

Anti-Money Laundering Contract Clauses in Financial Institutions: A Comparison between the Philippines and the United States^{1, 2}

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Abstract

Money laundering is a major case worldwide and different countries are finding ways to combat this serious issue of washing dirty money. The Philippines is confronted with a major money laundering case in 2016 and the purpose of this research is to compare the anti-money laundering contract clauses of financial institutions in the Philippines and United States as to formulate recommendations to strengthen the Anti-Money Laundering Act. Comparison of the anti-money laundering clauses are done using multi-attribute decision making analysis with non-compensatory and compensatory methods. Anti-money laundering contract clauses in financial institutions in the United States present greater scope and provisions to fight money laundering. It includes a detailed suspicious account reporting and relaxed bank secrecy act. Hence, a recommendation was formulated for the anti-money laundering act of the Philippines which is to add covered institutions, lower threshold for covered transactions, and clearer and stronger enforcement of sanctions.

Key Words: *Covered Institutions, Covered Transactions, Unlawful activities and Fraudulent Practices, Consequence and Prevention Programs*

Introduction

A huge anti-money laundering case in 2016 almost put the banking system of the Philippines in jeopardy when 81 million dollars was stolen from the Bangladesh bank account in the US Federal Reserve Bank in New York and was transferred to Rizal Commercial Banking Corporation (RCBC), a local bank in the Philippines. The stolen money was later on transferred to casinos and junket operators. This situation led to questions how the financial institutions in the Philippines play part in upholding the Anti-Money Laundering Act which is a major issue worldwide.

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Money laundering is defined to be as the method of “washing” the money from illegal means as to appear it to be a clean money which can be through depositing in banks or using other institutions/businesses to circulate the dirty money. Anti-Money Laundering Act was created to combat this way of generating income from illegal means. Prevention of money laundering is a major responsibility of financial Institutions as it is generally the means to launder money from crimes. Anti-money laundering is included in many financial institutions’ contract clause to support the Anti-Money Laundering Act and there are certain consequences for both parties who fail to uphold the said act.

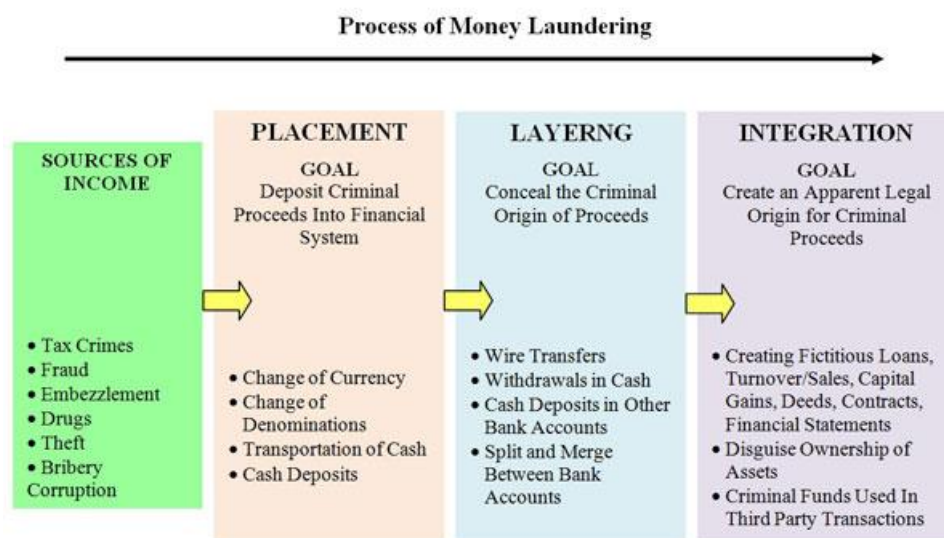


Figure 1: Process of Money Laundering retrieved from <http://www.onestopbrokers.com/2015/01/12/stages-money-laundering/>

This paper will analyse the contractual clauses of anti-money laundering in different financial institutions in the Philippines and compare it to the United States as the United States is one of the major countries who suffered from money laundering cases and made significant advances to combat this. The United States was once confronted by numerous cases of money laundering. According to statistics, for every year, there is \$ 500 to trillion of dollars that are laundered money generated through financial institutions which is half of this laundered money is carried out in the United States. In response to the 2001 terrorist attacks in US, the country strengthens its measures to fight money laundering and terrorist financing. Moreover, the Federal Reserve Bank of New York is a major central bank where most bank accounts worldwide are kept.

