This is crucial considering that, with tighter regulations, money launderers would be deterred and less inclined to use the banks as their accomplices. According to compliance experts, attempts to prevent money laundering in banks have resulted in money launderers shifting their modus operandi to less regulated institutions (Teichmann, 2017; Sarigul, 2013). BNM advocates that compliance with AML laws, regulations, and rules should always be a top priority. Moreover, persistent supervision by the regulatory authorities at the domestic and international levels will ensure that the banking industry's AML compliance program will work robustly to combat money laundering.

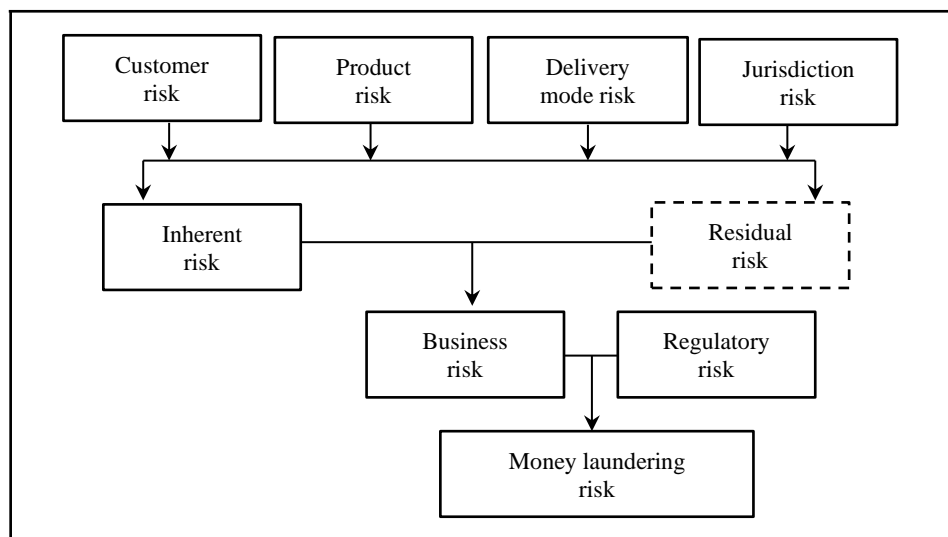
This paper aims to demonstrate the integrated AML initiatives that have affected the Malaysian banking industry, focusing on achieving FATF's fully compliant status. Subsequent sections will describe money laundering risk and how it fits into the setting of the Malaysian banking industry, the integrated AML initiatives, and finally, the evaluation of FATF compliance status. Malaysia is not far behind in achieving FATF's fully compliant status. Hence, the objectives of this paper are to provide insights into the initiatives that are already in place, as well as identify loopholes that can be taken into consideration for future FATF assessment.

2.0 OVERVIEW OF MONEY LAUNDERING RISK IN THE BANKING INDUSTRY

Money laundering risk in banks can be grouped under two broad categories – regulatory risk and business risk (sub-categorised into inherent and residual risk) (Sathye & Islam, 2011), as shown in Figure 1. Regulatory risk is associated with non-compliance with related requirements for AML, which includes customer identification, reporting, record keeping, and implementation of an AML program. Banks must comply with any legal obligations to safeguard against money laundering risk. On the other hand, business risk implies uncertainty

and danger of loss, as well as any event that poses a risk due to unforeseen circumstances that could cause banks to fail (Hoque & Said, 2021). Inherent business risks emanate from the customers' seeking banking services, the products offered to the customers, the delivery method of the products, and the geographical location from which the customer comes or the location where the offering of products and conduct of transactions occur. Business risks that might still exist despite a strong framework for managing money laundering risks are referred to as residual risks.

The bank officers' evaluation of client risk, namely the underlying business risk, is where the most important component of money laundering risk comes from. Both Sathye and Islam (2011) and Killick and Parody (2007) similarly explained the inherent business risk by emphasising the description of the source of risk. The customers themselves, individual or institutional customers, bear risks due to their source of income and wealth, past activities, and the intended nature of the activities. The customers deemed risky should be assigned a high alert on the possibility of an alleged money launderer, for example, politically exposed persons (PEPs), a customer who has an unusual request for service provision, and a customer whose source of funds is unexplained.



