

## MONEY LAUNDERING

### Banks On High Alert

*Throughout much of Latin America and the Caribbean, banks and other financial institutions are getting tougher on money laundering. For the bad guys, the game of cat-and-mouse continues, as they jump from one country to another, looking for the weakest link in the chain.*

**Alexis Chistik, Miami**

Risks related to money laundering are more prevalent than ever in the Latin American financial industry. This is due in large part to problems with local banking regulations, but also deficiencies in the local regulatory agencies responsible for monitoring compliance with anti-money laundering rules. US government authorities, such as the Financial Crimes Enforcement Network (FinCEN), as well as multinational bodies charged with implementing and ensuring compliance with cross-border norms, such as the Financial Action Task Force (FATF), have sanctioned a number of countries in the region, either by placing them on a black list or by issuing public warnings to abstain from certain practices.



This turbulent scenario means increased challenges for any financial institution with correspondent banking relationships in Latin America. Some banks, most notably Wachovia, have been hit with multi-million dollar fines. Others have decided to pull out of certain markets or significantly reduce their scope of business. But neither action will put an end to money laundering. Ill-gotten gains of drug traffickers and other criminals will continue to find new markets, new channels and new victims. In this article, we will shed some light on the challenges that banks face when doing business in Latin America.

This year, FinCEN, a US Treasury Department agency, has issued a series of recommendations to international banks to minimize their operations in certain high-risk markets, including Ecuador, Paraguay and Bolivia.

#### **ON THE BLACK LIST: ECUADOR, PARAGUAY, BOLIVIA**

In the case of Ecuador, the decision was motivated by a lack of political will to abide by recommendations of FATF to punish the financing of terrorist organizations. President Rafael Correa's links to the "Axis of Evil," particularly his ties with Iran, were the biggest concern. According to a paper published by the University of Miami's Center for Hemispheric Policy, a Venezuelan group with ties to Iran purchased six ocean-going tuna boats in Ecuador, which are used to ship cocaine to the US and European markets.

In Paraguay and Bolivia, despite some willingness to cooperate on the part of their governments, the banking systems lack effective anti-money laundering controls. In Paraguay, the porous border continues to be a major issue, not only because of the trade in counterfeit goods through Ciudad del

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Este, but because of the Brazilian black-market currency traders, known as “doleiros.” Also of concern are the presence of terrorist cells in the tri-border region and the lack of government action to shut them down, despite the fact that certain individuals and companies have been included on the watch list by the Office of Foreign Assets Control (OFAC), another agency of the US Department of the Treasury.

Bolivia, meanwhile, continues to be one of world’s premier cocaine producers and its president, Evo Morales, the coca growers’ chief lobbyist. Bolivian drug traffickers export cocaine across the unpatrolled borders with Brazil and Argentina, destined for Europe, their primary market, according to a recent United Nations study.

But these three rogue countries are not the only ones that pose money-laundering risks in the region. Hugo Chavez’ Venezuela, the rich cousin and banker to Ecuador, Bolivia and Paraguay, poses its own serious challenges. The country is one of the major transshipment routes for the Colombian drug cartels.

#### **VENEZUELA vs COLOMBIA: AT OPPOSITE ENDS OF THE SPECTRUM**

Venezuela is currently suffering from a fiscal deficit fueled by the government’s spending on social programs that were once financed by plentiful proceeds from oil exports. As the country’s petrodollar reserves have been depleted, the government’s suffocating exchange rate regime has prohibited Venezuelan citizens from buying dollars or moving dollars overseas.

For a time, the Chavez government, faced with a need to finance the operations of its state-owned oil company PDVSA, allowed a swap market to prosper, which created an escape valve for the currency markets. Called *permutas*, the swaps involved local dollar-denominated bonds and US Treasury bonds. In recent years, this legal swap market allowed for the creation of a parallel exchange rate for the Venezuelan bolivar. In June, however, the government shut down this swap market and, along with it, a number of currency brokers, whose owners were apparently opponents of the Chavez regime.