From this analysis, a recommendation for the anti-money laundering contract clauses in the Philippine financial institutions will be formulated as to strengthen and create new programs to strengthen the Anti-Money Laundering (AML) Act.

Step 1: Problem Evaluation

Money Laundering is a serious case worldwide. It is a critical case where money from unlawful activities is circulated into a means to appear as a clean money. Money laundering causes problems to banks and monitoring must be structured as criminals are finding different ways to move the proceeds of crime into the market in a way it will not be traced. This case happens in different contexts and the purpose of this paper is to analyse the contractual clauses of financial institutions of the Philippines relative to the United States as to formulate a recommendation to strengthen the AML in Financial institutions and the AML act as a whole.

To summarize, this paper has been designed to research, analyse and answer the following questions:

1. What are the provisions of the AML contract clause of the financial institutions in the Philippines with the basis of AML Act?
2. How effective it is compared to the AML contract clause of the financial institutions in the United States?
3. What could be improved in order to strengthen the AML in financial institutions in the Philippines and the AML Act in general?

Methodology

Step 2: Feasible Alternatives

This short research will evaluate the AML Contract clauses of Financial Institutions in the Philippines and the United States with the basis of the AML Act or Manual of the two countries. In the basis of this research, financial institutions contract clauses will be compared. The terms and conditions of the contract clause of its products and services will be scrutinized as how it strong its commitment and support to AML.

Alternative 1: AML contract clause of financial institutions in the Philippines

Alternative 2: AML contract clause of financial institutions in the United States

Step 3: Development of Alternatives

In order to strongly implement the adherence of financial institutions to the worldwide fight of money laundering, the central banks of the Philippines and the United States has formulated regulations, contract clauses and standards covering all financial institutions and related organizations which has a high risk for money laundering.

The *AML contract clauses of financial institutions in the Philippines* do as much as it can to be closer to the international standards as to promote its cooperation to the global fight against money laundering. To fight money laundering, banks were required to perform customer

identification, keep records, report covered and suspicious transactions, relax bank secrecy laws and perform freezing/recovery of dirty money.

The *AML contract clause of banks* in the United States promotes the Bank Secrecy Act which requiring banks to create AML programs. These programs include customer identification, reporting of suspicious activities and a financial intelligence unit to oversee anti-money laundering programs and cases. It also imposes civil and criminal sanctions for violations of the Bank Secrecy Act.

Terms and conditions of the contract clause of financial institution give considerable importance to the Anti-Money Laundering Act. It has strong compliance to the AML act. Hence, AML act will be considered as the basis of analysis of the terms of conditions of the products and services of financial institutions of the Philippines and the United States as to analyse the level of adherence of financial institution to combat money laundering.

Step 4: Selection of Acceptable Criterion (a criteria)

Attribute	Attribute Rank	Alternative Option's Range
Covered Institutions	3	AML US > AML PH
Covered Transactions	2	AML US > AML PH
Unlawful Activity	0	AML PH > AML US
Consequences and Sanctions	1	AML US > AML PH
Prevention Programs	5	AML US > AML PH
Bank Secrecy	4	AML US > AML PH

Figure 2: Non-compensatory model technique- lexicography

Anti-Money Laundering requirements, manual or act worldwide includes *covered institutions, covered transactions, unlawful activities and fraudulent practices* as to assess the scope of the money laundering. *Consequences and sanctions* are also considered as to identify how strong AML is enforced. Lastly, *prevention programs* are taken into consideration as to assess activities and initiatives to prevent and reduce money laundering cases. As part of prevention programs, financial Institutions are imposed to do risk-based approach which includes *due diligence* which is the identification and verification of the customer and beneficiary's identity as well as the purpose and nature of the business relationship. Moreover, financial Institutions are required to do *suspicious account reporting (SAR)* as to eliminate money-laundering at the initial stages of it. *Bank Secrecy* will also be considered as to analyse how this law is supporting or hindering money laundering.