Source: Sathye & Islam (2011)

Figure 1: Classification of money laundering risk in banks

Product risk is the risk posed by the products the banks offer their customers and their inherent attractiveness to money launderers as a means of illegal activity (Sathye & Islam, 2011). Some products offered by the banks may present greater appeal to money launderers. For instance, investment products with periodic annuity returns and full maturity payment are ideal for

money launderers. The way the products are delivered to the customers also poses a different level of risk to the banks. Products delivered face-to-face generally pose a lower risk than those delivered online, considering that face-to-face interactions could provide more visual signs of money laundering.

With the Internet, customers are offered a variety of online transactions that do not require a direct interface with customers (McDowell & Novis, 2001; Sathye & Islam, 2011). For the banking industry, online transactions, for example, online fund transfers, pose a greater risk as the customer's identity is not visually verified. For jurisdiction risk, money laundering risk can be country-specific, in which the economic activity that gave rise to the income or wealth was derived from or where the activity is to occur. Among these risk elements, customer risk is the strongest link that connects all four risk elements. Banks need to develop profiles on these risk elements to form the basis for determining customer identification documents to ensure a thorough assessment of the related risks.

The operations of banks are about taking risks, albeit calculated ones (Al-Tamimi & Al-Mazrooei, 2007; Mat Isa et al., 2021). Nevertheless, some risks, such as money laundering risk, are not inherently drawn by the nature of banking operations but inadvertently absorbed into the banking industry due to poor control and non-compliance with AML policies (Naheem, 2015; Pramod, Li, & Gao, 2012), as well as due to the inability of the bank officers to filter the risk posed by the customers (Dhillon et al., 2013; Favarel-Garrigues, Godefroy, & Lascoumes, 2007). Banks would face criminal charges if they knowingly accept money laundering risk into their institutions (Simser, 2013).

In the context of this study, money laundering risk is defined as the money laundering-related threats and vulnerabilities faced by banks while conducting their banking businesses. The three processes for converting illegal money into legitimate money, namely placement, layering, and integration, broadly apply to banks (Idowu & Obasan, 2012; Simwayi & Guohua, 2011). The three-staged process of money laundering can be simplified because the stages can often overlap, and in some cases, any stages can be skipped. It should be noted that some money laundering transactions can also be affected in one or two stages, depending on the money laundering technique being used. Commonly, in passing through these stages, criminals are more interested in laundering money to fuel their next criminal activities and not getting caught by the authorities than in generating returns from the illegal money.

3.0 LANDSCAPE OF THE MALAYSIAN BANKING INDUSTRY

In Malaysia, the banking industry comprises licensed institutions, namely commercial banks, Islamic banks, international Islamic banks, and investment banks. As of December 2021, there are 26 commercial banks (including 19 licensed foreign banks), 18 Islamic banks (including one international Islamic bank) and 11 investment banks (BNM Website). Commercial banks are the largest and most significant providers of funds in the banking system. The main functions of commercial banks are to provide retail banking services (accepting of deposits, granting of loans and advances, and financial guarantees), trade finance facilities (letters of credit, discounting of trade bills, shipping guarantees, trust receipts, and banker's acceptance), treasury services, cross-border payment services, and custody services (safe deposit). Commercial banks are also authorised to deal in foreign exchange and are the only banking industry allowed to provide current account facilities.

Domestic and foreign Islamic banks serve the same function as commercial banks, with the exception that they are run by Shariah principles (Islamic laws), which forbid the payment or acceptance of interest fees (known as "riba"), and any actions that foster uncertainty (known as "gharar"). The operations of investment banks are slightly different from those of commercial banks and Islamic banks, where the product offerings are in the short-term money market and capital raising activities, including financing, specialising in syndication, corporate finance and management advisory services, arranging for the issue and listing of shares, as well as investment portfolio management.

All banks are under the purview of BNM, the statutory body entrusted to promote monetary and financial stability in Malaysia (BNM, 2018). Financial system stability is achieved by developing a sound, resilient, progressive, and diversified financial sector to support economic growth. The seven functional areas spearheaded by BNM are economics and monetary policy, investment and operations, regulations, payment systems, supervision, organisational development, and communications. Among these, two areas, regulation and supervision, are the closest links between the banking industry and the money laundering risk management framework.

