



**ST.MARY'S UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**

**ANTI-MONEY LAUNDERING AND COUNTER FINANCING OF TERRORISM:  
PRACTICES AND CHALLENGES OF COMMERCIAL BANKS IN ETHIOPIA**

**BY**

**AMANUEL ABEBE**

**JUNE, 2016**

**ADDIS ABABA, ETHIOPIA**

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**Amanuel Abebe**

## **ACRONYMS AND ABBREVIATIONS**

**AML:** Anti Money Laundering

**CDD:** Customer Due Diligence

**CFT:** Counter Financing of Terrorism

**CTR:** Cash Transaction Report

**DNFBP:** Designated Non-Financial Businesses and Professions

**ESAAMLG:** East and South Africa Anti Money Laundering Group

**FATF:** Financial Action Task Force

**FIC:** Financial Intelligence Center (Ethiopia)

**FSRBs:** FATF Style Regional Bodies

**IMF:** International Monetary Fund

**KYC:** Know Your Customer

**ML:** Money Laundering

**NBE:** National Bank of Ethiopia

**OECD:** Organization for Economic Cooperation and Development

**PEP:** Politically Exposed Persons

**SDN:** Specially Designated Nationals

**STR:** Suspicious Transaction Report

**TF:** Terrorist Financing

**UN:** United Nations

**UNTOC:** United Nations Transnational Organized Crime Convention



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## **Abstract**

*Money laundering and terrorist financing are considered as criminal phenomenon that can undermine national security and economic development goals of nations in addition to negatively affecting the integrity and stability of financial sectors which in turn can have a severely devastating consequences on the economic, financial and social wellbeing of countries (Lilley, 2006). To this end, the international community has made the fight against money laundering and the financing of terrorism a priority. Ethiopia recently endeavored to combat money laundering and terrorist financing by criminalizing money laundering and financing of terrorism through proclamation no. 780/2013. In this regard, banks play a leading role as the main objective of the law is to ensure the integrity of the Ethiopian financial system. Therefore, the purpose of this research is to assess the Anti-Money Laundering (AML) and Counter Financing of Terrorism (CFT) practice and challenges of commercial banks in Ethiopia in accordance with international standards and applicable laws. To this end, 6 commercial banks were selected out of 17 commercial banks operating in Ethiopia through purposive sampling based on asset size and year of establishment alongside the leading body, Financial Intelligence Center of Ethiopia (FIC), for subsequent assessment. Thus, the study adopted descriptive research methods by utilizing survey approach which consist structured questionnaire and semi-structured interview to collect the relevant data from the concerned respondents of compliance/risk management staff of selected commercial banks and official of Financial Intelligence Center of Ethiopia (FIC.) Accordingly, it was revealed that, despite the significant progress registered, the AML/CFT practice of the banking sector is unsatisfactory as well as that of the FIC in terms of emphasis being given, level of awareness among senior management, technological advancement and cooperation among law enforcement agencies. Therefore, the banking sector in particular and the country in general are vulnerable to money laundering and terrorist financing risks unless adequate emphasis is given and collaborated effort is exerted towards instilling a robust AML/CFT regime in the banking sector and the country.*

**Key Words: Money Laundering, Terrorist Financing, AML/CFT, Commercial Banks, FIC.**

# Chapter One

## 1. Introduction

### 1.1 Background of the Study

Money laundering is not a new phenomenon; it is as old as crime itself. However, the forms and dimensions of this type of crime have evolved and become more sophisticated as a result of the rapid growth of globalization, integration, and economic liberalization, as well as dramatic developments in the provision of financial information, in technology, and in communications (IMF, 2012). Illegal money can be moved anywhere in the world with speed and ease. Tax havens (offshore centers) that offer stability, quality of service, and bank secrecy allow criminals to shield money in complex networks of shell companies. At the same time, the escalation of the drug market and the globalization of organized crime have led to an increased international awareness of the problem of money laundering. Money laundering and terrorist financing are transnational, cross-border, multifaceted, and complex problems that require cooperation and coordination among actors looking to successfully respond to them (Bartlett, 2002).

Money laundering and the financing of terrorism can, and do, occur in any country in the world, especially those with complex financial systems. Countries with negligent, ineffective, or corrupt AML and CFT infrastructures are also likely targets for such activities indicating that no country is exempted.

The origin of the international community's war against money laundering was mounting because of the global drug crisis in the 1980's. Since then, the global concern regarding drug trafficking and money laundering has become a prominent issue of international concern. The monetary costs attributed to international money laundering are staggering and the social cost of money laundering is immense. As well, international banking and monetary regulation, an evolving and dynamic area of international law remains hotly debated and is the focus of many international regulation efforts (Maney, 2002).

Ethiopia's efforts to combat money laundering and terrorist financing are relatively recent. Although Ethiopia had already criminalized money laundering in the revised penal code of 2005, the legal AML/CFT framework has only been in existence since 2009, with amendments to the law in 2013 through the Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation

No. 780/2013 criminalizing Money Laundering and Financing of Terrorism (Tu'emay Aregawi Desta, 2013).

One of the main objectives of the law is to ensure the integrity of the Ethiopian financial system. In this regard, banks play a leading role as one of the institutions covered by the law. Accordingly, this study tries to assess the Anti-Money Laundering and Countering Terrorist Financing practices and of commercial banks in Ethiopia.

## **1.2 Statement of the Problem**

Profits generated by some organized criminal activities, such as drug trafficking or traffic in human beings, cause a threat not only to public safety, because of the huge economic power accumulated by a number of criminal organizations, but also financial systems themselves and to economic development. Recent events showed that terrorist groups also build financial empires, the purpose of which are specifically to undermine public safety and international financial stability.

While money laundering and the financing of terrorism can occur in any country, they have particularly significant economic and social consequences for developing countries, because those markets tend to be small and, therefore, more susceptible to disruption from criminal or terrorist influences.

Not only do money laundering and terrorist financing negatively affect the integrity and stability of the financial sector, but they also undermine national security and economic development goals.

As per the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) mutual evaluation report in May, 2015, the main sources of illicit proceeds generating activity in Ethiopia are corruption, tax evasion, human trafficking and smuggling, arms trafficking and smuggling of contraband. In terms of terrorist financing, the report revealed that Ethiopia is located in a highly volatile region with both Eritrea to the North and Somalia to the East providing support to terrorists or armed opposition groups calling for a robust AML/CFT regime in the country.

Ethiopia has recently established AML/CFT regime through proclamation N0. 780/2013 on Prevention and Suppression of Money laundering and Financing of Terrorism Issued by The Federal Democratic Republic of Ethiopia and Directive number 01/2014 on Financial Anti-Money laundering and countering the financing of terrorism and compliance Issued by Financial Intelligence Center of the Federal Democratic republic of Ethiopia. Consequently, Ethiopia is no longer on the FATF "Public Statement" which is list of Countries that have been identified as having strategic AML deficiencies.

However, the Eastern and Southern Africa Anti-Money Laundering Group mutual evaluation report (May, 2015) has revealed various insufficiencies regarding the effective implementation of AML/CFT program

in Ethiopia. The report mainly indicated the lack of Risk Based Approach to AML/CFT as national risk assessment was still ongoing process and thus national AML/CFT policies are not risk based. In addition, the report revealed limited awareness of the problems of money laundering and terrorist financing and their impacts and limited measures on anti-money laundering and countering the financing of terrorism (AML/CFT) and inadequate capacities to implement existing frameworks and legislation.

The banking sector is particularly vulnerable to money laundering and terrorist financing risks owing to the fact that the traditional banking process of deposit taking, money transfer and lending do offer vital laundering mechanisms. Therefore, this study tries to examine AML/CFT practices and challenges of commercial banks in Ethiopia as the leading institutions and the measures being taken by FIC in light of FATF recommendations and best practices.

### **1.3 Research Questions**

Cognizant of the problems stated, the study tries to assess the effectiveness of AML/CFT practices and identify challenges in Ethiopian commercial banks and seek to answer the following research questions:

- ✓ Are the Ethiopian commercial banks' AML/CFT practices in line with international standards and sufficient to address vulnerabilities resulting from money laundering and terrorist financing?
- ✓ What are the challenges of implementing effective AML/CFT practices in commercial banks in Ethiopia?
- ✓ What are the opportunities toward implementation of effective AML/CFT practices in commercial banks in Ethiopia?
- ✓ What are the measures being taken by the leading AML/CFT body, the FIC, towards realization of robust AML/CFT regime?
- ✓ Has the National Risk Assessment been undertaken to enable risk based approach to AML/CFT policies and supervision?

## **1.4 Objectives of the Study**

The general objective of this research is to assess the effectiveness and identify the challenges of Ethiopian commercial banks AML/CFT practices in light of regulatory requirements and international best practices. In addition, the specific objectives of the study are to:

- ✓ Evaluate the sufficiency of Ethiopian commercial banks AML/CFT practices to address vulnerabilities resulting from money laundering and terrorist financing.
- ✓ Find out the challenges of implementing effective AML/CFT practices in commercial banks in Ethiopia.
- ✓ Assess the opportunities towards implementation of effective AML/CFT practices in Ethiopian commercial banks.
- ✓ Examine the measures being taken by the leading AML/CFT body, the FIC, towards realization of robust AML/CFT system.
- ✓ Investigate whether the National Risk Assessment has been undertaken to enable risk based approach to AML/CFT policies and supervision.

## **1.5 Significance of the Study**

The international community has made the fight against money laundering and the financing of terrorism a priority. Among the goals of this effort are: protecting the integrity and stability of the international financial system, cutting off the resources available to terrorists, and making it more difficult for those engaged in crime to profit from their criminal activities.

Accordingly, the study tries to assess the AML/CFT practices and challenges of commercial banks in Ethiopia. Consequently, the study will have the following significances:

- ✓ The findings produced by the study will identify and provide contemporary information which can be used in the fight against money laundering and terrorist financing activities.
- ✓ By looking into challenges and opportunities facing the banking sector, the study can provide valuable suggestions about effective AML/CFT mechanisms to the stakeholders.
- ✓ As limited research has been conducted in the area, the study can initiate further research by academicians and practitioners alike.
- ✓ Moreover, this can be used as an input for conducting further and extensive research on the area.

## **1.6 Scope of the Study**

The current Ethiopian AML/CFT legal framework covers financial institutions such as banks, insurance companies, micro finance institutions, postal savings, money transfer institution or any other institution designated as such by the NBE. The regime also covers designated non-financial businesses and professions (DNFBP) such as real estate agents and brokers, dealers in precious metals or precious stones, lawyers, notaries, and other independent legal professionals, independent accountants as may be designated by FIC (Proclamation No.780/2013).

However, from the institutions mentioned above, the study focused on selected commercial banks and the leading body, Financial Intelligence Center, for subsequent assessment of their respective AML/CFT activities.

## **1.7 Limitations of the Study**

In the course of conducting the proposed research, the researcher faced limitations of related researches conducted on the area as the issue is relatively new. Accordingly, documents about AML/CFT programs and manuals, journals and publications related to the proposed subject were limitedly utilized. Moreover, the researcher faced problems due to unwillingness and negligence of some respondents due to sensitivity of the proposed issue.

## **1.8 Organization of the Paper**

The research is organized in five chapters. Chapter one provides the general introduction about the whole study. The second chapter deals with review of theoretical and empirical literatures. The third chapter provides details of research design, sample frame and size, source and instrument of data collection, the procedures and the methods of data collection and the methods of analysis. Chapter four contains summary of results and discussion of the research. Finally, the last chapter presents conclusion of the research and recommendations forwarded based on the findings.

# Chapter Two: Literature Review

## 2.1 Review of Theoretical Literature

### 2.1.1 Money Laundering and Financing of Terrorism: Conceptual Framework

For most countries, money laundering and terrorist financing raise significant issues with regard to prevention, detection and prosecution. Sophisticated techniques used to launder money and finance terrorism add to the complexity of these issues. Such sophisticated techniques may involve different types of financial institutions; multiple financial transactions; the use of intermediaries, such as financial advisers, accountants, shell corporations and other service providers; transfers to, through, and from different countries; and the use of different financial instruments and other kinds of value-storing assets (Schott, 2006).

As per the UNTOC (2000) (Palermo Convention )<sup>1</sup>, money laundering can be defined as the process of converting illegitimately obtained proceeds into seemingly legitimately obtained proceeds by concealing or disguising the true,

- Nature and Source,
- Location,
- And ownership of illicitly obtained proceed.

Where does the dirty money that needs to be laundered come from?

Dirty money comes from every kind of criminal activity on a global basis. Some of the sources include: drug trafficking, illegal arms trading, human smuggling, prostitution, corruption, fraud, forgery, armed robberies, blackmail extortion, arts and antique fraud, internet fraud, smuggling and tax fraud (Lilley, 2006).