Importance for each of the evaluation criteria is ranked with 0-5 as 5 being the highest. Prevention Programs is given an importance of 5 as financial institutions are required by the Anti-Money Laundering Act and Financial Intelligence Unit of each of the countries to conduct programs to prevent money laundering which are due diligence and reporting of suspicious transactions. Prevention programs are an important factor to financial institutions as it is the first step for money laundering called as placement wherein criminal proceeds are deposited to

financial institutions. Bank Secrecy is given an importance of 4 as it is an important factor to hinder the identification and investigation of money laundering. The stricter the bank secrecy is the harder it is to identify and conduct investigation to the accounts involved. Covered institutions are given a rank of 3 and covered transactions are given an importance of 2 because it is generally tied to the financial institutions compliance to the AML act which is more likely controlled by the governing bodies of the said act. Consequences and unlawful activities are given a rank of 1 and 0 respectively because it is also tied to the AML act which is under the supervision of the government.

Findings

Step 5: Analysis and Comparison of Alternatives

For analysis and comparison, non-dimensional scaling technique and additive technique weighing of compensatory method will be used.

Attributes	Value	Formula	Dimensionless Value
Covered Institutions	9	$(10-9)/(10-9)$	1
	10	$(10-10)/(10-10)$	0
Covered Transactions	High Threshold	Relative Rank $(2-1/2)$	0.5
	Low Threshold	Relative Rank $(1-1/2)$	0
Unlawful Activity	11	$(11-11)/(11-11)$	0
	6	$(11-6)/(11-6)$	1
Consequences and Sanctions	2	$(5-2)/(5-2)$	1
	5	$(5-5)/(5-5)$	0
Prevention Programs	Marginal	Relative Rank $(3-1/4)$	0.5
	Strong	Relative Rank $(2-1/4)$	0.25
Bank Secrecy Law	Strict	Relative Rank $(2-1/2)$	0.5
	Relaxed	Relative Rank $(2-1/2)$	0

Figure 3: Dimensionless scoring of two alternatives based on scores and relative rank

Attributes	AML Contract Clause Philippines	AML Contract Clause US
No. of Covered Institutions	9	11
Amount of Covered Transactions	High Threshold (500,000 PHP=12,000USD)	Low Threshold (10,000 USD)
No. of Unlawful Activity	11	6
No. of Consequences and Sanctions	2	5
Strength of Prevention Programs	Marginal	Strong
Bank Secrecy Law	Strict	Relaxed

Covered Transactions		Prevention Programs		Bank Secrecy	
High Threshold	0	Marginal	0	Strict	0
Low Threshold	1	Strong	1	Relaxed	1

Attributes	AML Contract Clause Philippines	AML Contract Clause US
Covered Institutions	0	1
Covered Transactions	0	1
Unlawful Activity	1	0
Consequences and Sanctions	0	1
Prevention Programs	0	1
Bank Secrecy Law	0	1
Total	1.0	5.0

Figures 4: Relative weighing of the alternatives

For non-dimensional scaling technique of compensatory method, it is shown that United States has greater scope and provision with regards to criteria considered with a score of 5.0 versus that of the Philippines with 1.