All banks are bound by all the relevant acts administered by BNM. Among others, the statutes that need to be complied with by the banking industry are the Financial Services Act 2013, Islamic Financial Services Act 2013, Money Services Business Act 2013, Anti-Money Laundering, Anti-Terrorism Financing, and Proceeds of Unlawful Activities Act 2001 (AMLA). BNM has been proactive in tackling globalisation and market liberalisation under the Financial Sector Masterplan (2001-2010), and Financial Sector Blueprint (2011-2020) set

out for the emergence of new players in the banking industry, which call for strong risk management practices across the banking industry (BNM, 2011, 2020). This has heightened the need for a more responsive risk management framework that includes money laundering risk management.

In Malaysia, the crimes of money laundering have been expanded to implicate expansive predicate offences, and AMLA has listed 365 such offences. Figure 2 highlights the most notable crimes with different levels of threats that elucidate money laundering. Among those crimes, corruption, fraud, and illicit drug trafficking top the chart to post a high level of threat from money laundering. In 2021, Malaysia deteriorated by five spots to rank 62 in the global rankings of Transparency International Malaysia's (TI-M) Corruption Perceptions Index (CPI) 2021, marking the second consecutive year of a decline in the rankings (Idris, 2022). This is supported by PricewaterhouseCoopers (PwC, 2020), which shows corruption is one of the disruptive economic crimes in Malaysia. Similarly, other kinds of fraud, including asset misappropriations, customer fraud and cybercrime, accounted for almost 50% of the total fraud (PwC, 2020). Drug trafficking remains one of the most notorious crimes in Malaysia, with millions of ringgits traded each year (United Nations Office on Drugs and Crime, 2019). Given the various types of crimes, criminals constantly find ways to clean up their dirty money, and banks are commonly the easiest target.

Types of crime	Threat level	Types of crime	Threat level
Corruption	High	Money counterfeit	Medium
Fraud		Environmental crimes	
Illicit drug trafficking		Illegal remittance	
Organised crimes		Murder	
Smuggling		Kidnapping	
Counterfeiting and piracy of products	Medium	Insider trading and market manipulation	Low
Robbery and theft		Extortion	
Human trafficking/migrant smuggling		Illicit trafficking of stolen goods	
Sexual exploitation		Illicit arms trafficking	
Tax evasion		Sea robbery	
Terrorism and terrorism financing	High		

Source: BNM (2018)

Figure 2: Money laundering threat level of different crimes

Money launderers for various predicate offences would require a mechanism to transform the money from illicit origins to make it appear legitimate, and banks are the preferred choice (McDowell & Novis, 2001). Money launderers target banks because of their inherent appeal in terms of convenience of location, wide range of products and services offered, and money launderers' peculiar preferences (BNM, 2014). As shown in Figure 3, money laundering affects various sectors with a high inherent threat, predominantly in the banks within the financial sector category.

The banking industry is expected to face greater challenges due to its increased size and complexity. The emerging landscape demands the banking industry enhance its risk management standards to address risks that may evolve from changing industry practices and the operating environment. Concerning money laundering risk, the complexity of transactions and diminishing the financial border are expected to pose greater challenges to the banking industry in the coming years (Nazri et al., 2019). Banks must ensure that their defence against money launderers is consistently strong across their operations and that adequate infrastructure is in place to facilitate risk management. This will ensure that potential risks to financial stability in the new financial landscape continue to be addressed through timely and appropriate measures.

Financial sectors	Vulnerability level	Non-financial sectors	Vulnerability level
Banking institutions	High	Casino	High
Money changing		Lawyers	Medium
Non-bank remittance		Offshore trust	
Fund/Unit trust	Medium	Company secretaries	
Offshore banking		Real estate agents	
Non-bank deposit taking		Onshore trust	Low
Stockbroking	Low	Gaming	
Life insurance		Jewellers	
Money Lending		Accountants	
Non-bank cards		Pawnbroking	
E-money		Notaries	

Source: BNM (2014)

Figure 3: Inherent vulnerabilities of different sectors to money laundering risk

4.0 INTEGRATED AML INITIATIVES

The AML initiatives stand on two basic pillars – prevention and enforcement (Levi & Reuter, 2006; Pamungkas, 2020). Prevention covers four aspects: sanctions, regulation and supervision, reporting and customer due diligence (CDD). In comparison, enforcement takes charge of three aspects: confiscation, prosecution and punishment, and investigation. In responding to the ever-evolving money laundering risk, Malaysia has taken proactive steps to adopt a comprehensive and integrated framework in combating money laundering involving national and international building blocks. By preventing criminals from profiting from the proceeds of unlawful activity and simultaneously fostering local and international confidence in financial institutions that operate in Malaysia, an effective AML program safeguards the financial system's integrity (BNM, 2014). The subsequent sections outline the domestic and international AML regimes which shape the foundation upon which Malaysia establishes its AML initiatives - the legal requirements of AMLA as the main pillar of AML law enforcement in Malaysia and the Malaysian banking industry's role in combating money laundering risk.

