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Banking & finance - Banks pay price of terrorism

» **Jules Stewart, a freelance journalist.**, 25-10-2001

Account registers, suspicious transaction reports, and know your customer rules are expensive - for banks and their customers.

The international crackdown on money laundering in the wake of the 11 September terrorist attack on the US will put a strain on relationships between banks and their corporate customers. Banking supervisors have been set a benchmark for national "know your customer" (KYC) practices in a paper on customer due diligence issued by the Basel Committee on Banking Supervision. The committee has identified deficiencies in a large number of countries' KYC policies for banks. It recommends that banks should not only establish the identity of their customers but that they also need to monitor account activity to determine and spot abnormal transactions.

The US Congress has brought in draconian measures to combat laundering, and other countries have fallen in line. Germany, for instance, has enacted legislation to set up a central register of the more than 300 million current accounts in the country. All suspicious transactions must be followed up by banks and reported.

"This is going to drive up fees for customers as banks will have to put more money into their anti-laundering systems," says Christian Lorenz, editor of securities and banking at online compliance information service Complinet. "It adds yet another layer to the expanding complex of national and international KYC rules."

The impact of the anti-money laundering measures is likely to be felt on two levels. On the one hand, banks will have to report and investigate all suspicious transactions, while corporates will be asked to provide background on specific deals. An entire raft of transactions will be held up for inspection, especially if they come through a Gulf bank.

"Banks will review their relationships," says Norman Bernard, a director at First Consulting. "You can't avoid fleas on fleas. For instance, Barclays New York may get a payment from a reasonably respectable second-tier bank that has a correspondent relationship with a not-so-terribly respectable bank. An order might come to pay \$45,000 to someone who has had an account at Barclays for three months, and it will trigger an investigation. An enormous number of transactions will be covered by quantum, irregularity or correspondent criteria."

Corporates at all levels are usually careful about where they put their money. However, the changing nature of banking often means a corporate treasurer may not always know where his company's funds

are being invested.

Warren Edwardes, chief executive of Delphi Risk Management, points out that corporates are increasingly investing in funds operated by top-tier international banks. "These institutions set up large money market funds and corporates cannot control where they are investing," he says.

Islamic banks will bear the brunt of the crisis on the basis of guilt by association. The obvious precedent was the collapse of BCCI in 1992, when a Scottish local authority and several corporates found themselves in trouble for having placed funds with the bank. At that time corporates all over the world reviewed their relationships with Middle East and Pakistani banks. "It was a classic case of mud sticking," says a UK banker.

The US Congress is determined to hand the treasury secretary powers to penalise banks in countries determined to be of "primary money laundering concern". The secretary could force these banks to identify the ownership of secret accounts or bar them completely from correspondent relations with US banks.

Companies are already minimising their exposure to the Islamic banking system, as there is an assumption that these institutions are natural conduits for terrorist-linked funds. This in turn will cause problems for corporates with significant exposure to markets such as Indonesia or Malaysia. Multinationals often work with Islamic banks in these countries to establish their credibility with the local authorities, because government relationships are often key to success.

Overall, the anti-money laundering offensive will touch off a two-way flight to quality. Corporates will want to make sure their funds are held by reputable institutions, while banks need to ensure they are dealing with clean customers. However, Edwardes is quick to advise against hasty decisions. "Corporates and banks have to be careful because counter-parties have long memories," he says. "It is difficult to build up relationships - and all too easy to destroy them."

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