One common example of money laundering is the movement of profits from illicit sources through a series of bank or brokerage accounts to make them appear to be proceeds of legitimate business activity. This process is of critical importance, as it enables those perpetrating the criminal activities to enjoy these profits without revealing their sources, thereby making detection of the criminal activity less likely (Maney, 2002).

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<sup>1</sup><http://www.undcp.org/adhoc/palermo/convmain.html>.



On the other hand, International Convention for the Suppression of the Financing of Terrorism (1999)<sup>2</sup>, Article 2, defined financing of terrorism as an act of providing a person funds by any means (directly or indirectly), deliberately and knowingly so that the funds will be used in full or part to carry out a terrorist act by a terrorist or a terrorist organization. Terrorist financing could also be described as a mechanism whereby funds are processed from any source – including legitimate ones – to finance frontline terrorist activities or those who encourage, plan or engage in terrorism (Lilley, 2006).

Terrorism can be financed by variety of sources including: donations, the use of charities and non-profit organizations, fraud, smuggling, the narcotics trade, and other criminal activities (Lilley, 2006).

### **2.1.2 Stages of Money Laundering**

Criminal organizations are involved primarily in profit-making crime. They are established for this purpose as well as to exploit crime opportunities in a systematic and large scale manner. The consequence is that the operation of a criminal organization may generate a vast amount of wealth, but at the same time, a vast number of problems. The generated cash is neither easy to hide nor to utilize. Sudden use of unexplained wealth may raise suspicion. Investigators may easily establish a link between cash, illicit activities, and their perpetrator (Thony, 2000). It is thus necessary, for criminal organizations to;

- I. Erase the link between the crime and the money;
- II. Erase the link between the money and its new owner and finally;
- III. Shelter the profits<sup>1</sup> from possible confiscation.

The above activities represent the very nature of money-laundering, which generally develops in three phases mentioned below (Schott, 2006).

- I. Placement:** this first phase consists of introducing the funds gained from criminal activities into the banking and financial system; this phase has become more and more filled with risk due to the heightened attention now given these movements of cash by law enforcement, and the now widespread requirement that banks report suspicious transactions.

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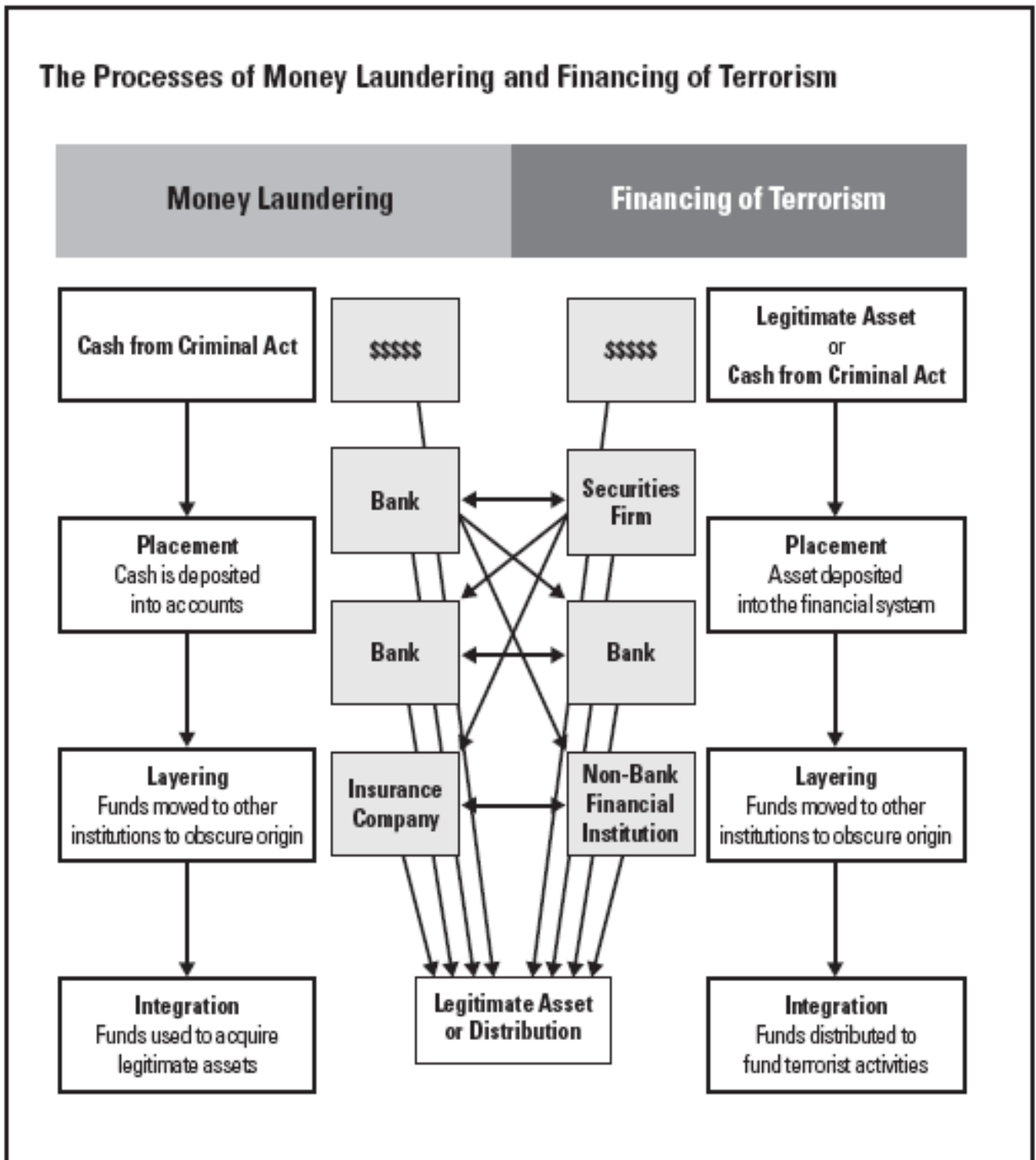
<sup>2</sup> <http://www.un.org/law/cod/finterr.htm>.

- II. Layering:** The second phase consists of putting the funds that have entered the financial system through a series of financial operations, the purpose of which is to mislead potential investigators and to give these funds the appearance of having a legal origin. This is the money-laundering phase that most often uses offshore mechanisms. Numerous comings and goings between financial havens and the launderers' banks, punctuated by false invoices, false loans, or other devices, ultimately mislead investigators regarding the origin of the money.
- III. Integration:** the third and final phase in money-laundering, once these funds appear to have a legitimate origin, consists of reintroducing the funds into the legal economy,
- Through consumption of luxury items, since the goal of profitable criminal activity is first to be able to “burn” the ill-gotten funds;
  - Through investments in common place assets, including shares in companies, real estate, etc;
  - through investments in economic entities that are themselves susceptible of becoming money laundering machines including casinos, hotels, restaurants, cinemas, etc., as well as in companies in which payments are made in cash and where the dirty money can easily be mingled.

The description of money-laundering mechanisms shown in the *figure 1* below takes a simplified view of the process. The reality may be more complex or more basic depending on certain factors that impact the money laundering strategies of criminal organizations, such as the quantity of assets, the structure and level of organization of the criminal organization, and in particular, the hiring of financial experts to develop and implement money laundering schemes (Thony, 2000).

These three stages are also seen in terrorist financing schemes, except that stage three integration involves the distribution of funds to terrorists and their supporting organizations, while money laundering, as discussed previously, goes in the opposite direction—integrating criminal funds into the legitimate economy (Schott, 2006).

Figure 2.1 Stages of ML/TF



Source: Schott, Paul Allan (2006)

### **2.1.3 The Link between Money Laundering and Terrorist Financing**

It was discussed earlier that the techniques used to launder money are essentially the same as those used to conceal the sources of, and uses for, terrorist financing. Accordingly, funds used to support terrorism may originate from legitimate sources, criminal activities, or both. Nonetheless, disguising the source of terrorist financing, regardless of whether the source is of legitimate or illicit origin, is important. If the source can be concealed, it remains available for future terrorist financing activities. Similarly, it is important for terrorists to conceal the use of the funds so that the financing activity goes undetected (Schott, 2006).

Similarly, mysterious ties often unite organized crime and terrorism. A sort of objective alliance forms in many instances between criminal and terrorists groups, fed by their convergent interests: criminal organizations benefit from the ability of terrorist and guerrilla organizations to do damage, while the latter in turn benefit from the financing that criminal activities can obtain for them (Thony, 2000).

This link between the geography of terrorist movements and the geography of large-scale drug trafficking are sometimes self-explanatory. For instance, the Revolutionary Armed Forces of Colombia (FARC) are to be found in cocaine producing areas, whilst the African civil wars are taking place in areas where precious stones and other natural riches are extracted; the soldiers of Al-Qaeda in Afghanistan and the KhunSa rebels in Myanmar foment their armed actions in the world's largest opium-producing areas (Thony, 2000).

### **2.1.4 Money Laundering and the Banking Sector: Points of Vulnerability**

Money laundering is often thought to be associated with banks and money changers. The traditional banking process of deposit taking, money transfer and lending do offer vital laundering mechanisms. The basis of virtually every international business transaction is a transfer of assets in the form of currency or instruments as a consideration for that transaction (Schott, 2006). Banking has contributed greatly to the speed and efficiency of transfer of funds connected with such transaction all over the world. Entry of cash into the banking system, cross border flow of cash and transfer with in and out of the financial system are exposed areas in the laundering process.

The transfer of value often relies on banking structure to a greater degree. Even when the laundered value is transferred indirectly via goods and services, it is the banking system which is often used to reconcile the relevant accounts. The banking system is also often used to transfer value even when

launderers utilize other methods such as those available in the security and insurance sectors (FATF, 2010)<sup>3</sup>.

The sheer size and scope of the global financial sector, the complexity of banking arrangements and products which allow concealment are also other factors that make banking sector abused by launderers. Moreover, their vulnerability is facilitated by the removal of capital controls and liberalization of global finance. A dark side of globalization- money laundering becomes a major threat to the banking sector. Globalization complements money laundering by accelerating the mobility of goods, capital and services that aggrandizes the scope in the financial sector including banks (Lilley, 2006).

## **2.1.5 Global Initiatives to combat Money Laundering and Financing of Terrorism**

In response to the growing concern about money laundering and terrorist activities, the international community has acted on many fronts. The international response is, in large part, recognition of the fact that money laundering and terrorist financing take advantage of high speed international transfer mechanisms, such as wire transfers, to accomplish their goals, (Schott, 2006). Therefore, concerted cross-border cooperation and coordination are needed to thwart the efforts of criminals and terrorists. Accordingly, the main international institutions initiating the combat against money laundering and financing of terrorism are discussed as follows.

### **2.1.5.1 The United Nations**

The United Nations (UN) was the first international organization to undertake significant action to fight money laundering on a truly world-wide basis (Schott, 2006). The UN actively operates a program to fight money laundering; the Global Program against Money Laundering (GPML), which is part of the UN Office of Drugs and Crime (ODC). Most importantly, the UN has the ability to adopt international treaties or conventions that have the effect of law in a country once that country has signed, ratified and implemented the convention, depending upon the country's constitution and legal structure. Thus, the UN treaties and conventions will be a major force in harmonizing national laws and enforcement actions around the world which can serve as a benchmark and assess countries AML/CFT regime.

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<sup>3</sup>[http://www.fatf-gafi.org/media/fatf/content/images/National\\_ML\\_TF\\_Risk\\_Assessment.pdf](http://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf)

## **I. The Vienna Convention (1988)**

Due to the growing concern about increased international drug trafficking, the UN initiated an international agreement to combat drug trafficking and money laundering which resulted in the adoption of the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) ( Vienna Convention)<sup>4</sup>(Schott, 2006). The convention primarily deals with provisions to fight the illicit drug trade and does not use the term money laundering although call upon countries to criminalize the activity.

## **II. The Palermo Convention (2000)**

The UN adopted International Convention against Transnational Organized Crime (TOC) in order to expand the effort to fight international organized crime<sup>5</sup>. With respect to money laundering, the convention specifically obligates each ratifying country to:

- Criminalize money laundering and include all serious crimes as predicate offenses<sup>6</sup>of money laundering, whether committed in or outside of the country, and permit the required criminal knowledge or intent to be inferred from objective facts;
- Establish regulatory regimes to deter and detect all forms of money laundering, including customer identification, record-keeping and reporting of suspicious transactions;
- To establish Financial Investigation Units (FIUs) to analyze and disseminate information and to strengthen cooperation both domestically and internationally;
- Promote international cooperation.