4.1 Domestic and International AML Regime

The BNM is the key authority in safeguarding financial stability in Malaysia, and the AML regime is a framework that guides its AML prevention and enforcement efforts. Figure 4 shows that the Malaysian AML regime is designed to cover four important aspects - the legal and

regulatory framework, preventive measures for reporting institutions¹, financial intelligence unit and law enforcement agencies, and domestic and international cooperation. This AML regime harmonises and integrates national and international efforts to combat the threat of money laundering. Within BNM, this AML regime shapes a comprehensive framework that acts as the fundamental reference for the formulation of higher-level policy and the operations of the working agencies.



Source: BNM Website

Figure 4: Malaysian AML regime

The National Coordination Committee coordinates the implementation of the AML regime on the domestic front to Counter Money Laundering (NCC) (BNM, 2014, 2015). The NCC comprises 16 members drawn from supervisory and regulatory agencies, law enforcement agencies (LEAs), and policy-making ministries, with BNM serving as the secretariat. The objectives of the NCC are to develop and implement the national strategy, policies, and measures to counter money laundering and to ensure that the national AML framework is consistent with international standards. Under the ambit of the NCC, the National Risk Assessment (NRA) is conducted to assess the country's exposure and vulnerabilities of various sectors to money laundering risk (BNM, 2014). Results of the NRA are communicated to the reporting institutions, supervisors, regulators, and LEAs to assist in prioritising the deployment of resources to combat money laundering. The NRA is also seen as the preparatory assessment

¹ 'Reporting institutions' in AMLA are those institutions listed in the First Schedule of the Act, which, among others, include commercial and Islamic banks; international Islamic banks; investment banks; the Federal Territory of Labuan conventional and Islamic banks; and the Federal Territory of Labuan conventional and Islamic investment banks.

for MER, a wide-ranging assessment of a jurisdiction's performance in implementing the FATF standards (FATF, 2012).

The Financial Intelligence and Enforcement Department (FIED) of BNM is responsible for performing BNM's functions as the competent authority under the AMLA (BNM, n.d.c). The Financial Intelligence Unit (FIU) is a set-up in the FIED whose functions are to manage and provide comprehensive analysis of the financial intelligence received relating to money laundering. The financial intelligence inputs may come from various sources such as suspicious transaction reports (STRs) and cash threshold reports (CTRs) received from the reporting institutions, LEAs, and foreign FIUs. The financial intelligence information is then disseminated to the respective LEAs for further action. The LEAs have the power to enforce the law under AMLA for any offence committed or have reason to suspect the commission of an offence under their respective purview. The LEAs may also request assistance from the FIED to assist in the investigation.

The FIU collaborates with other countries' FIUs by establishing the Egmont Group of Financial Intelligence Units (Egmont Group) (FATF, 2012). The Egmont Group is a group of global FIUs established to provide a forum to improve cooperation among countries in the fight against money laundering. It is also an effort to foster the implementation of AML measures among the member countries. As of February 2022, there are 166 member countries worldwide, and Malaysia has been a part of the Egmont Group since July 2003. The FIU has participated actively in the coalition by sharing information and financial intelligence with other members through a secured network. The members of the Egmont Group meet regularly to find ways to promote the advancement of the FIUs and develop a platform for information exchange, training, and the sharing of expertise.

At the international level, FATF is an inter-governmental body established by the G7 countries in 1989 and based in Paris that acts as the international body for AML standards setting (FATF, 2012). The mandate of the FATF is to set standards and to promote the effective implementation of legal, regulatory, and operational measures for combating money laundering and other related threats to the integrity of the international financial system. In collaboration with other international stakeholders, the FATF also works to identify national-level vulnerabilities to protect the international financial system from misuse. One of the first tasks of the FATF was to develop recommendations to combat money laundering, known as the 40 Recommendations on AML Initiatives, which set out the measures national governments should take to implement effective AML programmes. In developing the AML standards, FATF incorporates the key principles of the United Nations Conventions and Resolutions

(UNSCRs), such as the Vienna Convention (United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances), the Palermo Convention (The International Convention against Transnational Organized Crime), Security Council Resolution 1373 and Security Council Resolution 1267. Malaysia was accorded 'Observer' status by the FATF in 2014 and was later converted to full member status by the FATF in February 2016. Inclusion as a full FATF member demonstrates Malaysia's strong commitment to combat money laundering and reflects a safer business environment in Malaysia with controlled money laundering risk.

