

# SUPERVISING FUNDS TRANSFERS THE COLOMBIAN EXPERIENCE

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# Background

“Informal funds transfer systems” have always been illegal in Colombia.

- The Colombian Foreign Exchange Statute, issued in 1991, defines funds transfers, as a foreign exchange operation that must be canalized through an intermediary of the foreign exchange market (FOREX).
- All intermediaries are subject to state supervision, either by the Colombian Banking Superintendence or the Securities Exchange Commission, depending on the kind of intermediary.
- Before 1991, Colombia had a highly rigid foreign exchange control system; tenure of foreign exchange was highly restricted.

# Background

- The Central Bank acting as monetary authority fixed the price of foreign currency; the use of its funds transfer service was mandatory.
- Colombia learned the hard way that a restrictive and monopolistic system generates very active **black** markets; funds transfers were no exception.
- In order to enhance the security and health of the Colombian financial system, the foreign exchange market was liberalized, opening new interesting opportunities for doing business; illegal providers received clearly the following message:

funds transfers is no longer a crime, you are welcome to do business.

# Background

Liberalization meant among other things:

- government no longer has the monopoly of foreign exchange;
- the market determines the price of foreign currency;
- financial institutions, security brokers and money remitters (casas de cambio) are permitted to intermediate the FOREX (this provision is crucial to understand the huge development and expansion that the money transfer business has experienced since 1991);
- money transfer providers are subject to permanent onsite and offsite supervision;
- illegal providers are subject to severe sanctions and penalties;
- the new statute gave confidence and transparency to the market by explicitly defining foreign exchange operations and the persons able of conducting them.
- New rules makes mandatory for providers to maintain the same level of transparency as the rest of the intermediaries of the FOREX and to implement the full range of AML controls as financial institutions.

Helping providers of funds or Casas de Cambio to do legal business was no easy task.

- Providers had to be guided step by step;
- the banking superintendence issued an effective regulation that states that the casas de cambio (providers of funds) must follow, where applicable, the same rules and standards as financial institutions.
- The banking superintendence also issued the examination regime for providers of funds,
- The process of introducing providers to legality was a long one, it took a couple of years.
- A special division was created, where a team of examiners undertakes a permanent onsite and offsite examination.
- An examiner's report is written with the conclusions of the onsite examination and then sent to the provider for its comments.

a proactive and very strict supervision, had the effect, that hawala is no longer common in Colombia.

- Hawalas face, one or several of the following sanctions:
  - Cease and desist orders. Daily fines of one thousand dollars.
  - The liquidation of the institution
  - The liquidation of all illegal operations, through an expedite administrative process.
- For the purpose of determining if an institution is pursuing illegal funds transferring activities, the Superintendence has the power to inspect accounting books, files and records

# Supervision

- Since the year 2000, Colombian emigration has brought a substantial increase in funds transfers to our country.
- The growth of the latin migration to the USA increased from 12 millions in 1995 to 17 million in 2002.
- For 2003, 40% of latinos living in USA sent money to their home countries. According to the inter american development bank, one of every ten latinos is a beneficiary of a funds transfer, in the case of Colombia one of every ten.
- 56% of the transfers have their origin in USA and 27% in Spain.
- By the end of 2003, donations and funds transfers amounted to US\$ 3000 million dollars, its participation as a percentage of the gross internal product shifted from 2% in the year 2000 to 3.9% in 2003.

# Supervision

- During 2004 the amount of funds transfers received through casas de cambio (providers of funds) was of more than two thousand million dollars (US\$ 2.000)
- The figures show the necessity for the providers of funds to have an adequate supervision.
- For this purpose , the supervisory body must understand the risks involved in money laundering and in the financing of terrorism and how this risk must be faced.

## PRINCIPAL RISKS RELATED TO AMF/CFT

AML/CFT risks relate to both private and public sectors.