Attribute	Relative Rank	Normalized Weight (A)			AML CC FI in the Philippines		AML CC FI in the USA	
		(B)	(AxB)	(C)	(AxC)			
Covered Institutions	2	2/15	=	0.13333	1	0.13333	0	0
Covered Transactions	2	2/15	=	0.13333	0.5	0.06665	0	0
Unlawful Activity	1	1/15	=	0.06666	0	0	1	0.06666
Consequences and Sanctions	1	1/15	=	0.06666	1	0.06666	0	0
Prevention Programs	5	5/15	=	0.33333	0.5	0.16665	0.25	0.0833325
Bank Secrecy	4	4/15	=	0.26666	0.5	0.13333	0	0
SUM	15		SUM	0.999976	SUM	0.566593	SUM	0.899999

Figure 5: Additive weighing technique of compensatory method

Prevention Programs in the AML contract clause of financial institutions in the United States is conducting an enhanced due diligence which comprises of identification and verification of customer’s identity, verification of business relationships and reporting of suspicious transactions. Reporting of Suspicious transactions of United States is very much detailed; it covers criteria of suspicious transactions and guidelines for filing. The Philippines need to develop in this area as the reporting of suspicious transaction covers criteria but specific guidelines for reporting is lacking. In terms of enhanced due diligence, it is not required for the United States to conduct identification and verification of beneficiary’s details however, it is required in the Philippines but verification is not enforced fully.

In terms of the **Bank Secrecy**, the United States has a Bank Secrecy Act requiring financial institutions to collaborate with the government suspected money laundering cases. The opposite with regards in the Philippines, the Bank Secrecy Law is the prohibition of the inquiry and disclosure of accounts in the financial institutions in the Philippines. There are exemptions such as written consent of owner, court ruling and litigation. However, no specific commitment to AML and the bank secrecy law of the Philippines is considered to be strict which hinders investigation of money laundering.

Covered institutions scope of the United States covers different areas that are high risk with money laundering and Philippines are lacking in some areas.

Covered transactions in the Philippines have a very high threshold on the basis of the value of money and cost of living in the country. As a matter of fact, it has higher threshold than United States while US is 105% higher in terms of the cost of living than the Philippines.

Unlawful activities and fraudulent practices covered are wider in the Philippines than in United States. However, **consequences and sanctions** are much detailed in United States than in the Philippines.

Step 6: Selection of the Preferred Alternative

From the analysis above using compensatory model, ratings of each of the AML contract clause of financial institutions will be multiplied to the importance weights and totalled to get the highest score to select the preferred alternative.

Total weighed score for AML contract clause of financial institutions in the Philippines is 0.57 while the total weighed score for AML contract clause of financial institutions in the United States is 0.90

The AML contract clause of the financial institutions in the United States is the preferred alternative for covered institutions, covered transactions, consequences and sanctions, prevention programs and bank secrecy with improvement on the enhanced due diligence which is the identification and verification of the beneficiary in the transaction and higher scope for the identified unlawful activities and fraudulent practices.

Step 7: Performance Monitoring and Post Evaluation Result

One way to monitor performance is if the AML contract clause for financial institutions have been amended or revised as to bring it closer to the AML contract clause of the United States with few recommendations mentioned. The AML contract clause of the financial institution will be assessed in terms of its compliance with the international standard as contained in the Financial Action Task Force (FATF) 40+9 Recommendations. One key tool to use is the Methodology for Assessing Compliance with the FATF 40+9 Recommendations. Another way is to do a Detailed Assessment Report (DAR) which is the analysis of regulations to strengthen the system and suggest ways for compliance with FATF Standard. These are methods used worldwide to assess the compliance of institutions to the international AML standards. Moreover, cases of money laundering will also be considered as to check progress of prevention and early identification.

Conclusion

This research paper was undertaken to answer the following questions:

1) What are the provisions of the AML contract clause of the financial institutions in the Philippines with the basis of AML Act?

The terms and conditions of the contract clause of the general products and services of banks in the Philippines are giving significant importance to the AML Act which states that the account with the bank is ruled by the governing AML Act. Hence, clients must agree that products, services, facilities and channels are governed by the AML council. Moreover, the bank is not limited by the Know Your Customer (KYC) procedure which is part of due diligence but compliance with all the pertinent documents required by the bank as well. The banks require customer identification sheets and signature cards as a part of the enhanced due diligence.