At the regional level, Malaysia is a member of the Asia/Pacific Group on Money Laundering (APG), a FATF-style regional body (APG website). APG is an autonomous and collaborative international organisation that was established in 1997. As of December 2021, the members of APG comprise 41 countries and several international and regional observers, such as FATF, the International Monetary Fund, the World Bank, the United Nations Office on Drugs and Crime, and the Egmont Group. Malaysia has been a member of APG since May 2000 and is subjected to periodic assessments of MER. The MER involves an assessment of a country's formal compliance with FATF's 40 recommendations on AML initiatives and how effectively those recommendations have been implemented.

Within the banking community, the Basel Committee on Banking Supervision is a committee of banking supervisory authorities established by the central bank governors in 1974 (Basel Committee on Banking Supervision, 2013). It provides a forum for cooperation on banking supervisory matters, including money laundering risk. Though the committee has no superior authority over the governments and central banks to which it makes recommendations, its guidelines are broadly followed by the banking industry worldwide. BNM has shown strong support for the Basel Committee's efforts in combating money laundering by adopting the money laundering-related guidelines issued by the committee.

Another organisation that plays a role within the banking community is the World Bank, which focuses more on the affairs of developing countries (The World Bank, 2017). Like the Basel Committee on Banking Supervision, the World Bank issues circulars and policy papers on money laundering within a broader context, such as resource implications and capacity building to strengthen the AML regime worldwide. A more exclusive collaboration of thirteen global banking industries, the Wolfsberg Group, works to develop frameworks and guidance for the banking community in managing financial crime risk, particularly concerning AML policies and related collective programs. With the all-inclusive AML regime that

comprises domestic and international mechanisms, cross-border concerted efforts are vital in the fight against money laundering risk.

4.2 Legal Requirements of AMLA

The main legal and regulatory aspect of the AML effort in Malaysia is AMLA, which was initially gazetted as a statutory law in July 2001 and came into force in January 2002 (AMLA, 2001). It covers the offences of money laundering in general, including investigation, freezing, seizure, and forfeiture of the proceeds of serious crimes and suspicious transactions. In 2014, AMLA was amended to provide for the offences of money laundering, measures for the prevention of money laundering activities, investigation of powers for law enforcement agencies, and public prosecutors to freeze and seize any properties involved in or derived from money laundering activities, proceeds derived from unlawful activities, instrumentalities of an offence, and the power of the court to forfeit properties derived from the proceeds of serious crimes. The amended AMLA came into force on 1st September 2014.

The First Schedule of AMLA contains a list of reporting institutions comprising two broad categories – financial institutions and designated non-financial businesses and professions. These reporting institutions must take certain measures designed to prevent money laundering offences. The Second Schedule of AMLA lists 365 serious offences under 42 pieces of legislation, which, if committed, are likely to result in a person benefitting or deriving proceeds from the offences committed (AMLA, 2001). The penalties upon conviction of an offence were substantially increased – a money laundering offence would carry a penalty of up to 15 years of imprisonment and a fine of not less than five times the value of the proceeds of the crime or RM5 million, whichever is higher. The enforcement of AMLA is undertaken by the various ministries and agencies (i.e., the LEAs) based on the nature of a crime and predicate offences under their respective purview of legislation listed in the Second Schedule of AMLA.

BNM has been appointed as the competent authority under the AMLA by the Minister of Finance (AMLA, 2001; BNM, 2014). As the competent authority, BNM's roles include receiving and analysing STRs from the reporting institutions; disseminating information on suspected offences derived from STRs analysis to the appropriate LEAs (such as Royal Malaysian Police, Royal Malaysian Customs, and Malaysian Anti-Corruption Commission) for investigation; and making recommendations to the relevant supervisory authority, enforcement agencies, and reporting institutions arising from any report or information received. Nevertheless, as AMLA is enforced by various agencies depending on their

legislative purview, BNM is, as the competent authority, only empowered to investigate money laundering offences relating to the laws administered by BNM.