- For the public sector:
  - Increase in criminality
  - Deterioration of public order
  - Corruption in public institutions
  - Loss of confidence of the public in the financial system
  - Country's reputation: public opinion (national / international)
- For the private sector:
  - Loss of reputation risk
  - Legal risk
  - Operational risk
  - Financial risk

**Risks are powerful incentives for the public and private sectors to fight against money laundering and the financing of terrorism**

As with any corporation, financial and non financial institutions in order to offer a service or a product, must:

- Use resources
- Assume a set of risks
- Manage them efficiently and
- Obtain a benefit

The maximum risk level acceptable must be closely related with the possibility of loss of image and reputation of the institution not with financial losses

## AML/CFT Risk management

- It's main incentive is to protect the integrity of the *institution and of the financial system*
- Differs from other risks financial institutions must face (e.g.: credit, market or liquidity risks) in that it is not necessarily of a financial character; there is not always a direct risk/benefit relationship .
- Its main indicators are not related with direct financial losses but with clients.
- As with other risks, it can't be eliminated. ( $R \neq 0$ )
- Attention must be concentrated in risk management .
- It is difficult to measure the effect that the loss of reputation has on a financial/non financial institution.

## AML/CFT Risk management

Risk management is a fundamental part of the strategy and decision making process in the institution

- The board of directors must lead the risk management process:
  - Involving completely in its implementation process
  - Demanding decisions to be made, controlled and evaluated according to criteria of loss of reputation and legal risk and NOT by the benefit/risk relation
  - Fixing criteria for acceptance of the risks to be managed according with the activity and the profitability aimed at by the institution

# AML/CFT Risk management

Cont.,

- Making decisions about new operations and about changes in the global profitability / risk profile of the organization, according to the prospect of the business and of the markets
- Evaluating results, explaining their origin and their connection with the risks assumed
- Analyzing and evaluating at all times the existing risks for the organization as a whole, and for each business or operation individually

## The board of directors must lead the risk management process

To achieve this, the board of directors must implement the necessary means for its accomplishment, including:

- Organization scheme
- Policies and procedures
- Methodologies and criteria to measure risks
- Information system
- Internal controls
- Incentives
- Staff training on AML/CFT
- Pertinent communication between head quarters and the rest of the organization and with competent authorities

## Elements of AML/CFT Risk management

Risk AML system must have at least the following elements:

- a) policies
- b) procedures
- c) mechanisms and instruments for control and
- d) procedures for the evaluation of the AML risk management system (the system adopted must also be periodically evaluated and revised)

# Elements of AML/CFT Risk management

## a) policies:

The Board of directors must define the policies that the institution will adopt regarding AML/CFT matters.

- Such policies must translate in rules of conduct that must be observed by everybody.
- Such policies and rules of conduct must be established in a “code of conduct”.
- AML/CFT policies must cover all the operations related with the services and products of the institution, being electronic, documentary, in cash or in any other form
- It is the duty of the organization not only to guarantee the compliance with the regulations, but to protect the image and reputation of the institution

# Elements of AML/CFT Risk management

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- it is essential that the mechanisms and instruments internally adopted be observed by all those who participate in the authorization, execution and revision of the different operations/ transactions
- Bank secrecy can't be opposed to competent authorities
- ethical principles will always have priority over commercial goals
- stricter procedures to determine if a potential customer is a politically exposed person
- policies to address non face to face transactions
- policies to prevent the misuse of technical developments in ML or terrorist financing schemes

# Elements of AML/CFT Risk management

The code of conduct must develop at least the following:

- strict compliance with the mechanisms and instruments adopted to combat ML
- criteria and procedures to resolve conflict of interests
- procedures to sanction non compliance with the code of conduct or with any other AML principle or regulation

# Elements of AML/CFT Risk management

Procedures must refer to:

- duties and responsibilities of the management bodies and of those responsible for the compliance of the rules regarding ML prevention.
- record keeping
- the realization of the different mechanisms and instruments for ML prevention
- the time basis for all employees to fulfill their AML/CFT duties
- how to comply with the information requested by the authorities
- communication between the main office and all the organization
- hierarchy, duties and responsibilities of the compliance officer
- Mathematical methodologies to identify patterns associated with ML and CF activities
- all procedures must be contained in a manual. The manual must be adopted by the Board of directors and distributed to all employees, leaving evidence of their reception and reading. Any modification to the manual must be informed

# Elements of AML/CFT Risk management

The AML/CFT risk management system must have a set of **mechanisms and instruments** designed to adequately comply with all regulations regarding the prevention of ML.

