

**Summary of Global Dialogue Series on  
Strengthening the Collaborative Process to Build Effective Anti-Money Laundering  
and Combating the Financing of Terrorism (AML/CFT) Regimes  
For  
Afghanistan**

June 2, 2004

**Background**

The risks posed by money laundering and terrorism financing to the reputation and integrity of financial systems are being recognized widely across the world. In response, the government agencies and financial institutions are working together to develop robust AML/CFT programs and internal control systems. Adoption of sound AML/CFT policies and procedures, including Know-Your-Customer (KYC), Suspicious Transaction Reporting (STR) and compliance testing, are critical elements in developing comprehensive AML/CFT regimes.

To successfully build effective AML/CFT regimes, policy makers, law enforcement agencies, financial regulatory and supervisory authorities, financial institutions, non-bank financial institutions, and international organizations – need to forge effective partnerships, both internationally and domestically. Strong links between international and domestic stakeholders will lead to better decisions based on greater understanding of the situation by the authorities and better implementation of the requirements by the private sector.

For this reason, the World Bank's Global Dialogue Series on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was designed to enable client countries, the World Bank, the International Monetary Fund (IMF), regional bodies emulating the international Financial Action Task Force, regional development banks, and other international organizations to discuss and exchange information on the challenges faced in the struggle against illicit money flows, to share the lessons of successes, and to identify the types of assistance countries need to combat money laundering and terrorist financing.

The dialogue for Afghanistan on June 2, 2004 brought together representatives from the World Bank, the IMF, and regulatory and financial sector representatives to exchange experience and information regarding Afghanistan's recent AML/CFT experience and the challenges associated with developing and implementing an AML/CFT strategy.

## **Participants and Speakers**

### **Moderator**

- Samuel Munzele Maimbo, Financial Sector Specialist, South Asia Region, the WB.

### **Welcome and Introduction**

- Alistair J. McKechnie, Country Director, Afghanistan, the WB.

### **Presentations**

- **“New International Standards on AML/CFT: Impact on the Financial Sector”** - Joseph Halligan, Senior Financial Sector Specialist, Financial Market Integrity, the WB.
- **“Implementing the International Standards: Developing an AML/CFT Strategy and Steps Required in Building the Regime”** - Ian De Vere Carrington, Senior Financial Sector Expert, Monetary and Financial Systems Department, IMF.
- **“AML/CFT Legal and Regulatory Reforms”** – Mr. Abdul Fitrat, First Deputy Governor, Da Afghanistan Bank.
- **“AML/CFT activities in Afghanistan”** – Mr. John Janes, Managing Director, Standard Chartered Bank, Kabul.

### **Discussants**

- Ross S. Delston, Consulting Counsel, Legal Department, IMF.
- Ahmed Elbashari, Regional Specialist, Middle East and North Africa, Financial Crimes Enforcement Network (FinCEN), Department of the Treasury.
- Ted Greenberg, Senior Counsel, Legal Vice Presidency and Financial Market Integrity, the WB.

## **Topics Covered**

The representatives of the WB and the IMF were invited to address the following issues:

- What are the current international responses to money laundering and terrorist financing?
- How can regulators effectively implement the International Standards on money laundering and terrorist financing?

The Central Bank representative and the representative from the financial sector were asked to address the following issues:

- What have been the country's responses to money laundering and terrorist financing?
- What institutional arrangements have been made to combat money laundering and terrorist financing?
- What are the key challenges for the country in combating money laundering or terrorist financing?
- What type of assistance does the country need from international organizations to fight money laundering and terrorist financing?

The dialogue provided an opportunity for the speakers and participants to discuss Afghanistan's anti-money laundering regime and efforts to combat the financing of terrorism. Speakers and participants addressed themselves to the following issues, needs and possibilities.

#### **A. International AML/CFT Best Practices**

Developments in international best practices with regards to the prevention and detection of money laundering and terrorist financing have been reflected in the new international standards. The main elements of these best practices are:

- criminalizing money laundering and terrorist financing;
- confiscating criminal assets and freezing terrorist funds;
- enhancing customer identification, due diligence and record keeping;
- reporting suspicious transactions;
- enhancing regulation and supervision;
- creating FIU; and
- reinforcing international cooperation.