## **III. International Convention for the Suppression of the Financing of Terrorism (1999)**

In response to the growing financing of terrorism concern, the UN adopted the International Convention for the Suppression of the Financing of Terrorism (1999)<sup>7</sup> which requires ratifying states to criminalize terrorism, terrorist organizations and terrorist acts.

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<sup>4</sup><http://www.incb.org/e/conv/1988/>.

<sup>5</sup> <http://www.undcp.org/adhoc/palermo/convmain.html>.

<sup>6</sup>Predicate Offense means any offence capable of generating proceeds of crime and punishable at least with simple imprisonment for one year(Schott, 2006).

<sup>7</sup> <http://www.un.org/law/cod/finterr.htm>.

### **2.1.5.2 Financial Action Task Force (FATF)**

Formed in 1989 by the G-7 countries,<sup>8</sup> The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction.

<sup>9</sup>FATF is a policy-making body, which brings together legal, financial and law enforcement experts to achieve national legislation and regulatory AML and CFT reforms. The FATF has been the most active international body in the area of trying to prevent money laundering, together with attempting to define the problem and encourage the adoption of effective counter measures (Lilley, 2006).

The FATF has developed a series of recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the 40 + 9 FATF Recommendations were revised in 1996, 2001, and 2003 and most recently in 2012 to ensure that they remain up to date and relevant, and they are intended to be of universal application.

#### **a) The 40 FATF Recommendations**

The FATF 40 recommendations<sup>10</sup> require states, among other things, to:

- Implement relevant international conventions;
- Criminalize money laundering and enable authorities to confiscate the proceeds of money laundering;
- Implement customer due diligence (e.g., identity verification), record keeping and suspicious transaction reporting requirements for financial institutions and designated non-financial businesses and professions;
- Establish a financial intelligence unit to receive and disseminate suspicious transaction reports, and
- Cooperate internationally in investigating and prosecuting money laundering.

#### **b) The 9 Special Recommendations on Terrorist Financing**

Towards addressing the world-wide effort to combat terrorist financing, FATF also adopted nine Special Recommendations on Terrorist Financing<sup>11</sup> (Special Recommendations) following the September 11

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<sup>8</sup>The G-7 countries are Canada, France, Germany, Italy, Japan, United Kingdom, and United States

<sup>9</sup> See <http://www.fatf-gafi.org>

<sup>10</sup>[http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf)

terrorist attacks of which countries use it as a benchmark for a self-assessment questionnaire of their country's actions to come into compliance with the Recommendations (Schott, 2006).

While it is noted that all recommendations are equally important, the recommendations as preventive measures<sup>12</sup> that specially deal with banks in relation to ML/TF are briefly discussed below.

- ✓ **Customer due diligence (CDD):** Banks should be prohibited from keeping anonymous accounts or accounts in obviously fictitious names and should undertake CDD when establishing business relations, there is a suspicion of ML/TF or carrying out occasional transactions.
- ✓ **Record-keeping:** Banks should be required to maintain, for at least five years, all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information requests from the competent authorities.
- ✓ **Politically exposed persons (PEP)<sup>13</sup>:** Banks should be required to have appropriate risk management system to identify whether the customer is PEP's and take reasonable steps to establish the source of funds and wealth of such persons.
- ✓ **Correspondent banking:** In addition to performing normal CDD, banks should gather sufficient information about a respondent institution, assess the respondent institutions' AML/CFT controls and clearly understand the respective responsibilities of each institution.
- ✓ **New technologies:** Banks should identify and assess the ML/TF risks that may arise in relation to the development of new product and business practices.
- ✓ **Wire Transfers:** Banks should include required and accurate originator information, and required beneficiary information, on wire transfers and related messages, and that the information remains with the wire transfer or related message throughout the payment chain.

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<sup>11</sup>The Special Recommendations [http://www.fatf-gafi.org/pdf/SRecTF\\_en.pdf](http://www.fatf-gafi.org/pdf/SRecTF_en.pdf)

<sup>12</sup> FATF 40 Recommendation, Preventive Measures 10-16.

<sup>13</sup> FATF defines PEPs as Individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of State owned corporations, important political party officials.



### **c) Methodology for AML/CFT Assessments**

In 2002, following lengthy consultations, the FATF, International Monetary Fund (IMF), and World Bank adopted a single assessment methodology<sup>14</sup> which was revised in 2004 to be used both by FATF in its mutual evaluations and by the IMF and World Bank in their assessments under their financial sector assessment and offshore financial center programs. The methodology sets out over 200 “essential criteria” that assessors should examine when carrying out assessments of an AML and CFT regime and covers the legal and institutional AML/CFT framework for a country, including financial intelligence units (Schott, 2006).

FATF has also recommended a Risk Based Approach (RBA) to AML/CFT<sup>15</sup> which means that competent authorities and financial institutions are expected to identify, assess and understand the ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively. FATF indicates that, RBA allows countries within the framework of the FATF requirements to adopt more flexible set of measures in order to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way.

#### **2.1.5.3 FATF Style Regional Bodies**

FATF style regional Bodies (FSRBs)<sup>16</sup> are groups organized according to geographical regions that have similar form and functions to those of FATF which are very important in the promotion and implementation of AML and CFT standards in their respective regions (Schott, 2016). These FSRBs encourage implementation and enforcement of FATF’s The Forty Recommendations on Money Laundering (The Forty Recommendations) and the 9 Special Recommendations on Terrorist Financing (Special Recommendations) discussed earlier and also administers mutual evaluations of their members.

The FSRBs are:

- Asia Pacific Group on Money Laundering (APG);
- Caribbean Financial Action Task Force (CFATF);
- Eurasian Group (EAG);
- Eastern & Southern Africa Anti-Money Laundering Group (ESAAMLG)<sup>17</sup>;
- Task Force on Money Laundering in Central Africa (GABAC);

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<sup>14</sup> <http://www.fatfgafi.org/media/fatf/documents/methodology/FATF%20Methodology%202022%20Feb%202013.pdf>

<sup>15</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf>

<sup>16</sup> [www.fatf.gafi.org](http://www.fatf.gafi.org)

<sup>17</sup> Ethiopia is a member of ESAAMLG

- Financial Action Task Force on Money Laundering in South America (GAFISUD);
- Middle East and North Africa Anti-Money Laundering Groups (MENA FATF);
- Council of Europe Committee of Experts on Evaluation of AML Measures and the Financing of Terrorism (MONEYVAL);and
- Inter-governmental Action Group against Money Laundering on Africa (GIABA).

#### **2.1.5.4 The Basel Committee on Banking Supervision**

The Basel Committee on Banking Supervision (Basel Committee)<sup>18</sup> was formed in 1974 by the central bank governors of the Group of 10 countries. Basel Committee issued its statement of principles on the ‘Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering of which member states are expected to comply with the doctrines listed (Lilley, 2006). A number of best-practice guidelines are contained in the report and the three supervisory standards of the Basel Committee and guidelines concerning money laundering are: Statement of the Principle on Money Laundering, Core Principles for Banking and Customer Due Diligence (CDD). These principles were intended to encourage vigilance against criminal use of payment system stated that banks should:

- Institute effective know your customer (KYC) procedure;
- Conduct their business to high ethical standards and comply with relevant laws and regulations;
- Cooperate with law enforcement agencies; and
- Adopt the principles together with training staff and retaining internal records. They should also test general compliance with the statement.

#### **2.1.5.5 Wolfsberg Group of Banks**

The Wolfsberg Group<sup>19</sup> is an association of 12 global banks, representing primarily international private banking concerns. The objective of the initiative is to bring leaders of private banking to cooperate in fighting money laundering outside competitive businesses and to establish a common global standard for private banking operation.

The Wolfsberg group has established four sets of principles for private banking that includes;

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<sup>18</sup><http://www.bis.org/index.htm>.

<sup>19</sup><http://www.wolfsberg-principles.com/index.htm>

- Wolfsberg Anti Money Laundering Principle on Private Banking (2000):11 principles that require due diligence procedures for opening and keeping watch over accounts especially those identified as Politically Exposed Persons (PEPs)<sup>20</sup>.
- Statements on the Suppression of Financing of Terrorism (2002)<sup>21</sup>:describes the roles that banks should play in fighting terrorism financing.
- AML Principle for Correspondent Banking<sup>22</sup>: adopted 14 principles to govern their relation with correspondent banks; and
- Monitoring Screening and Searching<sup>23</sup>: requires that banks develop suitable monitoring, screening and searching processes, using a risk-based profile approach.

In summary, the following activities are considered top AML/CFT measures by the various international initiatives discussed so far (Lilley, 2006).

1. Governments must criminalize money laundering.
2. Money launderers must be prosecuted and convicted. To achieve this, bilateral and multilateral treaties must be established and offenders must be extradited.
3. The proceeds of crime should be frozen and ultimately confiscated.
4. Countries, law enforcement agencies and institutions should share intelligence.
5. Banks should cooperate with law enforcement efforts and enquiries and should not assist money launderers.
6. Banks (and similar entities) must install vigorous identification procedures to verify that people opening an account are who they say they are.
7. Banks must keep records to assist law enforcement efforts.
8. Banks must report suspicious customers and transactions.
9. Banking secrecy must be removed if it facilitates money laundering.
10. Banks must install systems, train staff and monitor how they are doing.

<sup>20</sup>[Http://www.wolfsberg-principles.com/private-banking.html](http://www.wolfsberg-principles.com/private-banking.html)

<sup>21</sup><http://www.wolfsberg-principles.com/financing-terrorism.htm/>

<sup>22</sup><http://www.Wolfsberg-principles.com/corresp-banking.html>

<sup>23</sup> <http://www.wolfsberg-principles.com/monitoring.html>.

## **2.1.6 The Impact of Money Laundering and Terrorist Financing**

Criminal enterprises and terrorist financing operations succeed largely to the extent that they are able to conceal the origins or sources of their funds and sanitize the proceeds by moving them through national and international financial systems. The absence of, or a negligent or corrupt, anti-money laundering regime in a particular country permits criminals and those who finance terrorism to operate, using their financial gains to expand their criminal pursuits and fostering illegal activities such as corruption, drug trafficking, illicit trafficking and exploitation of human beings, arms trafficking, smuggling, and terrorism (Schott, 2006).

### **A. Increased Crime and Corruption**

Successful money laundering helps make criminal activities profitable; it rewards criminals. Thus, to the extent that a country is viewed as a haven for money laundering, it is likely to attract criminals and promote corruption (Schott, 2006).

Accordingly, havens for money laundering and terrorist financing have:

- A weak AML/CFT regime;
  - Some or many types of financial institutions that are not covered by an AML/CFT framework;
  - Little, weak or selective enforcement of AML/CFT provisions;
  - Ineffective penalties, including difficult confiscation provisions; and
  - A limited number of predicate crimes for money laundering

Left unchecked, ML, TF, and predicate crimes enable criminals to amass wealth, power, and influence, which in turn undermine the rule of law and have a corrosive, corrupting effect on society and the economic system as a whole (IMF, 2012)<sup>24</sup>.

### **B. International Consequences and Foreign Investment**

A reputation as a money laundering or terrorist financing haven, alone, could cause significant adverse consequences for development in a country. Foreign financial institutions may decide to limit their transactions with institutions from money laundering havens; subject these transactions to extra scrutiny, making them more expensive; or terminate correspondent or lending relationships altogether (Schott, 2006).

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<sup>24</sup><https://www.imf.org/external/np/pp/eng/2012/121412a.pdf>

Threats to financial stability and macroeconomic performance can be directly attributable to money laundering and terrorist financing in certain cases, resulting, for example, in loss of access to global financial markets and destabilizing inflows and outflows (IMF, 2012).

### **C. Weakened Financial Institutions**

Money laundering and terrorist financing can harm the soundness of a country's financial sector, as well as the stability of individual financial institutions in multiple ways (FATF, 2010)<sup>25</sup>. Although much discussion focuses on banking institutions, the same consequences, or similar ones, are also applicable to other types of financial institutions, such as securities firms, insurance companies, and investment management firms. The adverse consequences generally described as reputational, operational, legal and concentration risks are interrelated.

Accordingly, each has specific costs:

- Loss of profitable business,
- Liquidity problems through withdrawal of funds,
- Termination of correspondent banking facilities,
- Investigation costs and fines,
- Asset seizures,
- Loan losses and
- Declines in the stock value of financial institutions

### **D. The Economic Effects of Money Laundering**

The negative economic effects of money laundering on economic development are difficult to quantify. It is clear that such activity damages the financial-sector institutions that are critical to economic growth, reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption, which slow economic growth, and can distort the economy's external sector – international trade and capital flows – to the detriment of long-term economic development (Bartlett, 2002).