On the other end of the political spectrum from Venezuela and its populist allies, are Peru and Colombia, the world’s two biggest cocaine producers. In Peru, the banks have begun to get organized and have staged a number of events to focus on the prevention of money laundering. Still, they have a long way to go to catch up to Colombia, the region’s poster boy for anti-money laundering regulation and controls.

In recent years, Colombia has developed and implemented an impressive array of processes and tools to protect against the risk of money laundering and the financing of terrorist organizations. The Colombian government has conducted joint operations with the US Drug Enforcement Agency (DEA), which have led to the confiscation of drug cartel assets and the dismantling of cells of the FARC guerillas, as well as right-wing paramilitary groups. The government has also taken aggressive action to prevent identity theft and to unmask phony front men of illegal businesses. Despite all these efforts and successes, however, Colombia continues to suffer from the drug cartel stigma and has a long battle ahead before the drug gangs are eliminated.

#### **THE COLOMBIANIZATION OF MEXICO**

Colombia’s challenges now seem tame in comparison to those faced by Mexico, where the drug cartels have developed their primary logistics operations in recent years, given the country’s proximity to their biggest market. The drug gangs have multiplied and expanded their criminal networks in a process described by Andres Otero of Kroll in an earlier *Tendencias* article as the “Colombianization of Mexico.” The competition among rival drug gangs has resulted in thousands of drug-related killings.

The government of president Felipe Calderon has fully engaged the Mexican military in the battle against the drug gangs. And the US government, through the Merida Plan, has pledged assistance to the Mexican army. In addition, Mexico has closed down a number of *casas de cambio*, or currency exchange companies, that permitted suspicious million-dollar, cross-border transactions -- in one case for the intended purpose of buying helicopters in the US -- without even minimum screening of the would-be buyers.

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Wachovia and other banks in the US have been hit with massive fines for receiving deposits from these *casas de cambio* without doing the appropriate due diligence. Wachovia, alone, paid \$160 million. Other US money remitters were severely sanctioned by US authorities for not having effective controls at their outlets, where supposed family remittances were a front for drug gangs repatriating their earnings. In one case, the remittances were payments to so-called coyotes, Mexican guides paid by illegal immigrants to lead them over the border into the US.

In an effort to deter money laundering, the Mexican government recently placed a limit on the amount of cash that can be deposited at banks. As a result, it is expected that the flow of cash will increasingly move south to Guatemala, already besieged by drug gangs and corruption, and other Central American countries. While some of these countries have invested in money laundering prevention programs, they are still far from being on the forefront of best AML practices.

#### **PANAMA & URUGUAY: REFORMED SINNERS**

Panama will continue to be the preferred destination for much of Colombia's and Mexico's narco-dollars. The country's fully-convertible Balboa, which circulates as a dual currency with the US dollar, is one obvious attraction. Others include tax exemptions and political stability, as well as the prevalence companies that issue anonymous bearer shares.

Panama has been a magnet for corrupt politicians from all over Latin America, who traditionally hid their money in numbered bank accounts, and for drug cartels and illegal arms dealers, who set up shell companies. However, Panama's Superintendency of Banks, with the support of the Panama Bank Association, has begun to impose tighter controls. In response to new restrictions imposed by the Organization for Economic Cooperation and Development on tax havens, Panama is working on changes to its financial regulations to avoid being blacklisted.

Uruguay is doing the same. A longtime favorite destination for tax evaders from neighboring Mercosur countries, Uruguay has modified its financial regulations to avoid being tagged as a tax haven. The most significant is that the notorious SAFI (Sociedad Anonima Financiera de Inversiones) investment companies, whose shareholders were anonymous, are being eliminated. Purchasing shares in an Uruguyan SAFI was a favorite ploy by criminals and tax evaders to remain under cover.

#### **ARGENTINA NEXT ON THE BLACKLIST?**

While Uruguay and Panama are cleaning up their acts, Argentina is struggling. In its most recent report, the Financial Action Task Force on Money Laundering in South America (commonly known by its Spanish-language acronym GAFISUD) a regional inter-governmental organization, raised a long list of objections to the country's financial regulatory regime. Among various deficiencies, it noted that no one in Argentina had been indicted or jailed for money laundering and that its Financial Intelligence Unit (Unidad de Informacion Financiera) is highly politicized, with few full-time staff and most of its officials appointed by the government.