The LEAs are those agencies that are given the power to enforce the laws enacted by the Parliament of Malaysia (AMLA, 2001). Concerning the enforcement of AMLA, there are a total of 11 LEAs involved. The Royal Malaysian Police and BNM are the two main LEAs tasked with enforcing the law concerning money laundering offences. Other LEAs include the Companies Commission of Malaysia, the Department of Wildlife and National Parks, the Inland Revenue Board of Malaysia, the Labuan Financial Services Authority, the Malaysian Anti-Corruption Commission, the Malaysia Palm Oil Board, the Ministry of Domestic and Trade, Cooperatives and Consumerism, the Royal Malaysian Customs Department, and Securities Commission Malaysia. These LEAs are entrusted to enforce the provisions of AMLA, which fall under their respective jurisdictions, by referring to the nature of the predicate offences and the legislation within their purview.

4.3 AML Initiatives within the Malaysian Banking Industry

All banks are required by law to undertake preventive measures to prevent their institutions from being used as a conduit for money laundering activities (AMLA, 2001; BNM, n.d.a). The preventive measures include conducting a risk assessment, execution of CDD, submission of STRs and CTRs, maintenance and retention of records of transactions, and implementation of an AML compliance program reflective of the banks' money laundering risk profile (BNM, n.d.a). AMLA requires the banks to establish preventive measures such as customer identification and due diligence, reporting suspicious transactions, record keeping, appointment of compliance officers, and conducting AML training (AMLA, 2001). Banks must implement a flexible set of preventive measures proportionate to their level and nature of money laundering risk while remaining within the scope of AMLA requirements. Money laundering risk assessment comprises a whole range of assessments, ranging from the front-customer reception (onboarding) and transaction analysis (transaction monitoring) (Mat Isa et al., 2015). The first step of risk assessment involves the conduct of CDD, which enables the banks to be aware of a customer's background in determining if the customer is likely to be suspicious. The banks need to adopt a risk-based approach that mandates CDD checks on customers, particularly those deemed risky, such as people with PEP status and habitual crime offenders. If the customer and the transactions are suspicious, the banks must submit STRs and CTRs to the FIU (BNM, n.d.b). In all dealings, the banks are required to maintain an account, records, business correspondence, and documents relating to an account, business relationship,

transaction, or activity with a customer for at least six years from the date the account is closed or the business relationship, transaction, or activity is completed or terminated.

An AML compliance programme, central to managing money laundering risk in the Malaysian banking industry, includes compliance management, employee training, and system infrastructure (BNM, 2015). Banks are mandated by AMLA to establish a compliance function and appoint compliance officers in every branch who are responsible for keeping records as well as reporting any suspicious transactions (AMLA, 2001). Banks must also conduct employee training, guide employees on AML policies and procedures, and identify suspicious activities (BNM, 2014). It is thus important for banks to allocate adequate resources to appoint compliance officers, create training budgets for all employees involved in the prevention of money laundering, and provide training and technical assistance necessary to strengthen the banks in the fight against money laundering. In addition, banks must also provide significant financial support for AML by investing in robust system infrastructures such as screening and monitoring systems.

The AML initiatives at the banks are largely steered by the direction of the board of directors and senior management, which aligns with the laws and regulations enforced by BNM. AML implementation within the banks should be overseen by the board of directors, which should approve the AML policies and monitor the implementation of such policies. The board of directors fosters an AML compliance culture and creates a governance practice that should meet regulatory expectations. The senior management of the banks should implement AML measures and regard compliance with AML laws and regulations beyond just a tick-mark requirement (Nance & Tsingou, 2020; Podder, 2022). Furthermore, AMLA imposes certain monitoring obligations on banks in Malaysia that must be integrated into the banks' internal AML programs. Those monitoring programs should reflect the level of risk the banks face and must be continuously on alert for any emerging facets of money laundering risk. To have a secure banking sector, the board of directors and top management must ensure that activities for controlling money laundering risk go beyond simple compliance.