All illegal acts leading to money laundering must be criminalized. AML/CFT criminalization is often tied to legislation dealing with drug trafficking. However, predicate offenses for money laundering should go well beyond drug trafficking and should include all serious offences, such as fraud, bribery and corruption. Terrorist financing should be criminalized whether the source of funds is legal (i.e. contributions to charities or legitimate income) or illegal.

The proceeds and instrumentalities of money laundering should be confiscated by the state. It is important to ensure that law enforcement agencies, the FIU, or other competent authorities have the necessary legal power to identify, seize and freeze the illegal proceeds, and confiscate them effectively. Also, the authorities should have access to banking and financial transaction information in order to pursue investigations. It is important to create an effective system of freezing terrorist funds by administrative procedure rather than by court order since the former is faster. There are three basic source of information regarding terrorist financing: U.N. Resolution 1267 and 1373 as well as other terrorist lists developed at the national levels. These lists help identify the names of individuals or entities whose assets should be frozen.

Financial institutions should have appropriate customer identification and due diligence procedures, known as know your customer (KYC) procedures, in place. KYC procedures ensure that financial institutions maintain adequate knowledge about their customers and their financial activities. There are enhanced measures need to be taken for high-risk categories, including politically exposed persons (PEPs), correspondent banks, shell banks, none face to face business, and introduced business. Financial institutions should keep all necessary transaction records for at least five years, and contents of the records should be made available to the authorities upon request to permit prosecution of criminal behavior.

Suspicious Transaction Reporting (STR) should be applied not only to financial institutions but also to designated non-financial businesses and professions (DNFBP), including lawyers, accountants, casinos, and dealers in precious stones and metals. The reporting obligation for lawyers and accountants is subject to the legal professional privilege exemption, which should be reasonable.

A tier approach can be taken when regulating and supervising AML/CFT activities. Core institutions, such as banks, and insurance and securities companies, should be subject to the full range of regulation and supervision. Other financial institutions (i.e. money value transfer and money exchange businesses) and DNFBP (i.e. lawyers, dealers of precious stones and metals, and casinos) should also be subject to regulation and supervision, but the supervision should be reflected to the risk associated to each institution. Money value transfer and money exchange businesses should a minimum be required to register or get licensed.

A jurisdiction should create an FIU that serves the four major functions of receiving, analyzing and disseminating disclosures of STRs and other relevant information to law enforcement agencies, and exchanging information internationally with counterpart FIUs. An FIU can be established according to three different models: administrative, law enforcement, and prosecutorial. Each jurisdiction should decide which model to adopt based on its legal and cultural situation. Regardless of model, it is important that the FIU has operational independence and autonomy to ensure that it is free from undue interference.

The authorities should cooperate with foreign counterparts as much as possible. For example, a jurisdiction should exchange information and facilitate mutual legal assistance with regard to AML/CFT law enforcement matters, such as freezing and confiscation orders and extradition of its own citizens.

## **B. Regulatory and Supervisory Framework for Implementing AML/CFT Best Practices**

The actual implementation of the above international best practices involves following supervisory elements and efforts. Different supervisory models exist, including supervision by different regulatory bodies (insurance, banking, and securities) and

supervision by the FIU. A jurisdiction's circumstances and conditions should determine the model it chooses. Whichever model is chosen, adequate pool of resources should be available. The risk based approach for supervision enables the supervisors to apportion limited resources efficiently across sectors and types of activities by identifying and focusing efforts on what types of sectors and activities have higher risks.

The objective of supervision is to assess the compliance of internal control programs (i.e. CDD, record-keeping, and STRs) with AML/CFT laws and regulations. Assessing compliance can be done either/both by off-site or/and on-site inspections. Off-site inspections include: reviewing whether the financial institution's policies, manuals, and other documents are in line with the law; and using assessment questionnaires to obtain a better understanding of the compliance structure of the institution. On-site inspections add further value to off-site inspections by enabling supervisors to verify the analyzed information by talking to employees vis-à-vis and reading a compliance report.

The major role of supervisory authorities is to identify the underlying cause of a particular problem (i.e. inadequate policy, dysfunctional system, lack of training, or internal fraud), and provide a guidance recommendation. The guidance should assist financial institutions to develop and implement effective internal control programs. It is important for regulators to have adequate enforcement powers, including several degrees of sanction tools (i.e. ability to issue fines and revoke licenses). In addition, regulators need the ability to share information with other international regulatory authorities.