One time director of the International Monetary Fund (IMF), Michael Camdessus, once estimated the scale of money laundering as between 2% to 5% of world Gross Domestic Product (GDP)<sup>26</sup>. In some

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<sup>25</sup>Financial Action Task Force on Money Laundering, Basic Facts about Money Laundering, <http://www.Fatt.gafi.org/Mlaundrying-en.html>

<sup>26</sup><http://www.imf.org/external/np/speeches/1998/021098.htm>

emerging market countries, these illicit proceeds may dwarf government budgets, resulting in a loss of control of economic policy by governments. Indeed, in some cases, the sheer magnitude of the accumulated asset base of laundered proceeds can be used to corner markets -or even small economies (McDowell, 2001).

Money laundering can also adversely affect currencies and interest rates as launderers reinvest funds where their schemes are less likely to be detected, rather than where rates of return are higher. And money laundering can increase the threat of monetary instability due to the misallocation of resources from artificial distortions in asset and commodity prices (McDowell, 2001).

### **E. Compromised Economy and Private Sector**

One of the most serious microeconomic effects of money laundering is felt in the private sector. Money launderers are known to use “front companies,” i.e., business enterprises that appear legitimate and engage in legitimate business but are, in fact, controlled by criminals (McDowell, 2001). These front companies co-mingle the illicit funds with legitimate funds in order to hide the ill-gotten proceeds. Front companies’ access to illicit funds, allows them to subsidize the front company’s products and services, even at below market prices. As a consequence, legitimate enterprises find it difficult to compete with such front companies, the sole purpose of which is to preserve and protect the illicit funds, not to produce a profit (Lilley, 2006).

By using front companies and other investments in legitimate companies’ money laundering proceeds can be utilized to control whole industries or sectors of the economy of certain countries. This increases the potential for monetary and economic instability due to the misallocation of resources from artificial distortions in asset and commodity prices. It also provides a vehicle for evading taxation, thus depriving the country of revenue (IMF, 2012)

### **F. Damaged Privatization Efforts**

Money launderers threaten the efforts of many countries to reform their economies through privatization. These criminal organizations are capable of outbidding legitimate purchasers of former state-owned enterprises (Schott, 2006). When illicit proceeds are invested in this manner, criminals increase their potential for more criminal activities and corruption, as well as deprive the country of what should be a legitimate, market-based, taxpaying enterprise.

Furthermore, once a country's financial reputation is damaged, reviving it is very difficult and requires significant government resources to rectify a problem that could be prevented with proper anti-money-laundering controls (McDowell, 2001).

### **G. Social Costs**

There are significant social costs and risks associated with money laundering. Money laundering is a process vital to making crime worthwhile. It allows drug traffickers, smugglers, and other criminals to expand their operations. This drives up the cost of government due to the need for increased law enforcement and health care expenditures (for example, for treatment of drug addicts) to combat the serious consequences that result (Aluko, 2011).

Among its other negative socioeconomic effects, money laundering transfers economic power from the market, government, and citizens to criminals. In short, it turns the old proverb that crime doesn't pay on its head (McDowell, 2001).

Furthermore, the sheer magnitude of the economic power that accrues to criminals from money laundering has a corrupting effect on all elements of society. In extreme cases, it can lead to the virtual take-over of legitimate government (McDowell, 2001).

Therefore, it is important to note that having in place an effective AML/CFT regime is of paramount importance towards fighting crime and corruption, enhancing financial institutions and encouraging economic development (Schott, 2006)

## **2.1.7 The Anti-Money Laundering and Counter Financing of Terrorism Regime in Ethiopia**

As per the East and Southern Africa Anti-Money Laundering Group (ESAAMLG) mutual evaluation report in May 2015, Ethiopia faces a number of significant vulnerabilities that pose continual and increasing risks of money laundering and terrorist financing which include;

- the prevalence of a significant informal and largely cash-based economy;
- the prevalence of high-level serious crimes, such as corruption, tax evasion, smuggling, trafficking (human, drugs, and arms), and illicit financial flows;
- limited awareness of the problems of money laundering and terrorist financing and their impacts;
- poorly managed, leaky borders;
- limited control mechanisms over movement of cash;

- regional instability and the growing presence of transnational criminal networks in the region, extending into other sub-regions including the Sahel and West Africa; and
- Limited measures on anti-money laundering and countering the financing of terrorism (AML/CFT) and inadequate capacities to implement existing frameworks and legislation.

In response to the aforementioned risks, Ethiopia has established an AML/CFT regime based on the concept of sustainable economic development that is intolerant of illicit and corrupt practices and activities. However, the establishment and implementation of Ethiopia's AML/CFT regime is relatively recent. The legal AML/CFT framework has only been in existence since 2009, with amendments to the law in 2013.

Consequently, the FATF has welcomed Ethiopia's significant progress in improving its AML/CFT regime and joining East and Southern Africa Anti-Money Laundering Group (ESAAMLG) and indicated that Ethiopia has established the legal and regulatory framework to meet its commitments in its action plan regarding the strategic deficiencies that the FATF had identified in June 2010. As a result, Ethiopia is no longer subject to the FATF's monitoring process under its on-going global AML/CFT compliance process.<sup>27</sup>

### **2.1.7.1 The Legal Framework**

Although Ethiopia had already criminalized money laundering in the revised penal code of 2005, the existing AML/CFT framework came to existence in 2009 with amendments to the law in 2013 through Proclamation No. 780/2013 on The Prevention and Suppression of Money Laundering and Financing of Terrorism<sup>28</sup>. Accordingly, Ethiopian Financial Intelligence Center (FIC) was established as an autonomous government body to oversee the AML/CFT activities.

Ethiopia has also ratified a number of regional and international instruments that directly support its AML/CFT regime including the UN transnational organized crime convention, the UN Vienna convention against drugs and psychotropic substances and related Protocols and the IGAD<sup>29</sup> mutual legal assistance convention. In addition, the following are other existing laws that directly and indirectly contribute to the AML/CFT legal regime in Ethiopia (Tu'emay Aregawi Desta, 2013):

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<sup>27</sup>KNOWYOURCOUNTRY.COM : Risk and Compliance Report, 2015

(<http://www.knowyourcountry.com/ethiopia1111.html>)

<sup>28</sup> See Federal Negarit Gazette of the FDRE February 4, 2013

<sup>29</sup>IGAD is a regional economic cooperation group of countries located in East Africa and the Horn of Africa, recognized by the African Union and comprising Djibouti, Ethiopia, Kenya, Somalia, South Sudan, Sudan, and Uganda. Eritrea is not currently an active member following a self-imposed suspension



- Anticorruption laws, including proclamation numbers 433 and 434, both enacted in 2005, and their subsequent regulations;
- Antiterrorism proclamation number 652, enacted in 2009;
- Proclamation number 668, on disclosure and registration of assets of government officials, enacted in 2010;
- Proclamation number 699, on the protection of witnesses and whistleblowers of criminal offenses, enacted in 2010;
- Commercial Registration and Business Licensing Proclamation No. 731/2012
- Banking and insurance proclamations, regulations, and directives
- National Payment System Proclamation No. 718/2011
- Authentication and Registration of Documents Proclamation No. 467/2005

The existing AML/CFT proclamation The Prevention and Suppression of Money Laundering and Financing of Terrorism covers:

-Financial Institutions which include; banks, insurance companies, microfinance institutions, postal savings, money transfer institutions or such other institutions as may be determined by the National Bank of Ethiopia (NBE)<sup>30</sup>.

-Non-Financial Institutions also categorized as Designated non-financial businesses and professions (DNFBPs) currently operating in Ethiopia include real estate agents and brokers, dealers in precious metals and stones, auditors and accountants, and lawyers, NGO's, religious institutions or other charitable organizations.

### **2.1.7.2 Institutional Framework**

Though money laundering had been criminalized under Ethiopian law since 2004, action to fight money laundering and terrorist financing in Ethiopia received renewed impetus following the identification of Ethiopia by the FATF for strategic AML/CFT deficiencies in June 2010 (ESAAMLG, 2015). The National Committee for Anti-Money Laundering and Combating the Financing of Terrorism (the National Committee) was recently reorganized. According to its terms the National Committee's aims are to:

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<sup>30</sup>Banking Business Proclamation No. 592/2008, Art. 2(9)

- Assess the effectiveness of policies and measures to combat money laundering and the financing of terrorism in Ethiopia;
- make recommendations to the government for legislative, regulatory and policy reforms in respect of anti-money laundering and combating the financing of terrorism;
- promote co-ordination among the Financial Intelligence Center, investigatory authorities, supervisory authorities and other institutions with a view to improving the effectiveness of existing policies to combat money laundering and the financing of terrorism;
- formulate policies to protect the international reputation of Ethiopia with regard to anti-money laundering and combating the financing of terrorism;
- issuing from time to time guidance as to compliance with the Proclamation and regulations; and
- generally advise the government in relation to such matters relating to anti-money laundering and combating the financing of terrorism, as the government may refer to the National Committee.

The National Committee consists of the following members (Tu'emay Aregawi Desta, 2013);

- a) The Minister of Finance and Economic Development or his representative;
  - b) A representative of the Prime Minister's Office;
  - c) The Minister of Justice or his representative;
  - d) The governor of the National Bank of Ethiopia or his representative;
  - e) The Minister of Foreign Affairs or his representative;
  - f) Director General of Charities and Societies Agency or his representative;
  - g) The Commissioner General of the Federal Police or his representative;
  - h) The Director General of Ethiopian Revenues and Customs Authority or his representative;
  - i) The Director General of the Financial Intelligence Center or his representative;
  - j) The Commissioner of the Federal Ethics and Anti-Corruption Commission or his representative;
- and
- k) The Minister of Ministry of Trade or his representative.

The National Committee is chaired by the Minister of Finance and Economic Development, and the FIC acts as the Secretariat. Its tasks are listed above and it is the main policy-setting body on AML/CFT in Ethiopia. The Technical Committee that carries out a lot of the technical work consists of representatives of the Ministry of Finance and Economic Development, Ministry of Justice and the FIC, and has seven

members in total. The Technical Committee was responsible for drafting Proc. No. 780/2013 and the FIC Directive No. 01/2014 for financial institutions.

The Ethiopian FIC is the principal AML/CFT authority in Ethiopia and is responsible for coordinating the prevention and countering of money laundering and terrorist financing after being established as per Proclamations Nos. 657/2009 in 2009 and became operational in 2011 (ESAAMLG, 2015). The key objectives of the FIC are to coordinate various institutions involved in the fight against money laundering and the financing of terrorism, to organize and analyze the information it receives and disseminates to law enforcement and to perform other related tasks to enable implementation of the Proclamation.

As provided by article 21 of the AML law and the related regulation, the FIC has the following primary functions:

- To collect, store, analyze, and disseminate financial intelligence and information on money laundering, the financing of terrorism, and other related offenses;
- To investigate allegations of money laundering, the financing of terrorism, and other related offenses and refer cases to the relevant authorities, including police and the state prosecutor;
- To ensure compliance by and conduct inspections and supervision of accountable persons with the requirements of the AML law;
- To enhance public awareness about money laundering and terrorist financing; and
- To collaborate with other government agencies and the financial intelligence units (FIUs) of other countries in sharing information or technical assistance based on treaties or other legal authority.

Accordingly, the FIC has issued a “Financial Anti-Money Laundering and Countering the Financing of Terrorism Compliance” Directive No 01/2014 toward establishment of a robust AML/CFT regime in the country. In addition, the National Bank of Ethiopia has issued a directive on CDD to enable banks cope up with ML and TF activities.

The AML law provides authority to the FIC to investigate ML/TF offences, but in spite of the legal provision, the FIC is organized in an administrative model. Consequently, the FIC is referring suspected cases to concerned law enforcement agencies—the Ethiopian Federal Police Commission, the Ethiopian Revenues and Customs Authority (ERCA), and the Federal Ethics and Anti-Corruption Commission for further investigation (Tu’emay Aregawi, 2013).