Such mechanisms include:

- Customer Due Diligence
- Transaction records
- Detection and analysis of unusual transactions
- Determination of suspicious transactions and its timely reporting obligation to the FIU

# Elements of AML/CFT Risk management

Instruments for the proper application of the mechanisms are:

- Written manuals that include all the different procedures regarding AML
- codes of conduct
- ongoing employee training
- control over multiple transactions
- control over individual transactions in cash
- electronic consolidation of transactions
- understanding the market of the different products and services rendered by the institution will help it to identify the usual characteristics of these transactions in order to compare them with the transactions carried by their customers
- adequate technological tools
- warning signals: (situations, events, amounts of transactions, etc., that the national and international community has identified as guiding elements that may show an unusual transaction)

# Responsibilities of the financial and non financial institutions:

- Financial and non financial institutions must:
  - Design and develop their own AML / CFT risk management system
  - The system must be adopted according with the internal policy and the particular risk profile of the institution
  - The system must be effective and efficient
  - The institution must comply with its internal statutes, and with the law and regulations issued by the competent authorities
  - The objective of the institutions IS NOT to detect money laundering cases: its goal is to protect themselves against AML/CFT

## Responsibilities of the supervisor

- \* Make sure that institutions adopt adequate (efficient) AML / CFT risk management systems and that such systems work properly

To achieve this, the supervisor must make a global analysis of the system adopted and establish its effectiveness and efficiency

- The supervisor must determine if the institution only complies *formally* with all its obligations, or if it really has adopted an AML/CFT risk management system and a general environment that permits the preservation of its integrity and reputation, and complies as well with legal regulations
- The supervisor must issue written guide lines regarding basic aspects of AML/CFT.

## Responsibilities of the supervisor

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- asses the existence of adequate internal controls (inspection of policies, procedures, and representative samples, this are selected according with the type of institution: financial /non financial, its size, main operations etc)
- Adopt the necessary measures to cope with deficiencies or the failure to fulfill obligations
- The objective of the supervisor IS NOT to detect concrete money laundering cases: its main objective is to make sure that the institutions protect themselves against ML/CF

## Main aspects that the supervisor expects to find in the AML/CFT risk management system of the institutions under surveillance

- An AML/CFT compliance officer:
  - Proactive
  - With high management level
  - With direct access to the Board of Directors
  - Reporting directly to the Board of Directors minimum every three months
  - Decision making capacity
  - With the necessary technical and human resources to do his job
- An institution that complies strictly with principals and elements for the control of ML and CF activities
- The unrestricted application of the corresponding mechanisms for control and prevention of AML/CFT, specially customer due diligence (CDD)

## Main aspects that the supervisor expects to find in the AML/CFT risk management system of institutions under surveillance

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An institution that gives an ongoing general training to its staff on AML/CFT matters, and special training to employees in their specific AML/CFT areas of work.

An organization that annually destines the necessary budget to improve its AML/CFT risk management system and its AML/CFT general environment.

A major participation of the Board of Directors in the process of decision making, and its direct and periodic participation in the design, application and follow up of the adopted AML/CFT risk management system.

An internal auditor ship committee that verifies and evaluates the policies, procedures, mechanisms, methodology and in general, the overall AML/CFT risk management system and environment.

## Main aspects that the supervisor expects to find in the AML/CFT risk management system of institutions under surveillance

Cont.,

- An external auditor that evaluates:
  - compliance given by the institution to internal and external laws and regulations,
  - the effectiveness of the Board of Directors, of the internal auditor ship committee and of the AML/CFT compliance officer
- Institutions that have destined resources to investigate new ways and technologies used by criminals to commit ML/FT crimes
- Organizations with international reputation for their commitment to fight against criminal activities.

The appropriate management of the AML / CFT risk, is an effective way to fight against delinquency and organized crime.