Assessment elements should include: level of awareness of laws and regulations; adequacy of internal control policies and procedures; availability of adequate information systems and databases; availability of internal audit system; and adequate training. Since international AML/CFT standards evolve over time, it is important that all levels of employees are fully aware of the new standards and obligations. DNFBP should also be subject to regulation and supervision to comply with international standards. However, since there is no internationally accepted standards pertaining to regulating DNFBP, it is challenging to identify appropriate supervisory methodology for these sectors.

### **C. The AML/CFT Legal and Regulatory Environment in Afghanistan**

The opium production (generating approximately USD 2.2 billion revenue annually) is a large part of the current Afghan economy. This issue needs the address within a strategic framework, especially in the financial sector. Since Afghan's financial sector is exposed to money laundering risk, it is necessary that the jurisdiction strengthens its AML/CFT regime through international collaboration and assistance. Another unique issue associated with money laundering and terrorist financing in Afghanistan is the prevalence of active informal financial systems, including Hawalas and the black-market money exchange.

Afghanistan has recognized the importance of AML/CFT efforts and the necessity for international collaboration. However, Afghanistan has not yet adopted an AML/CFT

legislation nor created an FIU. Also, the Afghan Banking Law (the Da Afghanistan Banking Law), which governs AML/CFT supervisory issues, does not encompass elements that are part of international standards (particularly customer due diligence, filing of suspicious transaction reports, and record-keeping) to ensure effective internal control systems.

### Legal AML/CFT Reforms

To address these discrepancies, the Afghan government has committed to enact the draft AML/CFT legislation by September 2004 and create an effective FIU by January 2005. The high level inter-agency committee, composed of a broad range of constituencies, including Ministry of Foreign Affairs, Ministry of Justice, Ministry of Finance, the Office of Prosecutor and the Central Bank of Afghanistan, was created to discuss and develop an AML/CFT law that complies with international standards. In addition, the Afghan government has sought partnership programs with international bodies as well as donor countries to benefit from TA.

After the fall of the Taliban regime in November 2001, the Afghan government made efforts to combat money laundering and terrorist activities. The draft AML/CFT law incorporated international AML/CFT standards, including endorsing the U.N. Vienna Convention to criminalize money laundering activities, U.N. Resolution 1373 to freeze terrorist funds, STR Act, and customer due diligence programs. The draft law also includes the establishment of an FIU as well as extraditing criminals and confiscating criminal proceeds.

Another legal effort undertaken by the Afghan government includes endorsing the new banking law. This new banking law incorporated a licensing, reporting, and a minimum of five-year record-keeping requirements for both formal financial institutions and informal money exchange dealers and money service providers. The banking law has already passed the first Supreme Council meeting of the Central Bank in April 2004, and will be in effect as soon as it is published in the official gazette.

### Regulatory and Supervisory Challenges

Although efforts have been made to strengthen the AML/CFT system, there are few resources available and little expertise to combat the issues. The Afghan government requires resources for developing a centralized national database. Resources are also needed to develop training programs to enhance both the skill level and ability of employees to analyze and disseminate information in a timely manner with effective inter-agency coordination. In addition to the resources and expertise constraints, the major challenge for the country is to implement the effective AML/CFT law.

Due to an absence of a robust national payment system, resulting in a cash-based economy, the banking industry in Afghanistan is at the early emerging stage. The main challenges facing by the banking industry when developing internal control systems include: 1) lack of understanding of risks associated with money laundering and of the

applications of new laws and preventative measures by employees; 2) lack of qualified trained human resources; 3) lack of trust and cooperative attitude by customers; and 4) need to identify overall operational impact and consequences when applying the new international AML/CFT standards.

### Planned AML/CFT Reforms

An effective next step when developing an AML/CFT regime is to enact and implement an AML/CFT legislation that complies with international standards. The Afghan government is committed to enact the law by September 2004.

By January 2005, the Afghan government is planning to create an FIU under the Central Bank's premise. The FIU will be a semi-autonomous body, and the director general of the FIU will be nominated by the governor of the Central Bank and approved by the Supreme Council of the Afghanistan Bank for a five-year term appointment. However, the director general of the FIU will have full authority over operational issues and resources allocation. In order to ensure that the FIU operates effectively, the Central Bank intends to create a national database to receive, analyze, and disseminate STRs and other relevant information. The Central Bank will seek TA from the international organizations to accomplish this.