### 2.1.7.3 AML/CFT Requirements of the Banking Sector

Banks play a crucial role through their intermediary role between depositors and borrowers and channeling funds to investors resulting in much needed capital formation. On the other hand, Banks are often primary means by which dirty money is laundered. Cognizant of the adverse consequences of ML/TF activities, the sector has been given due emphasis to fight such activities. According to the Directive<sup>31</sup> issued by the FIC of Ethiopia, the primary compliance requirements of banks include;

- Institutional Framework: Establish, implement and maintain an effective program of compliance which includes policies, procedures and internal controls and a designated compliance officer in conformity with proclamations, directives and applicable laws.
- Customer Due Diligence (CDD) Measures:
  - Properly identify and verify customers using reliable independent documents;
  - Screen customer names against SDN sanctioned lists<sup>32</sup> upon establishing business relationships;
  - Conduct enhanced and continuous due diligence for high risk customers<sup>33</sup> and simplified due diligence for low risk customers;
  - Recording transactions and identifications evidence for a minimum period of ten years.
- Wire Transfer: Adequate capturing of originator and beneficiary information and obtaining and retention of records for cross-border wire transfer of USD 1,000 or domestic transfer or ETB 20,000 for at least ten years.
- Politically Exposed Persons (PEP): Put in place appropriate risk management mechanism to determine whether a potential customer or existing customers is PEP and apply enhanced CDD accordingly.
- Correspondent Banking: gather sufficient information about a respondent institution, assess the respondent institutions' AML/CFT controls and clearly understand the respective responsibilities of each institution. In addition, banks are prohibited from banking relationship with shell banks<sup>34</sup>.
- Monitoring and Reporting of Cash and Suspicious Transactions: over the course of their business, banks are required to identify and report any transactions deemed suspicious with

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<sup>31</sup>Financial AML/CFT Compliance Directives Number 01/20014

<sup>32</sup> The Specially Designated Nationals (SDN) sanctioned list is provided by UN and OFAQ (Office of Foreign Asset Controls) (<https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>)

<sup>33</sup> High risk customers as identified by FIC include; politically exposed persons, NGOs, Transfers from geographical and areas in which terrorism is a concern.

<sup>34</sup> The FIC defines Shell bank as a bank that has no physical presence in the country in which it is incorporated or licensed.

respect to the proceeds from illicit and criminal activities categorized as predicate offenses to the center. Similarly, banks are required to report all cash transactions in any currency above the sum of ETB 300,000 or USD15, 000 or equivalent currency in a single transaction or several transactions that appear to be linked.

In addition, banks are required to provide comprehensive employee awareness and training programs to make employees aware of their obligations towards protection from non-compliance risk and instilling a robust AML/CFT culture across their respective institutions.

## **2.2 Review of Related Empirical Studies**

### **2.2.1 Money Laundering, Corruption and Growth**

Veiga, Andrade and Oliveira (2006) aimed to provide empirical evidence on the impact of Anti-Money Laundering regulations on growth, corruption and investment. The researchers initially outlined that it is almost impossible to measure the total amount of money laundered within any country. The researchers proposed that when developed countries with highly developed institutional and enforceable frameworks adopt AML regulations, money laundering activities will move towards lax regulated countries which results in loss of funds available for licit economic activity thus having a negative effect on growth. Consequently, developed countries will apply pressure on those with lax AML regulations in the form of denying financial support and international access. As a result, the adoption of AML regulations by those countries will result in better image in international economic outlook and get access to international funds and financial markets, thus raising growth rates.

In order to achieve their objectives the researchers conducted cross-country analysis by identifying money laundering prevention initiatives as criminalizing money-laundering activities, money laundering activities of reporting suspicious transactions and establishing financial intelligence unit (FIU) by identified countries and assess their respective impact on corruption, investment and growth through multiple regression analysis covering the period from the year 1990 up to 2000 G.C. Accordingly, the study revealed that implementation of AML program discourages corruption and that a less corrupt country is more willing to implement AML regulation. On the other hand, the study indicated that a strong AML regulation in developing countries has a negative impact on growth as there could temporarily be a “dirty money run” from the economy while no significant impact was observed on investment.

### **2.2.2 Money Laundering and Financial Means of Organized Crime**

Schneider (2010) attempted to quantify the volume of money laundering activities for highly developed Organization for Economic Cooperation and Development (OECD) countries<sup>35</sup> covering the period from 1995 to 2006. The aim of the study was to shed some light about the size and development of money laundering as well as the financial means of organized crime. The researcher indicated that apart from the “official” economy there exists an “Underground Economy”, which characterizes an illegal economy including all sorts of criminal activities in contrast to the legal system with an estimated worldwide turnover of USD 1.3 trillion in 1998 and soared to 2.1 trillion USD in 2003. In addition, the researcher also acknowledged that the estimation of the volume of money laundering (size or the financial means of organized crime) is an extremely difficult task, mainly due to the lack of adequate data on worldwide basis and that existing estimations are afflicted with large errors thus can only be seen as preliminary scientific estimates or in some cases even “guesses”.

In order to achieve his objective, the researcher applied direct and indirect methods of quantification. The direct methods focused on recorded (“seized”/confiscated) statements of illegal payments from the public authorities and hence should provide – at first glance – a first rough estimate. The indirect methods try to identify the volume and development over time of money laundering activities with the help of causes and indicators. First, the various causes (e.g. the different criminal activities, income distribution) and indicators (confiscated money, prosecuted persons, income per capita) are identified and second, an econometric estimation is undertaken. Accordingly, volume of money laundering for the selected 20 OECD countries was between 273 and 603 billion USD for the period of 1995 up to 2006.

The researcher concluded by outlining the point that money laundering or the financial means of organized crime are extremely difficult to tackle and the need for robust international organizations which can effectively fight against organized crime and money laundering on global level.

### **2.2.3 Money Laundering and Its Regulation**

Chong and López-de-Silanes (2007) empirically investigated the determinants of money laundering and its regulation in over 80 countries by assembling a cross-country dataset on proxies of money laundering and the prevalence of feeding activities covering the period from 1996 to 2004. In addition, the researchers constructed specific money laundering regulation directories based on available information

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<sup>35</sup> OECD countries include Australia, Austria, Belgium, Canada, Denmark, Germany, Finland, France, Greece, Great Britain, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Switzerland, Spain and the United States.

on laws and their mechanisms of enforcement and measures their respective impact on money laundering proxies.

The study grouped the main sources of money laundering into three categories: criminal activities, such as drug traffic or import smuggling, the underground economy, and tax evasion thus to estimate proxies for the size of these feeding activities using multiple regression analysis through multiple-indicators multiple-causes (MIMIC) approach. Accordingly, the study revealed that the scope of money laundering in terms of underground economy amounted from 19% to 32% of GDP of the countries considered while indicating the prevalence of higher tax evasion and criminal activities patterns in Latin American countries considered.

In terms of measuring the impact of regulation on money laundering, the study identified three sub-indices including (1) disclosure of information by financial intermediaries; (2) criminalization of crimes and confiscation of proceeds; and (3) international cooperation in order to indicate their impact on money laundering through ordinary least square (OLS) regression analysis. Accordingly, the study indicated that out of the sub-indices considered, criminalization of crimes and confiscation of proceeds had a significant impact on money laundering followed by disclosure of information by financial intermediaries and international cooperation on the countries considered.

#### **2.2.4 Related Empirical Studies in Ethiopia**

Emerta Asaminew (2010) endeavored to estimate the size of informal or underground economy<sup>36</sup> and tax evasion in Ethiopia covering the period from 1971 to 2008. The researcher outlined that the prevalence of underground economy implies a loss of government revenue that would have been used to improve public services of broader advantage and can also have implications for economic planning as the official data will be misleading.

As per the literature review conducted by the study, the rationale for the underground economy activities emanate are

- to avoid payment of income, value added or other taxes,
- to avoid payment of social security contributions,

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<sup>36</sup>Out of the many existing definitions, Underground Economy was defined in the study as any economic activity that does not appear in the statistics of the national income and GDP.

- to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and
- to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms

In order to meet the intended objectives, the researcher implemented direct<sup>37</sup> and indirect approaches<sup>38</sup>, mainly money demand approach, and applying advanced statistical analysis of econometric model. Accordingly, the study indicated that the underground economy was widespread between 1977-1991 when the country was under continuous civil war and instability providing a favorable condition for the development of the underground activities and reached an average size of 41.5% of the recorded economy while dwindling to an average of 30% for years 1998-2006 and 33.3% during 2007-2008.

On the other hand, the study revealed that the amount of tax evasion reached 10% for the economy and suggested that the evaded tax due to the prevalence of unreported economy would have been an important resource for infrastructural and public service developments in the country and that bringing the unreported economy to the tax net remained as a challenge for the responsible body with significant implication on tax policy of the country. Finally, the researcher suggested that a significant portion of the underground economy can be converted to the recorded economy through optimal tax policy.

Biniam Shiferaw (2011) aimed to critically examine the anti-money laundering framework of the country with specific reference to the banking sector and to suggest ways of enhancing the effectiveness of the law in achieving its objective. The study suggested the existence of money laundering in Ethiopia and outlined that corruption, human smuggling, contraband and tax evasion activities are in need of money laundering in which banks have been wittingly or unwittingly participants in the process. In order to achieve its objective, the researcher attempted to examine the existing laws enacted to tackle money laundering to assess their adequacy or otherwise. Subsequently, the researcher critically analyzed the Ethiopian money laundering framework in comparison with internationally accepted standards.

Accordingly, the study revealed that the Ethiopian law promulgated to fight money laundering was not fully-fledged and does not go in line with some internationally accepted principles as proposed by

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<sup>37</sup>Direct Approaches include micro-surveys of the informal economy, tax audits and other compliance methods

<sup>38</sup>Indirect Approaches include the discrepancy between national expenditure and income statistics, the discrepancy between the official and actual labor force, the “electricity consumption” approach, the “transaction” approach, the “currency demand” approach and the MIMIC approach.



international initiatives. In addition, it was indicated that the law concerning KYC requirements, CTR, STR and other preventive measures suffer loopholes and such gaps create a fertile ground for money launderers to exploit the banking system. In conclusion the researcher acknowledged the remarkable progress made by the country in fighting money laundering activities while suggesting that provisions regarding confiscation, corruption and terrorist financing nexus with money laundering and the insufficiency of the anti-money laundering law in relation to banking sector needs reconsideration.

### **2.2.5 Summary and Knowledge Gap**

In line with the above conceptual as well as empirical review, it can be concluded that it is of paramount importance to have in place an effective Anti-Money Laundering and Counter Financing of Terrorism regime towards fighting crime and corruption, enhancing financial institutions and encouraging economic development. In this regard, banks play a leading role in the fight against money laundering and financing of terrorism. However, limited research has been conducted in the area with a specific reference to the banking sector. Therefore, the findings of this study can contribute to the endeavor of fighting money laundering and financing of terrorism in light of contemporary initiations globally.

# Chapter Three

## Research Design and Methodology

The study was designed to assess the Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) practices and challenges of commercial banks in Ethiopia against applicable laws and international best practices and standards. This chapter discusses how the research was designed, how selection and implementation of data sources and collection instruments were selected and implemented and the sampling framework and size alongside data analysis methods utilized to achieve its objectives as presented below.

### 3.1 Research Design

The objective of the research is to examine AML/CFT practices and challenges of commercial banks in Ethiopia as per international best practices and applicable laws. To this end, the study basically follows descriptive research method which is concerned with description of the state of affairs as it exists at present (Kotari, 2004).

This approach was preferred because it enables the assessment and description of the existing AML/CFT practice and challenges of commercial banks against international standards and applicable laws. Accordingly, by assessing the current Anti-Money Laundering and Counter Financing of Terrorism practices of Ethiopian commercial banks, the study tries to describe challenges and prospects toward effective implementation of AML/CFT practice as per regulatory requirements and international standards.

Therefore, survey approach was utilized to provide descriptive details to obtain a better understanding of the AML/CFT practice of commercial banks in Ethiopia. Survey approach is mostly used in business and management researches to answer questions WH questions and associated with explanatory and descriptive research types (Creswell, 2012). It is used to collect data from large population economically and uses questionnaires, structured observation and structured interview as data collection tools.

## **3.2 Sampling framework and Size**

The existing AML/CFT proclamation The Prevention and Suppression of Money Laundering and Financing of Terrorism covers Financial Institutions which include; banks, insurance companies, microfinance institutions, postal savings, money transfer institutions or such other institutions as may be determined by the National Bank of Ethiopia (NBE) and Non-Financial Institutions categorized as Designated non-financial businesses and professions (DNFBPs) currently operating in Ethiopia which include real estate agents and brokers, dealers in precious metals and stones, auditors and accountants, and lawyers, NGO's, religious institutions or other charitable organizations

However, the study focused on the commercial banks since the AML/CFT practice is being implemented only in the banking sector. To this end, purposive sampling design was implemented where sample items were deliberately selected by the researcher.

Accordingly, the study considered commercial banks leaving out the rest financial institutions covered by proclamation No. 780/2013. Out of the 17 commercial banks operating in Ethiopia, the researcher has opted to select a sample of 6 banks on the basis of asset size and year of establishment. Therefore, Commercial Bank of Ethiopia was selected as large size and first generation bank while Wegagen and Nib International Banks were selected as medium size and second generation banks. Finally, Lion International bank, Bunna International bank and Cooperative Bank of Oromia were selected as small size and third generation banks for the assessment. In addition, the study tried to examine the AML/CFT activities being undertaken by the designated organ, Ethiopian Financial Intelligence Center.