Banks are expected to face greater challenges due to their increased size and complexity. The banks' contribution is expected to strengthen, with assets of the banking industry rising to almost three times of GDP by 2020 (2010: 2.4 times of GDP) (BNM, 2011). The emerging landscape demands banks enhance their risk management standards to address risks that may evolve from changing industry practices and operating environments. Concerning money laundering risk, the complexity of transactions and the diminishing of the financial border are expected to pose greater challenges to banks in the coming years

(McDowell & Novis, 2001). Banks must ensure that their defence against money launderers is consistently strong across their operations and that adequate infrastructure is in place to facilitate risk management. This will ensure that potential risks to financial stability in the expanding financial landscape continue to be addressed through timely and appropriate measures.

5.0 EVALUATION OF FATF COMPLIANCE THROUGH MUTUAL EVALUATION REPORT

Malaysia has undergone four country assessments conducted by the FATF and APG – in 2001, 2002, 2007 and 2015, with a follow-up and re-rating exercise in 2018. The results of this country's assessment, known as the Mutual Evaluation Report (MER), outline the country's compliance with the FATF's 40 recommendations on AML initiatives. In 2001, MER focused on the Labuan International Offshore Financial Centre (LIOFC) (APG, 2001). The MER was a collaboration between APG and the Offshore Group of Banking Supervisors (OGBS). The other countries covered during the first series of MER are Samoa, Chinese Taipei, and Macau (China), because these offshore centres were more prone to abusing money launderers.

Despite the decision to separately evaluate LIOFC and Malaysia, the MER considers Malaysia's national laws, which apply to LIOFC. This has given weight to the argument that the MER in 2001 was a sneak peek of what Malaysia had in place for its AML regime. The findings of MER 2001 suggested that there was no serious problem with money laundering in the LIOFC. Nevertheless, the MER was short-changed in view that the Anti-Money Laundering Bill 2001 (thereafter known as AMLA) had just been introduced at that time, and a full evaluation of the compliance with FATF 40 recommendations on AML initiatives is contingent upon the passage of this legislation. The MER has nevertheless made several valuable recommendations, which were later adopted to strengthen the country's AML regime.

Once the AMLA came into force, the second MER exercise was conducted in 2002. This full-fledged evaluation of Malaysia's AML regime was inconclusive, given that implementation of AMLA was still at the teething stage. Nevertheless, no major findings were noted, and the APG team applauded Malaysia for its strong commitment towards international AML measures. The MER also noted that work had already begun to address many of the issues identified, including the passage of comprehensive AML legislation, the establishment of an FIU, extensive training and awareness campaign, and the enactment of mutual assistance legislation (APG, 2002).

In 2007, the second full-fledge MER was conducted, covering the evaluation of the institutional framework, the relevant AML laws, regulations, guidelines, and other requirements, and the regulatory and other systems in place to deter money laundering, as well as examining the capacity, the implementation, and the effectiveness of all these systems (APG, 2007). From 28 recommendations made by MER 2001 and MER 2002, only four recommendations were yet to be accomplished by the time MER 2007 was conducted. The latest full MER, issued in 2015, outlined 14 key findings, including the strengths and weaknesses of the country's AML regime (APG, 2015). It also made 11 priority recommendations that must be implemented to strengthen efforts to combat money laundering.

For MER 2007 and MER 2015, the rating of MER compliance with FATF 40 recommendations on AML initiatives is made according to four levels of compliance – Compliant (C), Largely Compliant (LC), Partially Compliant (PC), and Non-Compliant (NC) (APG, 2007, 2015). Table 1 presents the summarised number of ratings accorded for compliance with the FATF's 40 recommendations on AML initiatives for both MER 2007 and MER 2015.

Table 1: Mutual evaluation report ratings for 2007, 2015 and 2018*

Types of Ratings	MER 2007	MER 2015	MER 2018*
Compliant (C)	5	16	20
Largely Compliant (LC)	19	21	18
Partially Compliant (PC)	15	3	2
Non-Compliant (NC)	1	0	0

Note: * Under FATF's Follow-Up and Re-Rating Review

Table 1 shows that Malaysia has improved tremendously over the years in terms of compliance with the FATF recommendations. The most significant change is the conversion of 10 LC-level and 1 PC-level to 16 C-level in MER 2015 compared to only 5 C-level in MER 2007. Another notable change is the upgrades of 12 PC-level, which comprise a shift of 10 LC-level and 2 C-level, respectively. The single NC level in MER 2007 was also upgraded to LC level in MER 2015. In 2018, FATF recently issued an Enhance Follow-Up Report and Technical Compliance Re-Rating for Malaysia, which has seen further improvement with only two recommendations remaining as PC. In 2018, four recommendations were upgraded to register 20 C-level, with a corresponding reduction for LC-level and PC-level. These improvements

indicate Malaysia's strong and continuous commitment to improving its AML initiatives (APG, 2018).