In order to strengthen AML/CFT efforts, the banking industry intends to develop and update CDD policies and procedures as well as adopt the Wolfsberg AML Principles. Necessary elements for effective CDD policies include: having proper customer identification, knowing a customer on a risk-based KYC basis, monitoring customer's transactions, reporting suspicious transactions, and keeping records. Providing training and organizing awareness raising programs to promote AML/CFT issues and inform general public about the issue are also next steps to be implemented.

### **D. Recommended AML/CFT Reform Actions**

Overall, it was discussed and agreed that in order to forge an effective AML/CFT regime, the Afghanistan needs to enact adequate AML/CFT legislation and provide appropriate training to both regulatory and law enforcement staff.

More specifically, the following issues were discussed during the dialogue

#### *1. Commitment and Political Will*

- **Ensuring true commitment and political will.** All sectors must understand the importance of collaboration and be willing to cooperate for an AML/CFT regime to be successful.

#### *2. Legal and Regulatory Framework*

- **Enacting the AML/CFT legislation as a first priority.** When building an effective AML/CFT regime, a number of sequenced steps must be taken. The first of these steps is to enact the AML/CFT law which incorporates the revised FATF Recommendations. An FIU cannot operate without a legal basis. Once a solid legal framework has been achieved education will be necessary.
- **Adopting a comprehensive legal framework.** The AML/CFT law needs to define money laundering and terrorist financing as predicate offences as well as expand the scope of covered institutions. The law should enable the authorities to penalize the criminal act.
- **Introducing the “Wolfsberg AML Principles.”** The AML Principles established by the Wolfsberg Group, outline the central principles for banks to follow when conducting international banking. It would be beneficial for Afghanistan to pay close attention to these principles when developing the AML/CFT regime. However, it was emphasized that the Wolfsberg AML Principles should be endorsed in the premises of training aspect in order not to confuse with the FATF Recommendations.
- **Consistency in application.** The new law must be approached consistently by all institutions, both public and private. This will ensure that all stakeholders understand their role and that there is uniformity in all business sectors. By doing this, Afghan authorities and institutions will be able to work together to meet the international standards.
- **Establishing a clear and transparent regulatory framework for micro finance institutions and for procurement.** It was suggested that since Afghanistan has loose regulatory framework applies to micro finance institutions, regulatory and supervisory agencies should consider the risks associated with regard to the micro finance institutions. Once the risks are identified, a clear and transparent regulatory framework is necessary. Also, endorsement of a transparent procurement law which pertains to reconstruction financing projects was suggested.
- **Creating an effective FIU.** There are a number of issues to consider when establishing an FIU. While an FIU can be located in several different agencies, i.e. ministry of finance, central bank, or ministry of justice, it is important to recognize that each country is different. Thus, the decision of where to establish an FIU should be made based on relations of trust, available resources, and supervisory issues to work together. It is important that an FIU is autonomous, and has the authority to gather, analyze and disseminate information. Although some start-up costs will incur for development of a business plan and software, an FIU does not have to be extensive in staff or expensive to be effective. By sequencing various donor aid, according to the country’s expected need, costs can be kept at a minimum. Given the current situation in Afghanistan, it was suggested that the FIU be located under the premise of the Central Bank since the Central Bank has the most resources and the best skilled people, as well as is politically motivated and least corrupted.
- **Enticing the informal financial sector into formal economy.** The informal financial sector, i.e. alternative remittance system (ARS) or Hawala, can easily be abused and facilitate transnational crime and money laundering since activities and financial links are difficult to trace. In Afghanistan, informal financial institutions are not properly registered. Therefore, it was suggested that a basic law to

criminalize unlicensed business operations should be endorsed, and then, the authorities should provide inspection and guidance accordingly.

- **Strict enforcement.** The public must be assured that criminals will never get access to the money they laundered even after their jail term.

### 3. *Feedback Mechanism*

- **Ensuring coordination with law enforcement authorities and providing appropriate feedback to the private sector.** There should be communication between law enforcement agencies and the financial sector facilitated by an FIU. The authorities (FIUs) should develop a constant feedback mechanism to financial institutions especially on STR reporting and typology studies. Furthermore, the law must allow for the authorities to give this feedback as they are often legally constrained.
- **Ensuring appropriate feedback to the private sector.** The FIU should provide feedback to banks on how the financial information disclosers are used by the law enforcement, the FIU and courts as well as on the quality of the information submitted.