## **3.3 Type and Sources of Data**

In an effort to obtain information relevant to the study both primary and secondary data were employed. Accordingly, in order to get primary data, survey in the form of questionnaires, and interviews were prepared and conducted while secondary data documents pertaining to AML/CFT activities of the selected commercial banks' were collected from books, literatures, articles and journals.

### **3.3.1 Questionnaire**

Close ended questionnaires containing a total of 52 questions mainly extracted from FATF recommendations to the banking industry including background information were prepared and distributed to compliance/risk management staffs of the selected banks in order to assess the AML/ CFT

practice of their respective banks. The questionnaire is consisted of 5 parts. The first part is concerned with background information of respondents while the second part focused on general AML/CFT policies and procedures of selected banks. The third part is focused on AML/CFT preventive measures whereas the fourth part dealt with challenges of implementing AML/CFT in selected banks. The final part of the questionnaire is concerned with opportunities of implementing effective AML/CFT practice. A total of 30 questionnaires were constructed and dispensed to concerned staffs of selected banks out of which 27 (90%) were returned after being completed. Subsequent assessments were based on a Five point Likert Scale ranging from “Strongly Disagree” (1) to “Strongly Agree” (5).

### **3.3.2 Interview**

In order to obtain the necessary qualitative data, the researcher prepared semi-structured interview questions for subsequent discussion with the concerned official of the Financial Intelligence Center of Ethiopia. The interview generally focused on the Center’s perception on AML/CFT regime in Ethiopia and the banking sector, the AML/CFT implementation challenges faced, and institutional adequacy to oversee the implementation.

## **3.4 Methods of Data Analysis**

### **3.4.1 Quantitative Data Analysis**

Subsequent to collection of data from the concerned compliance/risk management of the selected commercial banks, the data related to general AML/CFT policies and procedures, AML/CFT preventive measures, AML/CFT implementation challenges and opportunities were analyzed and interpreted using different descriptive statistics such as mean and standard deviation, by utilizing SPSS version 20 for data entry and analysis.

### **3.4.2 Qualitative Data Analysis**

The part of data obtained through semi-structured interview was analyzed using narration and interpretations.

In summary, by obtaining the necessary data, the researcher summarized the responses of concerned respondents and fully described challenges and prospects to the effective implementation of AML/CFT practices and challenges thereby seeking answers to the research questions and achieving envisaged objectives.

# Chapter Four

## Results and Discussion

The previous chapters dealt with general introduction of the study, review of both related theoretical and empirical literatures to identify the knowledge gap and the research methodology used to attain its objectives. This chapter presents the empirical analysis of the data collected through semi-structured interview and close ended questionnaire which was analyzed using different descriptive statistics such as mean and standard deviation by utilizing SPSS version 20. Accordingly, the chapter has two sections in which the first section contains analysis of the data collected through questionnaire while the second section deals with presenting results of the interview conducted.

### **4.1 AML/CFT Practices and Challenges of Commercial Banks: Analysis of Close Ended Questionnaire**

In order to attain the study's main objective of assessing Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) practices and challenges of commercial banks in Ethiopia, a close ended questionnaire was prepared and distributed to selected banks which mainly covers AML/CFT policies and procedures, preventive measures, challenges and opportunities of implementing effective AML/CFT practice.

A total of 30 questionnaires were constructed and dispensed to concerned staffs of selected banks out of which 27 (90%) were returned after being completed. Subsequent assessments were based on a five point Likert Scale ranging from "Strongly Disagree" (1) to "Strongly Agree" (5) of which result is discussed below.

### 4.1.1 Demographic Background of Respondents

The table below summarized demographic composition of compliance/risk staffs of selected banks in terms of sex, age, qualification and experience.

*Table 4.1 Demographic composition of respondents*

| <b>Sex</b>                | <b>Percent (%)</b> |
|---------------------------|--------------------|
| Male                      | 59.3               |
| Female                    | 40.7               |
| <b>Age</b>                |                    |
| <25 years                 | 14.8               |
| 25- 35 years              | 51.9               |
| More than 35 years        | 33.3               |
| <b>Qualification</b>      |                    |
| Master's Degree           | 37                 |
| First Degree              | 59.3               |
| Below First Degree        | 3.7                |
| <b>Work Experience in</b> |                    |
| 0-5 Years                 | 25.9               |
| 6-10 Years                | 33.3               |
| More than 10 years        | 40.7               |

## 4.1.2 General AML/CFT Policies and Procedures

As part of assessing the AML/CFT practices and challenges of commercial banks, the first section of the questionnaire enquired about the general AML/CFT policies and procedures of the sample commercial banks of which results are presented below.

*Table 4.2 General AML/CFT policies and procedures of commercial banks*

| No | Items  | Mean        | S.D  |
|----|--|-------------|------|
| 1  | Compliance program, policy and procedure in line with international standards are in place approved by the Bank's board.   | 4.3         | 1.00 |
| 2  | Written policy framework is adopted stating the bank's commitment to comply with AML/CFT obligations in accordance with applicable proclamations and laws.                                   | 4.25        | 1.05 |
| 3  | Adequately resourced and independent audit function is designated to test the effectiveness of the compliance program against international standards and applicable proclamations and laws. | 3.89        | 0.89 |
| 4  | Sufficient resources are allocated for the proper function of AML/CFT compliance.  | 3.85        | 1.09 |
| 5  | Procedure is in place to identify, assess and understand money laundering and terrorist financing risks in the bank.   | 4.14        | 0.94 |
| 6  | Internal controls and procedures are in place in order to prevent criminals using the bank's facilities for money laundering and terrorist financing   | 3.66        | 0.96 |
| 7  | Written policies are developed documenting the process required to prevent, detect and report suspicious transactions.   | 3.85        | 1.23 |
| 8  | Record retention procedures are in place in accordance with applicable laws.   | 4.03        | 0.93 |
| 9  | Policy, manual and procedure are in place to manage and mitigate risks that have been identified.  | 3.92        | 1.03 |
|    | <b>Overall Score</b>   | <b>3.98</b> |      |

**Source:** Own computation through SPSS version 20

According to the respondents' feedback, the selected commercial banks have a compliance program, policy and procedure approved by their respective bank's board in place to identify, assess and understand money laundering and terrorist financing risks in their respective bank which also include a statement of their banks' commitment to comply with Anti-Money Laundering and Counter Financing of Terrorism obligations, record retention procedures, and manage and mitigate risks that have been identified all in accordance with international standards and applicable laws.

In addition, the respondents also indicated the selected commercial banks have allocated sufficient resources towards proper function of AML/CFT compliance supported by procedures documenting the process required to prevent, detect and report suspicious transactions. Moreover, internal controls and procedures are in place which helps prevent criminals using the bank's facilities for money laundering and terrorist financing purposes. Finally, it was indicated that the commercial banks have adequately resourced and independent audit function designated to test the effectiveness of the compliance program implemented in their respective banks.

Thus, it was learned that the selected commercial banks have the required compliance policy framework which is the crucial factor in the fight against money laundering and terrorist financing (Schott, 2006).

#### **4.1.3 Preventive Measures of Commercial Banks**

This part of the questionnaire seeks to assess the preventive measures being implemented by the selected commercial banks to curb money laundering and terrorist financing activities in accordance with internal policy and procedure, international standard and applicable laws of which results are presented below.



**Table 4.3 Preventive Measures**

| <b>No</b> | <b>Items</b>   | <b>Mean</b> | <b>S.D</b> |
|-----------|--|-------------|------------|
| 1         | A Compliance Officer is designated at a senior management level alongside appropriate employees with relevant competence and authority to oversee the bank's AML/CFT compliance program.   | 4.18        | 1.01       |
| 2         | Risk Based Approach is adopted to assess the bank's exposure to money laundering and terrorist financing risks.  | 2.29        | 0.72       |
| 3         | The bank conducts risk based assessment on its customer base and their transactions.   | 2.18        | 0.92       |
| 4         | Regular supervision is conducted on branches and subsidiaries to ensure the effective implementation of the compliance program.  | 3.96        | 0.85       |
| 5         | Automated compliance system is in place to detect and report suspicious transactions and customers   | 2.29        | 1.46       |
| 6         | The bank refrains from establishing relationship with shell banks and maintaining anonymous accounts.  | 4.7         | 0.60       |
| 7         | The bank identifies and assesses potential money laundering and terrorist financing risks that may arise due to development of new products, business practices and technologies.  | 3.44        | 0.89       |
| 8         | Automated screening tool is in place to identify Politically Exposed Persons (PEPs).   | 1.9         | 1.03       |
| 9         | Know your customer (KYC) procedures are properly implemented before establishing business relations, whenever doubt exists about the adequacy of previously obtained records and whenever suspicion of money laundering and financing of terrorism arises. | 3.9         | 1.15       |
| 10        | Customer due diligence (CDD) procedures are carried out on customers on an ongoing basis   | 3.48        | 1.31       |
| 11        | Enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions to/from high risk jurisdictions.  | 3.18        | 1.21       |
| 12        | Customers are screened against international SDN sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis.  | 1.8         | 0.93       |
| 13        | Accurate originators' and beneficiaries' information is captured during local and international wire transfer.   | 3.96        | 1.09       |
| 14        | Relevant customer and transaction records are kept as required by applicable laws.   | 3.85        | 1.09       |
| 15        | KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money  | 3.33        | 1.03       |

|    |   |             |      |
|----|---|-------------|------|
|    | transfer agencies.  |             |      |
| 16 | The bank fully cooperates with international organizations and correspondent banks towards AML/CFT endeavors.   | 4.37        | 1.00 |
| 17 | Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious transaction and customers | 4.18        | 1.07 |
| 18 | Existing AML/CFT policies, procedures and manuals are communicated to the concerned employees   | 4.03        | 1.01 |
| 19 | New AML/CFT related laws or changes to the existing policies or practices are timely communicated to concerned employees  | 3.66        | 1.14 |
| 20 | Employees are prohibited from disclosing (Tipping-off) the fact that a suspicious transaction or related information is being filed to concerned authorities.   | 4.18        | 0.87 |
|    | <b>Overall Score</b>  | <b>3.44</b> |      |

**Source:** Own computation through SPSS version 20

Considering preventive measures being implemented in the selected commercial banks, feedback from the respondents indicated that the required compliance officer is designated at a senior management level to oversee the AML/CFT activities with the relevant competence and authority. Likewise, it was indicated that the banks conduct regular supervision on branches and subsidiaries to insure effective implementation of the AML/CFT program while refraining from establishing business relationship with shell banks and maintaining anonymous accounts in addition to cooperating with international organizations and correspondent banks towards AML/CFT endeavors in accordance with FATF recommendations.

Moreover, it was responded that respective commercial banks deliver regular training to their employees and communicate existing and new AML/CFT related policies, procedures, manuals, proclamations and laws which are crucial in raising awareness about several aspects of money laundering and terrorist financing and enhance the AML/CFT activities (Lilley, 2006). Similarly, the feedback indicated that employees of the respective commercial banks are prohibited from disclosing (Tipping-off) sensitive information about reporting of suspicious transactions while relevant customer and transaction records are kept for reasonable period of time as required by applicable laws.

The response obtained also indicated that the banks implement know your customer (KYC) procedures are implemented prior to business relationship establishment, whenever the adequacy of previously obtained information is questioned and upon suspicion of money laundering and financing of terrorism arises while customer due diligence procedures are carried out on customers on ongoing basis. Elsewhere, the feedback indicated that KYC procedure and assessment of AML/CFT control is conducted to some extent before establishing business relationship with potential banks and money transfer agents. Elsewhere, the identification and assessment of potential money laundering and terrorist financing risks arising from development of new products, business practices and technologies was deemed unsatisfactory.

As can be seen in the above table, the respondents indicated that deficiencies exist in their respective banks in terms of implementing risk based approach to assess their banks' exposure to money laundering and terrorist financing risks and conducting risk based assessment on their customer base and transactions which is crucial for conducting enhanced due diligence on customers and transaction categorized as high risk in contrast to FATF standards<sup>39</sup> which recommends application of risk based approach to identify, assess and understand ML/TF risks to which banks are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively.

Similarly, severe deficiencies were indicated in terms of having in place an automated compliance system to detect and report suspicious transactions and customers, to identify politically exposed persons (PEPs) and screen customers and transactions against international SDN sanctioned lists such as UN and OFAC before establishing business relationship and on an ongoing basis which is in line with EASMAALG (2015) mutual evaluation report which indicated the absence of technological means in the sector which compromises the expected AML/CFT activities.