In an effort to improve its image and to avoid being blacklisted by GAFISUD, the Argentine government began to impose a new set of regulations in an attempt to monitor tax evasion and place limits on foreign exchange transactions, barely one year after passing a capital repatriation law (referred to jokingly by some at the time as the "capital laundering" law).

With these and other new restrictions on the free and anonymous flow of money throughout Latin America, what's a money launderer to do? It might be tempting to just pack one's bags -- filled with cash -- and retire to the Caribbean. But watch out, as some of the islands have also imposed limits on the amount of cash one can bring in. Still, in some Caribbean countries, notably the British Virgin Islands and the Cayman Islands, it is possible to set up bearer share companies and, with the help of specialized law firms, create complex organizational structures designed to hide the source of funds and, in some cases, to evade local taxes. In the Dominican Republic, where several cases have been investigated by the local authorities, the banks are keeping close tabs on foreign investments in resorts and real estate developments.

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## CONCLUSION

Money laundering in Latin America and the Caribbean is game of cat-and-mouse. The money launderers continue to move from place to place, looking for the weakest link in the chain where the screening of clients and the restrictions on the movement of monies are least strict. But governments and financial institutions are making life difficult. Throughout the region, banks have been required to implement controls to mitigate the risk of money laundering. In addition, banks in Latin America and the Caribbean have had to invest more in prevention in order to comply with tougher demands of their correspondent banks in the US. Those demands will continue to get tougher.

And it's not just banks that have had to implement money laundering prevention systems. The same applies to *casas de cambio*, brokerage firms and, in some countries, casinos, insurance companies, real estate investment trusts (REITs), credit card issuers, travel agents and car dealerships, as well.

To be sure, the effectiveness of money laundering prevention systems and terrorism financing detection systems in banks around the region is anything but uniform. Some financial institutions have implemented rudimentary monitoring systems that are produced internally on Excel spreadsheets, while others have developed sophisticated systems that rate clients according to a risk matrix and generate automatic alerts when transactions exceed certain pre-set limits.

Even more important than the level of sophistication of monitoring systems, however, is the ability of the financial institution to respond to red flags. In many cases, the number of alerts generated by the system overwhelms a bank's ability to respond. There are simply not enough trained specialists to analyze each suspicious situation. As a result, some alerts are never properly analyzed. And some investigations are opened but not carried through to the end. Suspicious cases fall through the cracks.

A number of financial institutions in Latin America and the Caribbean have competent compliance officers with international certifications, who diligently analyze unusual activities and file reports on suspicious clients. In other financial institutions, however, the compliance function is not considered vital, while the compliance officer has little experience, no decision-making power and ends up being a rubber stamp for decisions made by the sales department.

Some banks have broad employee training programs in money laundering prevention and detection. Some even offer e-learning programs, which allow for greater reach and flexibility. However, in many financial institutions, not all the employees are trained, the material is not user-friendly and there is no process of evaluation.

Some proactive banks in Latin America that want to improve their money laundering prevention systems to stay one step ahead of the regulators, thereby avoiding sanctions or closed accounts, have contacted the services of international consultants. A diagnosis of their prevention systems allows these institutions to identify the gaps and to adopt the best practices of leading international banks. Other banks, however, rely on the traditional reviews performed by the local superintendency of banks, which in many cases, leave them vulnerable and exposed in certain business practices, such as international transfers and trade finance, which are not inspected as thoroughly as they should by the local regulators.

Over the past five years, there have been significant improvements in the implementation of money laundering prevention systems in Latin America. Banks have adopted an impressive array of new tools to help them defend themselves in a battle with criminal organizations and money launderers that is becoming more complex every day. Still, Latin American financial institutions, as a whole, have a long way to go to match the best practices in the industry. As in every profession, techniques and counter-measures need to be re-defined and updated on a regular basis, as the criminals recalibrate their activities to adjust to new regulations and policies everywhere.

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