AML terms and conditions in contract clause of financial institutions are based on the Anti-Money Laundering Act which was revised thrice; the most recent revision was made in 2016. It has significant clauses which are the major themes of international AML standards. The covered institutions are all financial institutions which are banks, insurance companies and securities/investment companies, pawnshop, electronic money issuers and all subsidiaries and affiliates supervised by Central Bank of the Philippines. Covered transaction is amounting to 500,000 pesos or 12,000 in USD dollars which is very high in terms of the value of money vis a vis cost of living in the Philippines. Unlawful activities which are called predicate crimes were mentioned in detail. AML was able to mention 11 crimes considering kidnapping, murder and the like as a Racketeering Activity or as one predicate crime. Consequences and sanctions states imprisonment for up to 14 years and fine is up to twice the value of the monetary instrument.

Bank Secrecy Law of the Philippines states that accounts are prohibited to be disclosed without the consent of the owner, order of the court and in matters of litigation. Hence, it is difficult to immediately open and investigate accounts in the Philippines in cases of money laundering.

2) How effective it is compared to the AML contract clause of the financial institutions in the United States?

In the United States, the terms and conditions of the general products and services of the bank states its strong commitment and support to the AML and all products and transactions are governed by this ruling. Enhanced due diligence is done by identifying and verification of the customer's identity and business relationship. Moreover, the SAR (Suspicious Account Reporting) is very much detailed including criteria, guidelines for filing, templates, provisions, limitations etc. The AML of US has broader scope and provisions for covered institutions with casinos, real estates and export and import businesses and lower threshold for covered transactions amounting to 10,000 USD. In terms of sanctions and consequences, imprisonment is up to 20,000 years, fine up to 500,000 dollars, property subject to forfeiture, banks can lose license and charters and bank employees can be terminated. Moreover, the Bank Secrecy Act of US implies strong adherence to AML requiring financial institutions to cooperate with the government in cases of money laundering. Bank Secrecy is more relaxed which is a good provision for investigating money laundering cases.

To compare, the Philippines has a reasonable AML criteria however it needs to be improved as to bring it closer to the international standards of AML as to prevent and combat money laundering.

3) What could be improved in order to strengthen the AML in financial institutions in the Philippines and the Anti-Money Laundering Act in general?

In order to improve AML in financial institutions in the Philippines, enhanced due diligence should include verification of beneficiary in the transaction not just the client alone. Moreover, SAR should be revised in more detail including stricter guidelines, templates, provision, limitations as to immediately identify money laundering at the earlier stages of it. In terms of the AML Act, casinos, real estates and import and export businesses should be included in the covered institutions as it is where money can be found in greater amount. As a matter of fact, in

the introduction of this paper, it was mentioned that there is a big money laundering case in the Philippines where the hacked money was circulated in casinos preventing tracking of it because it is not part of the covered institutions. Threshold for the covered transactions should be lowered; USA has a 10,000 USD threshold while Philippines has 12,000 USD. It should be noted that USA has 105% higher in cost of living than the Philippines. Lowering threshold for covered transactions will require the financial institutions to investigate and verify transactions amounting to the set amount which is important to be able to prevent dirty money divided in chunks from entering financial institutions. Consequences and sanctions should include that property and financial institutions licenses can be forfeited and employees will be terminated. Clearer and strong enforcement of consequences and sanctions for money laundering is necessary. Finally, one of the most important is to relax Bank Secrecy Law with detailed adherence to the AML so that in cases of money laundering it will be easier for the government to open and investigate accounts.

Follow on Research

There's limited resources of AML in other financial institutions such as insurance companies and investment companies as according to literature these are relatively new and process of money laundering is still being studied in these contexts. Moreover, there is a relatively low risk on these financial institutions mentioned compared to banks. Hence, it will be interesting to study the actual money laundering cases in insurance and investment companies as to assess fully its role in money laundering and what measures should be done. However still, insurance and investment companies are still under the AML act. Moreover, it will be interesting to compare the AML contract clause of Financial Institutions of the Philippines and United States with that of AML International Standards.

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