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<sup>39</sup>[www.fatfgafi.org/documents/riskbasedapproach/](http://www.fatfgafi.org/documents/riskbasedapproach/)

#### 4.1.4 AML/CFT Implementation Challenges in Commercial Banks

This third part of the questionnaire intended to enquire about the various challenges facing the selected commercial banks towards implementation of effective AML/CFT practice as presented below.

*Table 4.4 AML/CFT implementation challenges*

| No | Items   | Mean       | S.D   |
|----|---|------------|-------|
| 1  | Tone at the top is not set and adequate emphasis is not given by senior management towards instilling strong AML/CFT culture across the bank. | 4.2        | 0.63  |
| 2  | The Presence of high percentage of population that is without access to financial services and cash based economy.                            | 4.18       | 0.73  |
| 3  | The presence of unregulated and unlicensed money and value transfer services (MVTs)   | 4.03       | 0.97  |
| 4  | Integrating AML/CFT requirements with business objectives, clients, products and processes is difficult.                                      | 3.74       | 0.944 |
| 5  | Absence of National ID card hinders effective KYC procedures.   | 4.48       | 0.75  |
| 6  | List of Politically Exposed Persons and local sanction lists are not provided by concerned regulatory bodies.                                 | 4.44       | 0.84  |
| 7  | Lack of technology to enhance the AML/CFT activities.   | 3.81       | 1.03  |
| 8  | Sufficient resource is not allocated to implement devised compliance program.   | 2.5        | 1.28  |
| 9  | Competent staffs are not assigned to oversee the compliance activities.   | 2.59       | 1.42  |
| 10 | Customers' negative attitude towards AML/CFT practices.   | 4.2        | 0.85  |
|    | <b>Overall Score</b>  | <b>3.8</b> |       |

**Source:** Own computation through SPSS version 20

According to the feedback from respondents of selected commercial banks, the factors that present challenge in terms of implementing AML/CFT measures include; lack of tone at the top and adequate emphasis by senior management leading to weak compliance culture, customer's negative attitude towards AML/CFT practices, prevalence of high percentage of unbanked population and cash based economy alongside unregulated and unlicensed money and value transfer services.

Likewise, it was indicated that absence of National ID and list of PEPs and local sanctioned lists hinder the effective KYC and CDD procedures which are vital part of AML/CFT practices. Elsewhere, lack of technology and difficulty of integrating AML/CFT requirements with business objectives, clients, products and process were also deemed challenges.

### 4.1.5 Opportunities of Implementing AML/CFT in Commercial Banks

The last part of the questionnaire inquired respondents about opportunities of implementing AML/CFT practices as presented below.

**Table 4.5 AML/CFT Implementation opportunities**

| No | Items  | Mean        | S.D  |
|----|--|-------------|------|
| 1  | The bank is protected from losses emanating from risk of non-compliance  | 4.14        | 0.90 |
| 2  | The bank's reputation and public confidence is enhanced.   | 4.37        | 0.49 |
| 3  | The bank significantly contributes to its corporate citizenship role.  | 4.44        | 0.64 |
| 4  | The bank's correspondent banking relation prospects are improved.  | 4.48        | 0.64 |
| 5  | The bank significantly contributes to financial stability in the banking sector and the economy  | 4.4         | 0.5  |
| 6  | Criminals are prevented from using the bank's services for money laundering and terrorist financing purposes.  | 4.29        | 0.86 |
| 7  | The bank contributes to endeavor of discouraging criminal activities such as corruption, tax evasion, human smuggling & trafficking and illegal arms trading | 4.22        | 0.84 |
|    | <b>Overall Score</b>   | <b>4.33</b> |      |

**Source:** Own computation through SPSS version 20

As per the feedback obtained from respondents of selected commercial banks, the internal opportunities of implementing AML/CFT measures include protection from risk of non-compliance, enhanced public confidence and reputation and improved prospects of correspondent banking relation.

Moreover, by implementing effective AML/CFT measures, it was indicated that banks discharge their corporate citizenship responsibilities and contribute to endeavor of discouraging criminal activities such as corruption, tax evasion, human smuggling & trafficking and illegal arms trading. Likewise, the response indicated that effective AML/CFT measures contribute to financial stability in the banking sector and the economy as a whole while preventing criminals from using the sector's services for money laundering and terrorist financing purposes which is in accord with literature suggestions regarding benefits of effective Anti-Money Laundering and Counter Financing of Terrorism practices (Schott, 2006), (Bartlett, 2002).

## **4.2 Analysis of Interview Conducted with FIC Official**

Towards meeting the study's outlined objectives, interview was conducted with Commander Tesfaye Gebregziabher, Team Leader of Financial Transactions Examination at Financial Intelligence Center of Ethiopia dated April 8, 2016. A total of 6 questions were forwarded of which results are presented below.

The first question raised was regarding the status of national risk assessment which was due to be conducted as per East and South Africa Money Laundering Group (ESAAMLG) recommendations. Accordingly, it was learned that the assessment which is essential for implementing a risk-based AML/CFT regime in the country has not fully been completed to the desired level and a partial draft has been sent to ESAMLG pending a feedback. The observed delay in conducting the national risk assessment was attributed to lack of coordination between concerned government organs tasked for the assessment, lack of sufficient budget and failure to discharge respective responsibilities by the concerned government organs. Therefore, it is difficult to understand the extent of money laundering and terrorist financing risks the country is facing and adopt risk based policy accordingly in the absence of a completed national risk assessment.

The second question was concerned with reasons for absence of politically exposed persons (PEPs) and local sanctioned lists which are crucial for implementing an effective KYC and CDD measures. Subsequently, the interview conducted revealed that directives and mandates to distinguish and distribute PEPs and local sanctioned lists to various stakeholders are not yet available thereby making it difficult for concerned institutions which are performing CDD measures. However, it was indicated that directives and procedures are being drafted and which will be sent for subsequent approval upon completion.

The third question forwarded enquired whether the FIC, according to its mandate and responsibility, examines the AML/CFT practice of banks in accordance with applicable laws by conducting regular supervision and communicate results promptly. Accordingly, it was indicated that the center conducts regular and ad-hoc supervision on banks which involves onsite and offsite visits. However, the subsequent findings which are important for the expected rectification are not promptly communicated to the concerned banks and are only discussed with presidents and directors of the respective banks during annual meetings which was attributed to lack of proper organizational structure and manpower to oversee the task.

The fourth question enquired whether the FIC communicate relevant statistics related to MT/TF trends, investigations and prosecutions. Thus, it was discussed that the Center maintains all relevant statistics but does not communicate the trends and results of investigations and prosecutions to reporting organs or the public in general owing the sensitivity and confidentiality nature of the cases. This is in contrast to ESMAALG recommendation which insists on communicating statistics of such to raise awareness of money laundering and terrorist financing within the various stakeholders and the general public. However, it was indicated that there is a continuous awareness creation sessions towards suppression of money laundering and terrorist financing.

The fifth question forwarded was about the various challenges facing the FIC towards instilling a robust AML/CFT regime in the country and the banking sector. Accordingly, it was outlined that there is low level of awareness among the concerned government organs regarding the various harmful impacts of money laundering and financing of terrorism and adequate emphasis has not been given to the fight against ML and TF resulting in lack of coordination between the center and concerned law enforcement organs which is consistent with ESMAALG (2015) mutual evaluation report. In addition, the endeavor to instill a robust AML/CFT has not yielded a satisfactory response from the general public regardless of continuous awareness creation efforts.

Institutional wise, it was indicated that the FIC is not properly structured and sufficiently equipped with the necessary manpower to oversee the AML/CFT implementation effectively which was attributed to the fact that the existing relatively low salary and benefit packages failing to attract the required qualified manpower specially from the banking industry.

Considering the challenges arising from the banking sector, it was revealed that there exists low level of awareness among top management of banks and misconception about loss of customer base and due to implementing AML/CFT measures leading to a weak compliance across the industry.

The sixth and final question requested the center to rate the existing AML/CFT practice of commercial banks against international standards and applicable laws. Consequently, it was revealed that the practice being implemented in the banking industry is way behind the desired level in meeting national requirements let alone international best practices. Accordingly, severe deficiencies exist in areas of suspicious transaction reporting (STR), implementing know your customer (KYC) and customer due diligence (CDD) measures, violating confidentiality code by tipping off customers after reporting

suspicious transaction and intentionally disguising suspicious transactions for personal gain. However, as can be seen from the table below, numbers of suspicious transaction reports and cash transaction reports being forwarded to the FIC have shown improvement since banks started reporting in January, 2012. Finally, it was suggested that instilling a robust Anti-Money Laundering and Counter Financing of Terrorism practice is a continuous process and the FIC has launched a nationwide awareness creation program towards implementing a robust Anti-Money Laundering and Counter Financing of Terrorism regime in the country.

**Table 4.6 Number of ML/TF related Conviction, STR and CTR trends**

| No | Item                                      | Year    |         |           |           | Total     |
|----|---|---------|---------|-----------|-----------|-----------|
|    |   | 2012    | 2013    | 2014      | 2015      |           |
| 1  | Conviction                                | 17      | 19      | 19        | 19        | 74        |
| 2  | Suspicious Transaction Report (STR)       | 36      | 500     | 574       | 842       | 1,952     |
| 3  | Cash Transaction Report (Above threshold) | 248,600 | 994,517 | 1,081,399 | 1,020,912 | 3,345,428 |

*Source: FIC 2016*



# Chapter Five

## Summary of findings, Conclusions and Recommendations

### 5.1 Summary of Findings and Conclusions

The fight against money laundering and terrorist financing has become a global phenomenon and banks play a crucial role in this endeavor. To this end, the study aimed to assess the Anti-Money Laundering and Counter Financing of Terrorism practice and challenges of selected commercial banks in Ethiopia and the leading body, Financial Intelligence Center of Ethiopia as per international standards and applicable laws using descriptive statistics. Accordingly, the findings identified are summarized below:

- The national risk assessment has not fully been completed due to lack of coordination between concerned government organs and sufficient resource;
- There is a low level of awareness among the concerned government organs regarding the harmful impacts of money laundering and terrorist financing;
- The FIC is not properly structured and sufficiently equipped with the necessary manpower to oversee the Anti-Money Laundering and Counter Financing of Terrorism practice implementation;
- The AML/CFT practice of commercial banks in Ethiopia is in line with international standards and applicable laws in terms of having in place a comprehensive AML/CFT framework which include the necessary resource, compliance man power and audit function to oversee the implementation of the devised compliance program;
- The commercial banks conduct regular supervision and deliver the relevant AML/CFT trainings alongside communicating related policies, procedures, manuals, proclamations and laws;
- Deficiency exists in the Anti-Money Laundering and Counter Financing of Terrorism implementation of commercial banks in areas such as suspicious transaction reporting (STR), implementing know your customer (KYC) and customer due diligence (CDD) measures and violating confidentiality code in contrast to regulatory requirements;
- There is a weak compliance culture in the banking industry resulting from lack of awareness and the fact that adequate emphasis is not being given by senior management of the respective banks;

- Risk based approach is not being implemented and the compliance activities are not automated to enhance the AML/CFT measures in contrast to FATF recommendation and international best practices.
- Lack of tone at the top, customer's negative attitude towards AML/CFT practices, prevalence of high percentage of unbanked population, absence of National ID and lack of technology were indicated as Anti-Money Laundering and Counter Financing of Terrorism implementation challenges.
- Enhanced public confidence and reputation, discouraging criminal activities, contribution to financial stability and improved prospects of correspondent banking relation are among the opportunities of implementing Anti-Money Laundering and Counter Financing of Terrorism practices.

It is difficult to understand the extent of money laundering and terrorist financing risks that the country is exposed to in the absence of a national risk assessment which is yet to be completed. The regulatory body, Financial Intelligence Center of Ethiopia itself is not adequately equipped with the necessary organizational structure and the required manpower to oversee its responsibilities. Furthermore, the emphasis given to combating money laundering and financing of terrorism efforts is low resulting from low level of awareness among the concerned government organs leading to lack of coordination between law enforcement agencies. Likewise, the Anti-Money Laundering and Counter Financing of Terrorism practice of commercial banks is insufficient in terms of meeting Financial Action Task Force (FATF) standards and applicable laws.

Finally, it can be concluded that although Ethiopia has made a significant progress in terms of combating money laundering and terrorist financing efforts, which is acknowledged by the international standard setter Financial Action Task Force (FATF), sizeable gaps still remain in meeting international standards which can be attributed to lack of awareness among the concerned stakeholders leading to reluctance to discharge respective responsibilities.