### 4. *Cooperation Mechanism*

- **Forging international cooperation with foreign government agencies.** Afghanistan has recognized the global need for an effective AML/CFT system and has asked foreign countries for their increased cooperation. One possible area of assistance that could be provided by the United States is tackling cross-border issues such as an illegal exchange and barter. It was suggested to seek the assistance of the U.S. Customs Service to track various suspicious cross border transactions and use its user-friendly software, Numerically Integrated Payment System (NIPS).
- **Seeking technical assistance from international organizations.** Since building an effective AML/CFT regime requires resources and training, it is recommended that Afghanistan communicates with international organizations to identify specific TA needs.

### 5. *Training and Education*

- **Educating all the relevant constituencies.** At the initial stage, all the stakeholders (i.e. supervisory agencies, law enforcement agencies, financial institutions, and DNFBP) need to be educated about AML/CFT in order to develop the best technique for Afghanistan's specific case. Supervisors must have a thorough understanding of what money laundering is, how it occurs, and why it is important. Law enforcement agencies must develop techniques to track money laundering as well as procedures for indictment. In Afghanistan, both banks and DNFBP, such as dealers in precious metals and stones, must understand risks associated with money laundering as well as the best practices for the preventative measures, including suspicious transaction reporting.

- **Ensuring continuous training for both the public and the private sectors.** There is a need to provide continuous training for the regulatory and supervisory authorities to support enforcement. The training may include case studies, including supervisory action against a financial institution for money laundering, thereby enabling them to understand practical examples of the pressures and complexities they may face in implementing an effective AML/CFT regime. For financial institutions, there is a need to have continuous training on the applications of new laws and preventative measures for all levels of the employees. Also, as AML/CFT issues are dynamic in nature, continuous studies in AML/CFT typologies are necessary to keep up to date with ever-changing criminal activities and to comply with international standards.

#### 6. *Guidance by the Public Sector*

- **Raising public awareness.** The public must be educated about the risks money laundering and terrorism financing can have on the economy and the country. In addition, the public needs to be made aware of the government's actions. If people have confidence that laws will be used for its intended purpose, they will see the benefits and be supportive. However, if the public views the AML/CFT regulations as simply a way for the institutions to gain more information about individuals, the new laws will not be supported or followed.
- **Assisting in the development of effective internal control systems/programs.** The authorities should assist financial institutions in developing and implementing effective internal control systems/programs to ensure compliance with requirements. Setting up KYC policy, especially paying attention to PEPs, is one of the most important elements for banks in Afghanistan to consider when developing effective internal control systems/programs.

#### 7. *Information Sharing*

- **Utilizing suspicious persons lists.** The financial institutions and the government authorities should pay attention to the lists of suspicious activities and individuals/organizations published by the U.N. and various countries to help Afghanistan become more aware of risky customers.
- **Developing tools to comply with customer due diligence measures.** Once the AML/CFT law covering customer due diligence requirements has been enacted, financial institutions need to develop the tools necessary for implementation. Also, the government authorities need to centralize the national database for effective information analysis and dissemination.

#### 8. *Risk-based Approach*

- **Encouraging a risk-based approach.** Banks should evaluate customers based on risk criteria. By understanding what criteria constitutes a risky customer, banks can become more cognizant of money laundering and terrorist financing. Thus, risk-based approach simplifies due diligence programs, allowing banks to focus on higher-risk individuals/organizations. FATF specifies higher-risk categories (i.e. PEPs, shell

banks and introduced business) but deliberately does not specify lower risk categories, thereby allowing flexibility for each country to make its own assessments based on the individual jurisdictional situation.

#### *9. National AML/CFT Strategy*

- **Establishing a high-level inter-agency committee to discuss the draft AML/CFT law.** In order to comply with the international AML/CFT standards, an inter-agency committee was established in Afghanistan. The committee consists of a broad range of agencies, including Ministry of Foreign Affairs, Ministry of Justice, and Ministry of Finance, to ensure collaboration.
- **Modernizing the payment system.** The less formal banking activities a jurisdiction has, the greater the risk that money laundering activities occur. Since the Afghan economy is largely cash-based, a robust national payment system needs to be developed. Modernization of the payment system can serve as a basis for consistency among the financial institutions across the country.

During the dialogue, broad context of AML/CFT issues were addressed and various potential TAs were identified to strengthen AML/CFT regime in Afghanistan. Once Afghanistan passes the AML/CFT law (expected September 30, 2004), more detailed discussions will be necessary.