These country assessments provide Malaysia with the platform for further improvements in the measures undertaken to combat money laundering. The ratings indicate the situation, but what is more important are the recommendations provided by the MERs. These recommendations are the driving factors for Malaysia to move forward and improve its AML initiatives to make the country a deterrent force for money launderers to commit their crimes. Thus, it is crucial for all stakeholders, particularly those directly associated with money laundering risk, such as banks and other financial intermediaries, to follow through on the MERs recommendations and take a proactive approach in implementing the recommendations that concern their institutions.

6.0 DISCUSSION AND CONCLUSION

Money laundering impairs the banks for two reasons: Firstly, it erodes the integrity of the institutions, and secondly, it may threaten financial liability. Numerous studies have found that money laundering endangers bank stability and is economically damaging. Despite concerted efforts by various parties to address the money laundering problem at the domestic and international levels, including establishing an AML prevention and enforcement regime and legal provisions, money laundering continues to pose a significant threat, particularly to the banking industry. Nevertheless, it is not impossible for the banks to eventually win the fight against money laundering, given that a solid foundation has been laid down through an integrated AML initiative, as discussed above.

In today's dynamic environment, money launderers will always try to resort to new ways of committing illegal activities. Thus, banks, as well as the regulatory authorities, should be one step ahead in formulating robust AML initiatives, which cannot stand alone but rather should be integrated to prevent any loopholes that money launderers can exploit. The banks are the key implementers of AML initiatives, but the involvement of various other parties is crucial to providing support in reaching a holistic effort. As money laundering risks could transcend borders, the need for international synergy initiated by FATF and APG, particularly, is even more demanding. Banks increasingly need domestic and international support to fight money laundering, given that criminals nowadays are far more sophisticated in circumventing laws and regulations.

In the context of the Malaysian banking industry, BNM is the anchor on the domestic front, assisted by the LEAs and the banks themselves in ensuring that the shield against money

laundering is intact to disallow any penetration of money laundering risk. The enactment of AMLA has significantly changed Malaysia's banking industry landscape, with various legal requirements that banks need to comply with. In the absence of AMLA, no other statute could comprehensively cover the provisions of predicate offences and the fines and penalties that could be imposed on money launderers. Thus, AMLA is a strong message to the money launderers that the offences are legally bound and punitive actions can be taken as provided by the Act.

Malaysia cannot fight money laundering alone, so close collaboration with international bodies such as FATF and APG has greatly curated how the country manages money laundering risk. The country assessment conducted through MER provides a benchmark that can be used to assess how Malaysia is doing compared to the other countries. The MER report shows that there may be room for improvement after the different steps have been implemented, giving Malaysia a chance to catch up with other top nations in the fight against money laundering. Eventually, with continuous improvements and support from the various parties, these integrated initiatives would catalyse Malaysia to achieve full-compliant status for all FATF 40 recommendations for AML initiatives.

This study provides insights for banks in managing their money laundering risk. The banks should be aware of the existing integrated initiatives and ensure that they support the whole initiative. The integrated AML initiatives harmonise national and international efforts to combat the threat of money laundering. The banks can act as the connecting point that implements the national strategy, policies, and measures to counter money laundering and to ensure that the national AML framework is consistent with international standards. Apart from the banking industry, this study could also provide some inputs for other institutions similarly exposed to money laundering risk, such as insurance companies, unit trusts, and stockbroking companies.

This paper is confined to reviewing secondary sources relating to money laundering, which could prove to limit the ability to interpret the findings of this study. In spurring further discussion relating to this study, a future study could explore how banks manage money laundering cases and their impacts on the overall health of the institutions. Additionally, an in-depth study could be conducted to examine how banks (as well as other financial institutions) and the authorities can collaborate to mitigate money laundering risk. Further study could also be conducted on the prospect of achieving FATF full-compliant status and how the status could have impacted the way banks react to money laundering risk. As money laundering is a real problem in the economy, having a solid understanding of the different facets of money

laundering could provide a better interpretation of the scale of the problem in the Malaysian economy.

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