## 5.2 Recommendations

**In view of the research's forgoing findings, the following recommendations are forwarded;**

- The concerned body, the National Committee for Anti-Money Laundering and Combating the Financing of Terrorism, should finalize a comprehensive national money laundering and terrorist financing vulnerability and threat assessment which is yet to be completed in order to identify the potential Money Laundering and Terrorist Financing risks the country is exposed to and adopt a risk based policy to implement a robust AML/CFT regime.
- Continuous awareness creation and capacity building sessions should be implemented for all relevant government organs, the financial sector, the media and the public in general about the nature, methods and impact of money laundering and terrorist financing alongside the legal obligations and consequences of non-compliance.
- The leading body, Financial Intelligence Center of Ethiopia, should be adequately equipped with the necessary organizational and personnel requirements so that the Center effectively discharges its responsibility of overseeing the AML/CFT regime in the country.
- National ID should be prepared and applied to effectively implement know your customer (KYC) & customer due diligence (CDD) measures.
- List of politically exposed persons (PEPs) and local sanctioned lists should be prepared and provided to the concerned commercial banks towards appropriate enhanced due diligence measures.
- The Financial Intelligence Center of Ethiopia in collaboration with the National Bank of Ethiopia should continuously conduct supervision and ensure the AML/CFT implementation in the banking sector as per international standards and applicable laws.
- Collaboration between law enforcement, investigative and regulatory bodies should be strengthened to collectively mitigate money laundering and terrorist financing risks.
- The AML/CFT practice of commercial banks should be supported by the necessary technology to automate and enhance the compliance activities.
- Senior management of commercial banks should set the right direction at the top to instill a strong compliance culture in their respective banks.
- Financial inclusion should be the way forward to alleviate the challenge posed by high portion of underfinanced population and cash based economy thereby discouraging the informal money transfer services and the underground economy in order to instill AML/CFT to the desired level.

- Given that money laundering and terrorist financing are cross-border challenges, Ethiopia should fortify regional and international collaboration with entities such as UN, FATF, IMF and ESMAALG to enhance the AML/CFT regime.

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**Appendix I: Close Ended Questionnaire for commercial banks’ respondents**

**St Mary’s University**

**School of Graduate Studies**

This questionnaire is prepared to collect data for the research to be conducted titled: **Anti-Money Laundering and Counter Financing of Terrorism: Practices and Challenges of Commercial Banks in Ethiopia**. The research conducted is as a partial fulfillment of the requirements for the Degree of Masters of Business Administration in General Management at St Mary’s University.

This is, therefore, to request that you provide appropriate and genuine data to the best of your knowledge for each question listed below. I would like to assure you that the information obtained will only be used for the purpose of the research. Finally, I would like to express my gratitude in advance for your cooperation.

**Part I. Background Information**

**Questionnaire for Compliance/Risk Staff of a bank**

**Name of the bank** \_\_\_\_\_

**Job Position** \_\_\_\_\_

| <b>Type</b>          | <b>Category</b>    | <b>Please Put a tick ( √ ) Mark</b> |
|----------------------|--------------------|-------------------------------------|
| Sex                  | Male               |                                     |
|                      | Female             |                                     |
| Age                  | <25 years          |                                     |
|                      | 25- 35 years       |                                     |
|                      | More than 35 years |                                     |
| Qualification        | Masters Degree     |                                     |
|                      | First Degree       |                                     |
|                      | Below First Degree |                                     |
| Work Experience in a | 0-5 Years          |                                     |
|                      | 6-10 Years         |                                     |
|                      | More than 10 years |                                     |



**Part II: Questionnaire for Compliance/Risk Staff of a bank**

**A. General AML/CFT Policies and Procedures**

➤ **Key: 5=Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree**

Please put a tick (√) mark to the extent that describes the general AML/CFT policies and procedure in

| No | General AML Policies and Procedures  | 5 | 4 | 3 | 2 | 1 |
|----|--|---|---|---|---|---|
| 1  | Compliance program, policy and procedure in line with international standards are in place approved by the Bank's board.   |   |   |   |   |   |
| 2  | Written policy framework is adopted stating the bank's commitment to comply with AML/CFT obligations in accordance with applicable proclamations and laws.                                   |   |   |   |   |   |
| 3  | Adequately resourced and independent audit function is designated to test the effectiveness of the compliance program against international standards and applicable proclamations and laws. |   |   |   |   |   |
| 4  | Sufficient resources are allocated for the proper function of AML/CFT compliance.  |   |   |   |   |   |
| 5  | Procedure is in place to identify, assess and understand money laundering and terrorist financing risks in the bank.   |   |   |   |   |   |
| 6  | Internal controls and procedures are in place in order to prevent criminals using the bank's facilities for money laundering and terrorist financing   |   |   |   |   |   |
| 7  | Written policies are developed documenting the process required to prevent, detect and report suspicious transactions.   |   |   |   |   |   |
| 8  | Record retention procedures are in place in accordance with applicable laws.   |   |   |   |   |   |
| 9  | Policy, manual and procedure are in place to manage and mitigate risks that have been identified.  |   |   |   |   |   |

your bank.

**B. AML/CFT Preventive Measures.** Please put a tick (√) mark to evaluate AML/CFT preventive measures in your B. bank.

**Key: 5=Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree**

| No | AML/CFT Preventive Measures   | 5 | 4 | 3 | 2 | 1 |
|----|---|---|---|---|---|---|
| 1  | A Compliance Officer is designated at a senior management level alongside appropriate employees with relevant competence and authority to oversee the bank's AML/CFT compliance program.  |   |   |   |   |   |
| 2  | Risk Based Approach is adopted to assess the bank's exposure to money laundering and terrorist financing risks.   |   |   |   |   |   |
| 3  | The bank conducts risk based assessment on its customer base and their transactions.  |   |   |   |   |   |
| 4  | Regular supervision is conducted on branches and subsidiaries to ensure the effective implementation of the compliance program.   |   |   |   |   |   |
| 5  | Automated compliance system is in place to detect and report suspicious transactions and customers  |   |   |   |   |   |
| 6  | The bank refrains from establishing relationship with shell banks and maintaining anonymous accounts.   |   |   |   |   |   |
| 7  | The bank identifies and assesses potential money laundering and terrorist financing risks that may arise due to development of new products, business practices and technologies.   |   |   |   |   |   |
| 8  | Automated screening tool is in place to identify Politically Exposed Persons (PEPs).  |   |   |   |   |   |
| 9  | Know your customer (KYC) procedures are properly implemented before establishing business relations, whenever doubt exists about the adequacy of previously obtained records and when ever suspicion of money laundering and financing of terrorism arises. |   |   |   |   |   |
| 10 | Customer due diligence (CDD) procedures are carried out on customers on an ongoing basis  |   |   |   |   |   |
| 11 | Enhanced customer due diligence is conducted on high risk customers such as, PEPs, NGOs, Non-resident customers and transactions to/from high risk jurisdictions.   |   |   |   |   |   |
| 12 | Customers are screened against international SDN sanctioned lists such as; UN and OFAC before establishing business relationship and on an ongoing basis.   |   |   |   |   |   |
| 13 | Accurate originators' and beneficiaries' information is captured during local and international wire transfer.  |   |   |   |   |   |
| 14 | Relevant customer and transaction records are kept as required by applicable laws.  |   |   |   |   |   |

|    |   |  |  |  |  |
|----|---|--|--|--|--|
|    |   |  |  |  |  |
| 15 | KYC procedure is conducted and AML/CFT controls are assessed before establishing business relationship with potential correspondent banks and money transfer agencies.  |  |  |  |  |
| 16 | The bank fully cooperates with international organizations and correspondent banks towards AML/CFT endeavors.   |  |  |  |  |
| 17 | Regular training is provided to concerned employees on the various aspects of money laundering and terrorist financing alongside methods of identification and reporting suspicious transaction and customers |  |  |  |  |
| 18 | Existing AML/CFT policies, procedures and manuals are communicated to the concerned employees   |  |  |  |  |
| 19 | New AML/CFT related laws or changes to the existing policies or practices are timely communicated to concerned employees.   |  |  |  |  |
| 20 | Employees are prohibited from disclosing (Tipping-off) the fact that a suspicious transaction or related information is being filed to concerned authorities.   |  |  |  |  |

**C. AML/CFT Implementation Challenges.** Please put a tick (√) mark to indicate the challenges of implementing AML/CFT your bank.

**Key: 5=Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree**

| No | AML/CFT Implementation Challenges   | 5 | 4 | 3 | 2 | 1 |
|----|---|---|---|---|---|---|
| 1  | Tone at the top is not set and adequate emphasis is not given by senior management towards instilling strong AML/CFT culture across the bank. |   |   |   |   |   |
| 2  | The Presence of high percentage of population that is without access to financial services and cash based economy.                            |   |   |   |   |   |
| 3  | The presence of unregulated and unlicensed money and value transfer services (MVTS)   |   |   |   |   |   |
| 4  | Integrating AML/CFT requirements with business objectives, clients, products and processes is difficult.                                      |   |   |   |   |   |
| 5  | Absence of National ID card hinders effective KYC procedures.   |   |   |   |   |   |
| 6  | List of Politically Exposed Persons and local sanction lists are not provided by concerned regulatory bodies.                                 |   |   |   |   |   |
| 7  | Lack of technology to enhance the AML/CFT activities.   |   |   |   |   |   |
| 8  | Sufficient resource is not allocated to implement devised compliance program.   |   |   |   |   |   |
| 9  | Competent staffs are not assigned to oversee the compliance activities.   |   |   |   |   |   |
| 10 | Customers' negative attitude towards AML/CFT practices.   |   |   |   |   |   |

**D. AML/CFT Implementation opportunities**

Please put a tick (√) mark to indicate the opportunities of implementing AML/CFT your bank.

**Key: 5=Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree**

| No | AML/CFT Implementation Opportunities   | 5 | 4 | 3 | 2 | 1 |
|----|--|---|---|---|---|---|
| 1  | The bank is protected from losses emanating from risk of non-compliance  |   |   |   |   |   |
| 2  | The bank's reputation and public confidence is enhanced.   |   |   |   |   |   |
| 3  | The bank significantly contributes to its corporate citizenship role.  |   |   |   |   |   |
| 4  | The bank's correspondent banking relation prospects are improved.  |   |   |   |   |   |
| 5  | The bank significantly contributes to financial stability in the banking sector and the economy  |   |   |   |   |   |
| 6  | Criminals are prevented from using the bank's services for money laundering and terrorist financing purposes.  |   |   |   |   |   |
| 7  | The bank contributes to endeavor of discouraging criminal activities such as corruption, tax evasion, human smuggling & trafficking and illegal arms trading |   |   |   |   |   |

## Appendix II: Semi Structured Interview for Financial Intelligence Center of Ethiopia

### Part III. Interview Questions to Financial Intelligence Center of Ethiopia

1. Has national risk assessment been conducted as per East and South Africa Money Laundering Group (ESAAMLG) recommendations?
2. Lists of Politically Exposed Persons (PEPs) and local sanctioned lists are not currently available. What are the reasons?
3. Does the FIC conduct regular supervision on banks to examine the AML/CFT practices in accordance with applicable laws? If so, are the findings communicated accordingly?
4. Does the FIC maintain and communicate relevant statistics such as STRs, ML/TF investigation, prosecutions and convictions, properties frozen to increase ML/TF awareness and response?
5. What are the challenges of instilling robust AML/CFT regime in Ethiopia and especially in the banking sector?
6. How is the performance of the banking sector's AML/CFT practice rated in light of international standards and applicable laws?

#### Number of ML/TF related Conviction, STR and CTR trends

| No | Item                                      | Year |      |      |      | Total |
|----|---|------|------|------|------|-------|
|    |   | 2012 | 2013 | 2014 | 2015 |       |
| 1  | Conviction                                |      |      |      |      |       |
| 2  | Suspicious Transaction Report (STR)       |      |      |      |      |       |
| 3  | Cash Transaction Report (Above threshold) |      |      |      |      |       |

## **DECLARATION**

I, the undersigned, declare that this thesis is my original work and has not been presented for a degree in any other university and that all sources of material used for the thesis have been duly acknowledged.

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**Amanuel Abebe**

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**Signature and Date**

## **ENDORSEMENT**

This thesis titled “ANTI-MONEY LAUNDERING AND COUNTER FINANCING OF TERRORISM: PRACTICES AND CHALLENGES OF COMMERCIAL BANKS IN ETHIOPIA” has been submitted to St. Mary’s University, School of Graduate Studies for MBA program with my approval as a university advisor.

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**Advisor**

**St. Mary’s University**

**Addis Ababa**

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**Signature and Date**